

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

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In the Matter of : CFTC Docket No. 01-01
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U.S. SECURITIES & FUTURES CORP., :
et al., :
: :
Respondents. :
: :
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ORDER MAKING FINDINGS AND IMPOSING SANCTIONS
AS TO RESPONDENT MICHAEL SKRABLE

I.

On October 26, 2000 the Commodity Futures Trading Commission ("Commission") filed a Complaint and Notice of Hearing ("Complaint") against Michael Skrable (the "Respondent" or "Skrable"), among others. The Complaint charges that Skrable violated Sections 4b(a)(i) and 4b(a)(iii), 4m and 4o(1)(A) and (B) of the Commodity Exchange Act ("the Act").

II.

In order to dispose of the allegations and issues raised in the Complaint as to him, Skrable has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Without admitting or denying any of the allegations of the Complaint or the findings herein, Skrable acknowledges service of this Order Making Findings and Imposing Remedial Sanctions ("Order"). Skrable consents to the use of the findings contained in this Order in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party.¹

¹ Skrable does not consent to the use of his Offer or the findings in this Order, consented to in his Offer, as the sole basis for any other proceeding brought by the Commission, other than a proceeding brought to enforce the terms of this Order. Skrable also does not consent to the use of his Offer or the findings in the Order by any other person or entity in this or in any other proceeding. The findings made in the Order are not binding on any other person or entity named as a defendant or respondent in this or any other proceeding.

III.

The Commission finds the following:

A. SUMMARY

During the period beginning in early 1996 through October 1998 (“the relevant period”), Skrable participated in and aided and abetted the fraud of a foreign broker located in Hamburg, Germany (the “foreign broker”), in violation of Sections 4b(a)(i) and 4b(a)(iii) of the Act. Skrable participated in the fraud by providing unallocated futures orders to a registered futures commission merchant (“FCM”) knowing that the foreign broker was subsequently fraudulently allocating the trades. By the same acts, Skrable employed a scheme to defraud and engaged in a course of business which operated as a fraud or deceit upon his clients, the foreign broker’s customers, in violation of both Section 4o(1)(A) and 4o(1)(B). Skrable also acted as an unregistered commodity trading advisor (“CTA”) in violation of Section 4m of the Act.²

B. SETTLING RESPONDENT

Michael Skrable resides at 1905 Vermont Avenue, Toms River, New Jersey 08755. Between early 1996 and October 1998, Skrable worked first as a CTA, and then as an agent or employee of an unregistered corporate CTA, providing commodity trading advice to the foreign broker’s customer accounts. During the period that he was providing trading advice to the foreign broker’s customers, Skrable was not registered with the Commission in any capacity.

C. FACTS

1. The Foreign Broker’s Allocation Fraud

Between early 1996 and October 1998, the foreign broker engaged in a multi-million dollar allocation fraud scheme. The foreign broker engaged in a “loading scheme” by allocating mostly winning trades to new customers from whom additional funds could be obtained. Armed with the purported successes in the customers’ accounts, the foreign broker’s salesmen enticed customers to add to their accounts, not uncommonly with additional deposits larger than their initial investments. To generate winning trades, the foreign broker usually directed traders working for it to place between 100 and 300 day-trades each trading day. Although some of these trades were winning trades, others were losing trades. Needing some place to allocate the losing trades each day, the foreign broker allocated losing trades to older accounts whose owners were less likely to make additional investments. The key to the success of the loading scheme was the foreign broker’s ability to allocate trades after they were executed with the knowledge of whether they were profitable.

² Nothing in this Order is intended as a comment on any other parties in this proceeding.

Deducting a 15 percent up-front fee and \$95.00 per round turn in commissions from its customers' accounts, the foreign broker's loading scheme diverted more than \$13.8 million in the form of commissions from the \$19 million funds it had raised from customers.

