



### III.

#### A. SUMMARY

As set forth below, SCI prearranged the execution of certain trades of its customers, in violation of Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2009).

On one or more occasions in November and December 2006, SCI prearranged futures trades in natural gas on the New York Mercantile Exchange (“NYMEX”) for its customers. The trades were part of a strategy involving the purchase and sale of the same quantity of NYMEX natural gas futures contracts by one customer and the opposite sale and purchase of the same quantity of NYMEX natural gas futures contracts by the other customer.

Prior to the trades being entered on the NYMEX, employees of SCI agreed with the floor broker that they would attempt to minimize the “slippage” or price difference between long and short positions by seeking trades with no more than a half a cent price differential between the buy and sell orders. The prearranged trades that employees of SCI caused to be entered into negated market risk and price competition and constituted fictitious sales in violation of Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006). Further, by knowingly prearranging the execution of orders to buy and sell futures in natural gas, SCI’s employees also engaged in noncompetitive transactions in violation of Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2009). Because these employees undertook their actions within the scope of their employment with SCI, SCI is liable for the violations of Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2009), pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2(a)(1)(B) (2006).

The Commission acknowledges the cooperation of Respondent during the investigation of this matter.

#### B. RESPONDENT

**Scotia Capital Inc.** is an investment dealer incorporated under the laws of Ontario, Canada, with its head office located in Toronto, Ontario, Canada. SCI is a wholly owned subsidiary of The Bank of Nova Scotia. SCI has never been registered with the Commission. ScotiaMcLeod is the retail brokerage division of SCI which was involved in the trades at issue here.

#### C. FACTS

##### **SCI’s Employees Prearranged Trades on the NYMEX Floor**

On one or more occasions in November and December 2006, SCI’s employees prearranged natural gas futures trades on the NYMEX. The trades were part of a strategy involving the purchase and sale of the same quantity of NYMEX natural gas futures contracts by one of the customers and the opposite sale and purchase of the same quantity of NYMEX natural gas futures contracts by the other customer.

Prior to the trades being entered on the NYMEX, employees of SCI agreed with the floor broker that they would attempt to minimize “slippage,” or price difference, between the customers’ long and short positions by seeking trades with no more than a half a cent price differential between the buy and sell orders. In various pre-trade telephone conversations between the employees of SCI and the NYMEX floor broker, SCI instructed the floor broker as to the specific quantity and delivery month of the contracts to be traded and instructed the floor broker to limit the price differential between the long and short positions to half a cent per lot. The prearranged trades, that employees of SCI caused to be entered, negated market risk and price competition.

## **D. LEGAL DISCUSSION**

### **1. SCI’s Employees Entered into Prearranged Trades That Constituted Fictitious Sales in Violation of Section 4c(a) of the Act**

The Commission has long held that prearranged trading is a form of a fictitious sale. *In re Harold Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,982 at 31,903 (CFTC Apr. 4, 1986). By determining trade information such as price and quantity outside the pit, and then using the market mechanism to shield the private nature of the bargain from public scrutiny, both price competition and market risk are eliminated. *Id.*

Section 4c(a) of the Act makes it unlawful for any person to offer to enter into, enter into, or confirm the execution of a transaction that is a fictitious sale. *In re Gimbel*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,213 at 35,003 (CFTC Apr. 14, 1988), *aff’d as to liability*, 872 F.2d 196 (7th Cir. 1989); *In re Shell Trading US Co.*, CFTC Docket No. 06-02 (CFTC Jan. 4, 2006). By enacting Section 4c(a), Congress sought to “ensure that all trades are focused in the centralized marketplace to participate in the competitive determination of the price of the futures contracts.” S. Rep. No. 93-1131, at 16-17 (1974); *see also Merrill Lynch Futures, Inc. v. Kelly*, 585 F. Supp. 1245, 1251 n.3 (S.D.N.Y. 1984) (Section 4c(a)(A) was generally intended to prevent collusive trades conducted away from the pits). As a result, Section 4c(a) broadly prohibits fictitious trades intended to avoid the risks and price competition of the open market.

