

UNITED STATES OF AMERICA  
Before the  
COMMODITY FUTURES TRADING COMMISSION

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10:48 am, Apr 29, 2013

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In the Matter of: )

Kevin McLaren and Edward Gorman, )

Respondents. )

CFTC Docket No. 13-22

ORDER INSTITUTING PROCEEDINGS PURSUANT TO  
SECTIONS 6(c) AND 6(d) OF THE COMMODITY EXCHANGE ACT, AS AMENDED,  
MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that in March 2010 (the “Relevant Period”), Kevin McLaren and Edward Gorman (collectively “Respondents”) violated Section 4c(a) of the Commodity Exchange Act and Commission Regulation (“Regulation”) 1.38(a). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Respondents engaged in the violations set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, Respondents have submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondents consent to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions (“Order”) and acknowledge service of this Order.<sup>1</sup>

<sup>1</sup> Respondents consent to the entry of this Order and to the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party; provided, however, that Respondents do not consent to the use of the Offer, or the findings or conclusions in this Order consented to in the Offer, as the sole basis for any other proceeding brought by the Commission, other than in a proceeding in bankruptcy or to enforce the terms of this Order. Nor do Respondents consent to the use of the Offer or this Order, or the findings or conclusions in this Order consented to in the Offer, by any other party in any other proceeding.

### III.

The Commission finds the following:

#### A. Summary

On several occasions in March 2010 (the “relevant period”) Kevin McLaren (“McLaren”) and Edward Gorman (“Gorman”) (collectively, “Respondents”), intentionally engaged in a number of prearranged calendar spread trades in spot month corn futures for the same quantity, price, and contract month. In each instance, Respondents executed the orders opposite each other.

Because the trades were intended to negate market risk and avoid *bona fide* market transactions, they were in violation of Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), which, *inter alia*, prohibits any person from entering into a transaction that is, or is of the character of, or is commonly known to the trade as, a “wash sale.” Furthermore, these were noncompetitive transactions in violation of Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2012).

#### B. Respondents

Kevin McLaren – McLaren first registered with the Commission as a floor broker in 1982, and has been registered as a floor broker and a floor trader since 2007.

Edward Gorman – Gorman first registered with the Commission as a floor broker in 1982 and has been registered as a floor trader since 2007.

#### C. Facts

On at least four days during the relevant period, Respondents knowingly prearranged the execution of calendar spread trades opposite each other in a manner to avoid market risk. The quantity, price, and contract months for these buy and sell orders were identical, and they were entered within moments of each other.

For example, on March 9, 2010, Respondents each placed buy and sell orders for 25 March 2010/September 2010 corn futures calendar spread contracts at identical prices within two seconds of each other. Two seconds later, Respondents placed offsetting sell and buy orders within one second of each other for the identical number of March 2010/September 2010 corn futures calendar spread contracts at prices identical to those in the previous transaction.

### IV.

#### LEGAL DISCUSSION

#### A. Respondents Violated Section 4c(a) Of The Act

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 of the character of, or is commonly known to the trade as, a ‘wash sale ...’” 7 U.S.C. § 6c(a) (2006). A wash sale is a form of

fictional transaction. *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 Goldwurm*, 7 A.D. 265, 274 (CEA 1948). Further, the Commission has long held that prearranged trading is a form of fictitious sales. *In re Harold Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,982 at 31,903 (CFTC Apr. 4, 1986).

A wash sale is a transaction made without an intent to take a genuine, *bona fide* position in the market, such as a simultaneous purchase and sale designed to negate each other so that there is no change in financial position. *Reddy v. CFTC*, 191 F.3d 109, 115 (2d Cir. 1999). *See also Goldwurm*, 7 A.D. at 274. Wash sales are “grave” violations, even in the absence of customer harm or appreciable market effect, because “they undermine confidence in the market mechanism that underlies price discovery.” *In re Piasio*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,276 at 50,691 (CFTC Sep. 29, 2000), *aff'd sub nom. Wilson v. CFTC*, 322 F.3d 555, 559 (8th Cir. 2003) (wash sales are designed to give the appearance of submitting trades to the open market, while negating the risk or price competition incident to the market and produce a virtual financial nullity because the resulting net financial position is near or equal to zero). *See also CFTC v. Savage*, 611 F.2d 270, 284 (9th Cir. 1979) (wash sales may mislead market participants because they do not reflect the forces of supply and demand).