2. The Trading Advisor's Role in the Fraudulent Allocation Scheme

Each trading day, the foreign broker authorized Skrable and other traders to make a certain number of round-turn day trades through the FCM. For his commodity trading advice, Skrable received compensation ranging from \$2-\$4 per round turn either directly from the foreign broker or from the unregistered corporate CTA. Skrable and other traders had complete discretion to determine the commodity, delivery month, limit price and timing of the futures transactions. The foreign broker, however, limited its traders to day trades. The foreign broker also required them to place stop orders when they established positions that (if executed at the stop price) would limit losses to only \$150 per contract, regardless of the volatility in the market.³ Orders to buy and sell futures contracts were telephoned by Skrable and the other traders to the FCM's order desk. When calling in orders, Skrable gave no account identification for the orders. The FCM's order desk personnel recorded the orders from Skrable and the other traders on the FCM's office order tickets but did not identify the specific account into which the order was to be placed.

After the positions were exited, FCM order desk personnel compiled a list of the offsetting trades done for the foreign broker's accounts, showing the trades' profitability. At various times during the trading day, these lists were faxed to the foreign broker. No open futures positions were included on the faxes. The foreign broker then faxed a list to the FCM indicating to which accounts the trades should be assigned. The FCM's personnel keypunched the foreign broker's futures trading information into the FCM's accounting database directly from the fax, never the order tickets.

On average, a foreign broker customer account was dissipated by trading losses and commissions in a little over two months. Once an account lacked sufficient capital to trade futures, the foreign broker would purchase deep out-of-the-money options (with small premiums) to convert as much as possible of the remaining funds to commissions.

3. Skrable's Knowledge of the Foreign Broker's Fraud

Skrable was aware of the foreign broker's fraudulent allocation scheme. Skrable knew that unallocated trades were provided to the foreign broker and that the foreign broker was allocating winning and losing trades unfairly.

D. LEGAL DISCUSSION

³ In some cases, the stops were even tighter. In the 30-year U.S. Treasury bond futures contract, for instance, the stops were placed only four ticks (the equivalent of \$125) away from where the position was established.

1. FRAUD IN CONNECTION WITH COMMODITY FUTURES CONTRACTS

Skrable violated Sections 4b(a)(i) and 4b(a)(iii) of the Act by participating in the fraudulent scheme. In addition, Skrable aided and abetted others' violations of Sections 4b(a)(i) and 4b(a)(iii) of the Act.

Establishing a violation of Section 4b(a)(i) and (iii) requires a showing that a person

- (1) (a) cheated or defrauded or attempted to cheat or defraud another person, or

(b) willfully deceived or attempted to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract
- (2) in connection with any order to make or the making of a contract of sale of a commodity for future delivery made or to be made for or on behalf of any other person.⁴

Failing to place account numbers on order tickets provides an opportunity to direct profitable fills to favored accounts, and Section 4b of the Act prohibits this type of allocation of winning and losing trades.⁵ In addition, it is clear that a futures broker owes a fiduciary duty to his customer, even a customer with whom the broker is not in direct privity:

[I]t [is] fraud to fail to “level” with one to whom one owes fiduciary duties. The essence of a fiduciary duty is that the fiduciary agrees to act as his principal’s alter ego rather than to assume the standard arm’s length stance of traders in a market.⁶

Thus, in *United States v. Ashman*, a floor broker was found to owe fiduciary duties to customers with whom he did not have any contact and where he only executed trade orders

⁴ 7 U.S.C. § 6(b)(a)(i) & (iii).

⁵ *In re GNP Commodities Inc.*, [1990 – 1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,214 (CFTC Aug. 11, 1992)(citing *In re Lincolnwood Commodities, Inc.*, [1982 – 1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,986 at 28,246 (CFTC Jan. 31, 1984); see also *In re Shahrokh Nikkhah*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,885 (CFTC May 12, 2000) (“a post-execution allocation process could only be deemed predetermined and fair for purposes of Section 4b(a) if it resulted in an equal division of the contracts among the eligible pool of customers”).