Although Section 4c(a) of the Act prohibits fictitious sales, the term is not defined in the Act. *In re Thomas Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,742 (CFTC Dec. 10, 1997); *In re Harold Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,982 at 31,903 (CFTC Apr. 4, 1986). A fictitious sale is a general category that includes, at a minimum, the unlawful practices specifically enumerated in Section 4c(a), as well as prearranged trading. *Id.*; *In re Gimbel*, ¶ 24,213 at 35,003; *In re Shell Trading US Co.*, CFTC Dkt. 06-02 (Jan. 4, 2006). The central characteristic of the general category of fictitious sales is the use of trading techniques that give the appearance of submitting trades to the open market while negating the risk or price competition incident to such a market. *In re Fisher*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,725 at 56,052 n.11 (CFTC Mar. 24, 2004); *Thomas Collins*, ¶ 27,194 at 45,742; *Harold Collins*, ¶ 22,982 at 31,902.

In this case, the various pre-trade telephone conversations between SCI employees and the NYMEX floor broker establish that the trades were illegitimately prearranged and, thus, were fictitious sales. Specifically, through the conversations, SCI employees intended that the trades be executed so as to negate the risk or price competition incident to the market by instructing that the equal and opposite orders be executed with the price differential between them limited to half a cent per lot. Consequently, by knowingly participating in the entry and execution of prearranged trades, the employees of SCI violated Section 4c(a), which makes it unlawful to offer to enter into, or to enter into, any commodity futures transaction that is a fictitious sale.

## **2. SCI's Employees Executed Noncompetitive Trades in Violation of Regulation 1.38(a)**

Regulation 1.38(a) requires that all purchases and sales of commodity futures be executed "openly and competitively." The purpose of this requirement is to ensure that all trades are executed at competitive prices and directed into a centralized marketplace to participate in the competitive determination of the price of futures contracts. Noncompetitive trades are generally transacted in accordance with express or implied agreements or understandings between and among the traders. *Gilchrist*, ¶ 24,993 at 37,652. Noncompetitive trades are also a type of fictitious sale, because they negate the risk incidental to an open and competitive market. *Fisher*, ¶ 29,725 at 56,052 n.11. Trades can be noncompetitive even though they were executed in the pit. *In re Buckwalter*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,995 at 37,683 (CFTC Jan. 25, 1991) (citing *Laiken v. Dep't of Agriculture*, 345 F.2d 784, 785 (2d Cir. 1965)). Prearranged trading is a form of anti-competitive trading that violates Commission Regulation 1.38(a). *Gimbel*, ¶ 24,213 at 35,003; *In re Shell Trading US Co*, CFTC Dkt. 06-02 (Jan. 4, 2006).

By entering into prearranged, noncompetitive trades on one or more occasion, SCI's employees violated Regulation 1.38(a).

## **3. SCI Is Liable For Its Employees' Violations Pursuant To Section 2(a)(1)(B) of the Act**

SCI's employees committed the above referenced acts in violation of Section 4c(a) of the Act and Regulation 1.38(a) while acting within the scope of their employment with SCI. Pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2(a)(1)(B) (2006), SCI is therefore liable for violation of Section 4c(a) of the Act and Regulation 1.38(a).

## **IV.**

### **FINDINGS OF VIOLATIONS**

Based on the foregoing, the Commission finds that SCI violated Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2009).

V.

**OFFER OF SETTLEMENT**

Respondent has submitted an Offer in which, without admitting or denying the findings herein:

- (A) Acknowledges service of this Order;
- (B) Admits the jurisdiction of the Commission with respect to all the matters set forth herein;
- (C) Waives: the filing and service of a complaint and notice of hearing; a hearing; all post-hearing procedures; judicial review by any court; any and all objections to the participation by any member of the Commission's staff in consideration of the Offer; any and all claims that it may possess under the Equal Access to Justice Act (EAJA), 5 U.S.C. § 504 (2006) and 28 U.S.C. § 2412 (2006), and/or Part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1 *et seq.* (2009), relating to, or arising from, this proceeding; any and all claims that it may possess under the Small Business Regulatory Enforcement Fairness Act, Pub. L. No. 104-121, §§ 231-232, 110 Stat. 857, 862-63 (1996), as amended by Pub. L. No. 110-28, 121 Stat. 112 (2007), relating to, or arising from, this proceeding; and any claim of Double Jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief;
- (D) Stipulates that the record basis on which this Order may be entered consists solely of this Order and the findings in this Order consented to in the Offer; and
- (E) Consents to the entry of this Order, which
  - (1) makes findings that SCI violated Section 4c(a) of the Act and Regulation 1.38(a);
  - (2) orders SCI to cease and desist from violating Section 4c(a) of the Act and Regulation 1.38(a);
  - (3) orders SCI to pay a civil monetary penalty in the amount of \$250,000; and
  - (4) orders SCI to comply with the undertakings consented to in the Offer and set forth below in Section VI of this Order.