“The factors that show a wash result are: (1) the purchase and sale (2) of the same delivery month of the same futures contract (3) at the same (or a similar) price.” *Piasio*, ¶ 28,276 at 50,685 (citing *In re Gilchrist*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,993 at 37,653 (CFTC Jan. 25, 1991)). In addition to these factors, intent must be proved to establish a violation of Section 4c of the Act. *Reddy*, 191 F.3d at 119; *see also In re Citadel Trading Co. of Chicago, Ltd.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,082 at 32,190 (CFTC May 12, 1986) (“[t]he central characteristic of a wash sale is the intent not to make a genuine *bona fide* trading transaction”) (citations omitted). In the context of liability for a wash sale transaction, the scienter requirement relates to the intent at the time the challenged transactions are initiated; specifically whether it was intended to negate market risk or price competition. *Piasio*, ¶ 28,276 at 50,685. Negated risk is not “the equivalent of no risk or the complete elimination of risk;” rather the Commission has “clearly held that risk is negated whenever it is ‘it is reduced to a level that has no practical impact on the transactions at issue.’” *Id.* at 50,688 (quoting *Gimbel*, ¶ 24,213 at 35,003 n.7). “[S]cienter may be inferred from the circumstantial evidence” and while motive is not an element of a trade practice case, “evidence of motive strengthens an inference of intent.” *Reddy*, 191 F.3d at 119 (citations omitted).

In this case, Respondents prearranged to have identical buy and sell orders executed opposite each other during the relevant period. This establishes that the resulting trades were intended to negate market risk and avoid *bona fide* market transactions. Consequently, Respondents violated Section 4c(a), which makes it unlawful to offer to enter into, or to enter into, any commodity futures transaction that is a wash sale.

**B. Respondents Violated Regulation 1.38(a)**

Commission Regulation 1.38(a) provides, in relevant part:

Competitive execution required; exceptions. All purchases and sales of any commodity for future delivery, and of any commodity option, on or subject to the rules of a contract market shall be executed openly and competitively by open outcry or posting of bids and offers or by other equally open and competitive methods, in the trading pit or ring or similar place provided by the contract market, during the regular hours prescribed by the contract market for trading in such commodity or commodity option. . .

17 C.F.R. § 1.38(a).

For the purposes of Regulation 1.38(a), “[n]oncompetitive trading consists of the use of trading techniques that negate risk or price competition that is incident to an open, competitive market.” *In re Avista Energy, Inc.*, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,623 at 52,358 (CFTC Aug. 21, 2001) (citing *In re Bear Stearns & Co.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,994 at 37,662 (CFTC Jan. 25, 1991)). *Scienter* is a necessary element of Regulation 1.38 and the Commission has routinely refused to find liability under the rule where the Division has failed to prove that respondent’s participation in the noncompetitive execution of futures trades was “knowing.” *E.g.*, *In re Buckwalter*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,995 at 37,685 (CFTC Jan. 25, 1991); *In re Bear Stearns & Co.*, ¶ 24,994 at 37,666; *In re Gilchrist*, ¶ 24,993 at 37,653 n.26. Here, the Division can show that McLaren and Gorman’s corn futures transactions were not executed openly and competitively as required by Regulation 1.38.

**V.**

**FINDINGS OF VIOLATION**

Based on the foregoing, the Commission finds that, during the Relevant Period, Kevin McLaren and Edward Gorman each violated Section 4c(a) of the Commodity Exchange Act and Regulation 1.38(a).

**VI.**

**OFFER OF SETTLEMENT**

Respondents have submitted the Offer in which they, without admitting or denying the findings and conclusions herein:

- A. Acknowledge receipt of service of this Order;
- B. Admit the jurisdiction of the Commission with respect to all matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based on violation of or enforcement of this Order;

C. Waive:

1. the filing and service of a complaint and notice of hearing;
2. a hearing;
3. all post-hearing procedures;
4. judicial review by any court;
5. any and all objections to the participation by any member of the Commission's staff in the Commission's consideration of the Offer;
6. any and all claims that they may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2006) and 28 U.S.C. § 2412 (2006), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1-30 (2012), relating to, or arising from, this proceeding;
7. any and all claims that they may possess under the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, §§ 201-253, 110 Stat. 847, 857-868 (1996), as amended by Pub. L. No. 110-28, § 8302, 121 Stat. 112, 204-205 (2007), relating to, or arising from, this proceeding; and
8. any claims of Double Jeopardy based on the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief;

D. Stipulate that the record basis on which this Order is entered shall consist solely of the findings contained in this Order to which Respondents have consented in the Offer;