⁶ *United States v. Ashman*, 979 F.2d 469, 478 (7th Cir. 1992) cert. denied sub nom. *Barcal v. United States*, 510 U.S. 814 (1993)(quoting *United States v. Dial*, 757 F.2d 163, 68 (7th Cir. 1985)).

communicated to him indirectly through FCMs or IBs. Among other duties a fiduciary owes the principal is a duty to inquire when the fiduciary has suspicions that the principal, in this case the foreign broker's customer, is being victimized by another's wrongdoing.

A. Primary Liability for Skrable

Skrable placed futures orders with the FCM for execution knowing that the orders were for customers and that they would be allocated in an unfair and inequitable manner. At some point, Skrable became aware that the foreign broker was misallocating the trades executed for the foreign broker's account. To the extent it was not obvious from the beginning, over time, as the trading advisor's own records indicate, he also came to know that their day-trading with tight stops, at the commission rate charged, resulted in no realistic possibility of profits while generating huge commission revenue for the foreign broker. Accordingly, Skrable violated Sections 4b(a)(i) and 4b(a)(iii).

B. Aiding and Abetting Liability for Fraudulent Trading Scheme

Skrable aided and abetted others' violations of Section 4b(a)(i) and 4b(a)(iii). Under Section 13(a) of the Act, a person aids and abets another's violation if (1) the Act was violated (the case law often refers to the violation as the "unlawful venture" that the alleged aider and abettor knowingly joins), (2) the named respondent had knowledge of the wrongdoing underlying the violation, and (3) the named respondent intentionally assisted the primary wrongdoer.⁷

In addition, "[i]n appropriate circumstances, passive conduct may amount to intentional assistance of the primary wrongdoer."⁸ The aider and abettor must know about the specific activity that was wrongful. It is not required to show that "the aider and abettor knew [that] the principal's activity was unlawful."⁹ This is particularly true where the aider and abettor "is himself an industry professional who operates in a highly-regulated field which imposes duties upon him that do not attach to the public at large."¹⁰

All three prongs of the aiding and abetting standard are satisfied. First, the foreign broker's loading scheme violated Section 4b(a)(i) and 4b(a)(iii) and constitutes a primary violation. Second, to the extent it was not obvious from the beginning, over time, Skrable became aware of the foreign broker's wrongdoing. Third, Skrable's paid role in providing unallocated futures orders to the FCM while knowing, at some point, that the foreign broker was

⁷ *In re Nikkhah*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,129, at 49,888 n.28 (CFTC May 12, 2000), citing *In re R&W Technical Services, Ltd.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,582, at 47,746 (CFTC Mar. 16, 1999).

⁸ *In re Western Financial Management*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,814 at 31,401 (Nov. 14, 1985)(finding that in appropriate circumstances, passive conduct may amount to intentional assistance of the primary wrongdoer).

⁹ *In re Lincolnwood Commodities, Inc.*, ¶ 21,986 at 28,255.

¹⁰ *Id.*

subsequently fraudulently allocating the trades establishes that he intended to assist the primary wrongdoer. Through his knowledge of the fraudulent scheme and his intentional participation in the scheme, Skrable is liable for aiding and abetting violations of Sections 4b(a)(i) and 4b(a)(iii).¹¹

2. FAILURE TO REGISTER AS COMMODITY TRADING ADVISORS

By failing to register with the Commission as a CTA, Skrable violated Section 4m of the Act. Section 4m requires (i) any CTA who (ii) uses the mails or any instrumentality of interstate commerce in connection with his business to be registered with the Commission unless the CTA does not provide trading advice to more than fifteen persons during the preceding twelve-month period.

First, Skrable was a CTA. Under Section 1a(5)(A) of the Act, a person is a CTA if that person:

- (a) engages in the business of advising others, either directly or through publications or writings, as to the value or the advisability of trading in futures contracts or options on futures contracts
- (b) for compensation or profit.