Upon consideration, the Commission has determined to accept the Offer.

## VI.

### ORDER

**Accordingly, IT IS HEREBY ORDERED THAT:**

1. SCI shall cease and desist from violating Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2009);
2. SCI shall pay a civil monetary penalty of Two Hundred Fifty Thousand Dollars (\$250,000) within ten (10) business days of the date of entry of this Order. SCI shall pay its civil monetary penalty by making electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made by other than electronic funds transfer, the payment shall be made payable to the Commodity Futures Trading Commission and sent to the address below:

Commodity Futures Trading Commission  
Division of Enforcement  
ATTN: Marie Bateman – AMZ-300  
DOT/FAA/MMAC  
6500 S. MacArthur Blvd.  
Oklahoma City, OK 73169  
Telephone 405-954-6569

If payment by electronic transfer is chosen, Respondent shall contact Marie Bateman or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondent shall accompany payment of the penalty with a cover letter that identifies SCI, and the name and docket number of this proceeding. Respondent shall simultaneously transmit copies of the cover letter and the form of payment to: (1) the Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21<sup>st</sup> Street, N.W., Washington, D.C. 20581 and (2) the Chief, Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission at the same address. In accordance with Section 6(e)(2) of the Act, 7 U.S.C. § 9a(2) (2006), any respondent that does not pay their respective civil monetary penalty in full within fifteen (15) days of the due date shall be prohibited automatically from the privileges of all registered entities, and, if registered with the Commission, such registration shall be suspended automatically until it has shown to the satisfaction of the Commission that payment of the full amount of the penalty with interest thereon to the date of the payment has been made; and

3. Respondent shall comply with the following undertakings as set forth in the Offer:

**(a) Future Cooperation With the Commission**

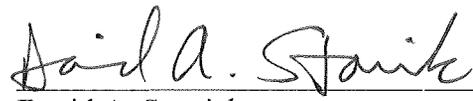
Respondent shall continue to cooperate fully and expeditiously with the Commission, including the Commission's Division of Enforcement, in this proceeding and in any civil or criminal investigation, litigation, or administrative or self-regulatory matter related to the subject matter of this proceeding. As part of such cooperation with the Commission, Respondent agrees to:

- (1) preserve all records relating to the subject matter of this proceeding, including but not limited to audio files, e-mails, and trading records for a period of five years from the date of this Order;
- (2) comply fully, promptly, completely, and truthfully with any inquiries or requests for information or documents;
- (3) provide authentication of documents and other evidentiary material;
- (4) produce any current (as of the time of the request) officer, director, employee, or agent of Respondent, regardless of the individual's location and at such location that minimizes Commission travel expenditures, to provide assistance at any trial, proceeding, or Commission investigation related to the subject matter of this proceeding, including but not limited to, requests for testimony, depositions, and/or interviews, and to encourage them to testify completely and truthfully in any such proceeding, trial, or investigation; and
- (5) assist in locating and contacting any prior (as of the time of the request) officer, director, employee or agent of Respondent.

**(b) Public Statements**

Neither Respondent nor any of Respondent's agents or employees under its authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in this Order or creating, or tending to create, the impression that this Order is without factual or legal basis; provided, however, that nothing in this provision shall affect Respondent's (i) testimonial obligations; or (ii) right to take appropriate legal positions in other proceedings to which the Commission is not a party. Respondent shall undertake all steps necessary to ensure that all of its agents and employees under their authority or control understand and comply with this undertaking.

By the Commission.

A handwritten signature in black ink, reading "David A. Stawick". The signature is written in a cursive style and is positioned above a horizontal line.

David A. Stawick  
Secretary of the Commission  
Commodity Futures Trading Commission

Dated: January 28, 2010