E. Consent, solely on the basis of the Offer, to the Commission's entry of this Order that:

1. makes findings by the Commission that Respondents violated Section 4c(a) of the Commodity Exchange Act and Regulation 1.38(a);
2. orders Respondents to cease and desist from violating Section 4c(a) of the Commodity Exchange Act and Regulation 1.38(a);
3. orders Respondents, individually, to each pay a civil monetary penalty in the amount of \$200,000, plus post-judgment interest;
4. orders that, for a period of 140 days, commencing on May 15, 2013, and ending on October 2, 2013, and after full payment and satisfaction of each paying Respondent's civil monetary penalty obligation, each Respondent be prohibited from directly or indirectly engaging in trading on or subject to the rules of any registered entity (as that term is defined in Section 1a of the Act, as amended, 7

U.S.C. § 1a) and registering with the Commission, and all registered entities shall refuse them trading privileges; and

5. orders Respondents to comply with the conditions and undertakings consented to in the Offer and as set forth in Part VII of this Order.

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

## VII.

### ORDER

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

- A. Respondents shall each cease and desist from violating Section 4c(a) of the Commodity Exchange Act, as amended, 7 U.S.C. § 6c(a) (2006), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2012).
- B. Respondents shall each pay a civil monetary penalty in the amount of two hundred thousand dollars (\$200,000), plus post-judgment interest, by May 15, 2013, or within thirty (30) days of the date of entry of this Order, whichever date is later (the "CMP Obligation"). If the CMP Obligation is not paid in full within thirty (30) days of the date of entry of this Order, then post-judgment interest shall accrue on the paying Respondent's CMP Obligation beginning on the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of this Order pursuant to 28 U.S.C. § 1961 (2006). Respondents shall pay each of their CMP Obligations by electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made other than by electronic funds transfer, then 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: Accounts Receivables --- AMZ 340  
E-mail Box: 9-AMC-AMZ-AR-CFTC  
DOT/FAA/MMAC  
6500 S. MacArthur Blvd.  
Oklahoma City, OK 73169  
Telephone: (405) 954-5644

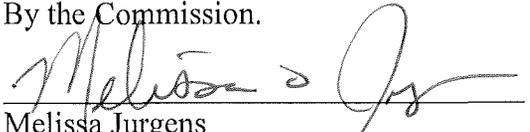
If payment is to be made by electronic funds transfer, the paying Respondent shall contact Linda Zurhorst or her successor at the above address to receive payment instructions and shall fully comply with those instructions. The paying Respondent shall accompany payment of the CMP Obligation with a cover letter that identifies the paying Respondent and the name and docket number of this proceeding. The paying Respondent shall simultaneously transmit copies of the cover letter and the form of payment to the

Chief Financial Officer, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581.

- C. Respondents are each prohibited from directly or indirectly engaging in trading on or subject to the rules of any registered entity (as that term is defined in Section 1a of the Act, as amended, 7 U.S.C. § 1a), registering with the Commission, and all registered entities shall refuse them trading privileges for a period of 140 days, commencing on May 15, 2013, and ending on October 2, 2013, and after full payment of each paying Respondent's CMP Obligation.
- D. Respondents shall comply with the following condition and undertaking set forth in the Offer:
  - 1. Public Statements: Respondents agree that neither they nor any of their agents or employees under their 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 a factual basis; provided, however, that nothing in this provision shall affect Respondents': (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Respondents shall undertake all steps necessary to ensure that all of their agents and/or employees under their authority or control understand and comply with this agreement.
- E. Cooperation with the Commission: Respondents shall cooperate fully and expeditiously with the Commission, including the Commission's Division of Enforcement, and any other governmental agency in this action, and in any investigation, civil litigation, or administrative matter related to the subject matter of this action or any current or future Commission investigation related thereto.
- F. Partial Satisfaction: Respondents understand and agree that any acceptance by the Commission of partial payment of each Respondent's CMP Obligation shall not be deemed a waiver of their obligation to make further payments pursuant to this Order, or a waiver of the Commission's right to seek to compel payment of any remaining balance.
- G. Change of Address/Phone: Until such time as Respondents satisfy in full their CMP Obligations as set forth in this Consent Order, Respondents shall provide written notice to the Commission by certified mail of any change to his telephone number and mailing address within ten (10) calendar days of the change.

The provisions of this Order shall be effective as of this date.

By the Commission.

A handwritten signature in cursive script, appearing to read "Melissa Jurgens", is written over a horizontal line.

Melissa Jurgens  
Secretary of the Commission  
Commodity Futures Trading Commission

Dated: April 29, 2013