Skrable engaged in activities that satisfy the first prong of the CTA definition. Skrable determined the nature and timing of futures transactions entered into on behalf of the foreign broker's customers. These orders to buy and sell futures contracts were telephoned by Skrable to the FCM's International order desk for immediate execution. Accordingly, Skrable engaged in the business of advising others as to the value or the advisability of trading in futures contracts.¹²

¹¹ It is not necessary to charge the primary violator in the same action brought against an aider and abettor to establish the aider and abettor's liability. *See, e.g., United States v. Murphy*, 768 F.2d 1518, 1532 (7th Cir. 1985) (rejecting argument, under Section 2 of Title 18, the provision on which Section 13(a) of the Act was modeled, that charges of aiding and abetting could only be brought if principals were also charged with a primary violation).

¹² The Courts and the Commission have found much more tangential advisory activities to satisfy Section 1a(5)(A)'s requirement of engaging in the business of advising others as to the advisability of trading futures. *See, e.g., CFTC v. British American Commodity Options Corp.*, 560 F.2d 135, 141 (2d Cir. 1977), *cert. denied*, 438 U.S. 905 (1978) (holding that a firm that "offer[ed] opinions and advice, and issued analyses and reports concerning the value of commodities" to clients, was a CTA); *Gaudette v. Panos* 644 F. Supp. 826, 839 (D. Mass. 1986) *rev'd on other grounds* 852 F.2d 30 (1st Cir. 1988) (defendants were CTAs where "defendants represented their advisory skills to be exemplary, suggested that plaintiffs open a commodity account and then recommended certain futures contracts for investment."); *see also In re Armstrong*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,657 at 40,148 (CFTC Feb. 8, 1993) *aff'd in part, rev'd in part on other grounds CFTC v. Vartiuli*, 225 F.3d 94 (2d Cir 2000)(publisher of monthly newsletter which also offered personal consultations and managed futures accounts gave commodity futures trading advice), *vacated on other grounds*, 12 F.3d 401

Skrable provided his advisory services for compensation, satisfying the second prong of the definition of a CTA. For his commodity trading advice, Skrable was paid between \$2 and \$4 per round turn. Thus, Skrable was a CTA under Section 1a(5)(A) of the Act.

The second element of a Section 4m violation is also satisfied. Skrable used either the mails or instrumentalities of interstate commerce in connection with his advisory businesses. By his use of the telephone to call in orders to the FCM's International Division's order desk, for instance, Skrable used an instrumentality of interstate commerce in connection with his CTA business. Accordingly, Section 4m required Skrable to be registered as a CTA unless he fell within the provision's exception for advisors to fewer than fifteen persons.

In applying the exception to the registration requirement, one must include even those who have received the CTA's advice indirectly. In *CFTC v. Savage*,¹³ the Ninth Circuit held that a CTA does not qualify for Section 4m's exception to the registration requirement where the one client to whom the CTA provided trading advice used the advice for trading the accounts of more than fifteen of its own customers.¹⁴ The evidence establishes that the orders placed by Skrable during any twelve-month period were placed into more than fifteen of the foreign broker's customers' accounts. Accordingly, Skrable falls outside the statutory exception to Section 4m's registration requirement.

As a result, Skrable's failure to register as a CTA violated Section 4m of the Act.

3. FRAUD BY COMMODITY TRADING ADVISORS

Skrable violated Section 4o of the Act by engaging in fraudulent activities as a CTA. Section 4o of the Act makes it unlawful for (i) any CTA, whether registered, required to be registered, or exempted from registration,¹⁵ (ii) to use the mails or any means or instrumentality of interstate commerce (iii) to (1)(A) "employ any device, scheme, or artifice to defraud any client. . . or prospective client" or (1)(B) "engage in any transaction, practice, or course of

(3d Cir. 1993); *CFTC v. Avco*, 28 F. Supp.2d 104 (S.D.N.Y. 1998)(finding producer of software meets definition of CTA based on personalized investment advice).

¹³ *CFTC v. Savage*, 611 F.2d 270, 279-281 (9th Cir. 1979).

¹⁴ The exception to Section 4m's registration requirement for CTAs who furnish advice to fifteen or fewer persons is limited to just that. Furnishing advice to more than fifteen, even on a belief that only fifteen or fewer persons are receiving the advice, is not protected by the exception. See *SEC v. Blavin*, 557 F. Supp. 1304, 1309 (E.D. Mich. 1983) (stating that the registration provision of the Investment Adviser Act of 1940, after which Section 4m of the Act is modeled, is "a strict liability provision"), *aff'd* 760 F.2d 706 (6th Cir. 1985).

¹⁵ *CFTC v. Savage*, 611 F.2d 270, 281 (9th Cir. 1979) (Section 4o applies to CTAs whether registered or not); see also *Damiani v. Futures Investment Company, Inc.*, [1980 – 1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,097 at 24,416-17 (C.F.T.C. Sept. 3, 1980) (President of registered corporate CTA, who provided trading advice and was listed as a principal on the corporate CTA's registration documents, held liable for Section 4o violation as a CTA).

business which operates as a fraud or deceit upon any client . . . or prospective client.”¹⁶ Section 4o of the Act implements the fiduciary duties that characterize the trading advisor’s relationship with his clients.¹⁷ Although Section 4o(1)(A) has been found to require a showing of scienter,¹⁸ Section 4o(1)(B) does not.¹⁹

While acting as a CTA, Skrable violated Section 4o(1) of the Act by the same conduct that violated Section 4b(a) of the Act.²⁰ At some point during the relevant period, Skrable became aware that the foreign broker was using the unallocated trades to allocate trades among customer accounts with the knowledge of which trades were winners and losers, thus satisfying the scienter requirement. Accordingly, Skrable employed a scheme to defraud and engaged in a course of business, which operated as a fraud or deceit upon his clients, the customers of the foreign broker, in violation of both Section 4o(1)(A) and 4o(1)(B).

IV.

OFFERS OF SETTLEMENT

Skrable has submitted an Offer in which he, without admitting or denying the findings herein: (1) acknowledges service of the Complaint and the Order; (2) admits the jurisdiction of the Commission with respect to the matters set forth herein; (3) waives a hearing, all post-hearing procedures, judicial review by any court, any objection to the staff's participation in the Commission's consideration of the Offer, all claims which he may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (1994) and 28 U.S.C. § 2412 (1994), as amended by Pub. L. No. 104-121, §§ 231-32, 110 Stat. 862-63 (1996), and Part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1, et seq. (2000), relating to or arising from this action, and any claim of Double Jeopardy based upon institution of this proceeding or the entry of any order imposing a civil monetary penalty or any other relief; (4) stipulates that the record basis on which the Order may be entered shall consist solely of the Complaint, Order and findings in the Order consented to in the Offer; and (5) consents to the Commission's issuance of the Order, which makes findings as set forth below and: (a) orders Skrable to cease and desist from violating the provisions of the Act that he has been found to have violated; (b) imposes civil monetary penalty of twelve thousand five hundred dollars (\$12,500); (c) prohibits him for a period of two (2) years and six (6) months from trading on or subject to the rules of any registered entity; (d) prohibits his registration with the Commission for a five (5) year period; and (e) orders Skrable to comply with his undertakings consented to in his Offer.

¹⁶ 7 U.S.C. § 6o.

¹⁷ *Savage*, 611 F.2d at 285.

¹⁸ *In re Commodities Int'l Corp.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,943 at 44,564 (CFTC Jan. 14, 1997).

¹⁹ *Messer v. E.F. Hutton & Co.*, 847 F.2d 673, 677 (11th Cir. 1988); *First Nat'l Monetary Corp. v. Weinberger*, 819 F.2d 1334, 1341 (6th Cir. 1987); *cf. Savage*, 611 F.2d at 285.

²⁰ *CFTC v. Skorupskas*, 605 F. Supp. 923, 932-33 (E.D. Mich. 1985) (the same conduct that violates Section 4b can violate Section 4o(1)).

V.

FINDINGS OF VIOLATIONS

Solely on the basis of the consent evidenced by the Offer, and prior to any adjudication on the merits, the Commission finds that Skrable violated Sections 4b(a)(i) and 4b(a)(iii), 4m, and 4o(1)(A) and (B) of the Commodity Exchange Act.

VI.

ORDER

Accordingly, it is hereby ordered that:

1. Skrable shall cease and desist from further violations of Sections 4b(a)(i) and 4b(a)(iii), 4m, and 4o(1)(A) and (B) of the Act.
2. Skrable shall pay a civil monetary penalty in the amount of twelve thousand (\$12,500), to be made within 10 (ten) business days of the date of the Order. Skrable shall make such payment by electronic funds transfer to the account of the Commission at the United States Treasury or by certified check or bank cashier's check made payable to the Commodity Futures Trading Commission and addressed to Dennese Posey, Division of Enforcement, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 20581, under cover of a letter that identifies Skrable and the name and docket number of the proceeding. A copy of the cover letter and the form of payment shall be simultaneously transmitted to Gregory Mocek, the Director, Division of Enforcement, Commodity Futures Trading Commission, at the following address: 1155 21st Street, N.W., Washington, D.C. 20581, and to Charles J. Sgro, Regional Counsel, Division of Enforcement, Commodity Futures Trading Commission, 140 Broadway, New York, New York 10005. In accordance with Section 6(e)(2) of the Act, 7 U.S.C. § 9a(2), if Skrable fails to make payment of his penalty within fifteen (15) days of the respective due date, he shall be automatically prohibited from trading on or subject to the rules of any registered entity, as defined by Section 1a(29) of the Act, 7 U.S.C. § 1a(29), until he shows to the satisfaction of the Commission that payment of the full amount of the penalty with interest thereon to the date of payment has been made;
5. Skrable is prohibited for a period of two (2) years and six (6) months beginning on the Suspension Date, from trading on or subject to the rules of any registered entity as that term is defined by Section 1(a)(29) of the Act, and all registered entities shall refuse Skrable trading privileges thereon;
6. Skrable shall not, for a period of five (5) years following the date of this Order: (i) apply for registration or seek exemption from registration with the Commission in any capacity, and shall not engage in any capacity requiring registration or

exemption from registration, except as provided for in Section 4.14(a)(9) of the Commission's Regulations, 17 C.F.R. § 4.14(a)(9) (2001); (2) act, directly or indirectly as a principal, agent, officer or employee of any person registered, required to be registered or exempted from registration, unless such exemption is pursuant to Commission Regulation Section 4.14(a)(9);

7. Skrable is directed to comply with his undertakings:
 - a. Neither Skrable, nor any of his agents or employees, if any, under his authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in the Order, or creating, or tending to create, the impression that the Order is without a factual basis; provided, however, that nothing in this provision affects Skrable's: (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Skrable shall take all steps necessary to ensure that his agents or employees, if any, understand and comply with this undertaking.
 - b. Skrable agrees to cooperate fully with the Commission's Division of Enforcement in this proceeding and any investigation, civil litigation and administrative proceeding related to this proceeding by, among other things: (i) responding promptly, completely, and truthfully to any inquiries or requests for information; (ii) providing authentication of documents; (iii) testifying completely and truthfully; and (iv) not asserting privileges under the Fifth Amendment of the United States Constitution.
 - c. Skrable acknowledges that failure to comply with the Order shall constitute a violation of the Order and may subject him to administrative or injunctive proceedings, pursuant to the Act.

Unless otherwise specified, the provisions of this Order shall be effective on this date.

By the Commission

Jean A. Webb
Secretary to the Commission
Commodity Futures Trading
Commission

Dated: July 26, 2002