UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

TROY MERTZ	:	
v.	:	CFTC Docket No. 13-E-01
CME GROUP INC., MARKET REGULATION DEPARTMENT	:	SUPPLEMNTAL BRIEFING ORDER

Troy Mertz appeals a final order of the CME Group disciplining him for violating Legacy CME Group Rule 432.B, which prohibits engaging in fraud, bad faith, or conduct or proceedings inconsistent with just and equitable principles of trade. Two related issues regarding the proceedings below concern us: First, it appears that Mertz may not have received sufficient notice that his post-closing day resolution of outtrades was a potential source of liability in CME's inquiry. Second, if notice of the charge was not sufficient, the record is unclear as to whether he suffered any resulting prejudice. As explained below, to clarify the record and ensure that fundamental fairness was observed in the proceedings under review we order supplemental briefing on these issues.

Background

During trading on May 6, 2010, the so-called "flash crash," Mertz, a floor broker filling orders in the CME S&P Options pit, had two trades that did not fully clear because his counterparty did not acknowledge those trades. Mertz eventually assigned those trades to his error account and cleared them the next day for a total profit of nearly $1.1 million. The CME's Market Regulation Group ("Market Regulation") brought enforcement proceedings alleging that Mertz intentionally underfilled those orders in pursuit of windfall profits, and CME's Probable

Cause Committee ("PCC") issued a Charging Memorandum charging that Mertz committed four violations of CME rules by intentionally underfilling the orders. These charges were considered by the CME's Business Conduct Committee ("BCC"), which found that Mertz did not intentionally underfill the orders. However, the BCC concluded that Mertz failed to follow applicable CME rules regarding the apportionment of outtrades, and he was therefore guilty of a violation, notwithstanding his lack of intent in creating the outtrades. Mertz timely appealed to the Commission.

Notice

On appeal, Mertz argues, *inter alia*, that the proceedings were not fundamentally fair, *see* 17 C.F.R. § 9.33(c)(2), because he did not have sufficient notice of all the charges against him. Mertz alleges that the BCC crafted a "new theory of liability" after trial in holding him liable for failing to resolve outtrades in conformance with CME Rules 527.A-C. *See* Mertz Br. at 11-12, 15.[1] Mertz appears to claim that the PCC's charges focused on *intentionally* underfilling the orders in question; Mertz argues that this did not provide sufficient notice that the BCC might conclude that the failed trades were *unintentional*, and yet find that Mertz violated the rules concerning the resolution of outtrades. *Id.*

Mertz's argument appears to have merit. The PCC's Charging Memorandum focuses extensively on its claim that Mertz intentionally underfilled orders. The Charging Memorandum never mentions Rule 527.A or Rule 527.C (much less articulates a violation of those rules in its actual charges), which figure prominently in the BCC's ultimate liability finding. *See* Tab F-6-7. It is true that some of the factual paragraphs of the Charging Memorandum mention Mertz's assignment of the unfilled orders to his error account and the subsequent trades he used to fill the

[1] Mertz's brief lacks page numbers. For ease of reference, the Commission uses CME's convention for numbering the pages of Mertz's opening brief. *See* CME Br. at 18 n.9.

orders at a profit. But it is unclear whether these references were sufficient to provide Mertz with adequate notice that the BCC could find a violation based solely on Mertz's failure to follow CME Rules 527.A and 527.C. *See* Tab A-5-8. In other circumstances, courts have held that finding liability on grounds different from those initially charged can result in reversal. *See In re Ruffalo*, 390 U.S. 544, 551 & n.4 (1968). Similarly, a deficient charging document could support reversal under these circumstances.

CME argues on appeal that Mertz had adequate notice. CME suggests the factual content of the Charging Memorandum (but not the charges themselves), the exhibits introduced at the BCC hearing, and testimony at the hearing itself all referenced post-closing handling of the trades at issue collectively provide the requisite notice. *See* CME Br. at 21-29. The Commission does not foreclose this argument and will consider it in its ultimate disposition of this case. However, it is clear at this stage that the Charging Memorandum did not mention violations of Rule 527.A or Rule 527.C and, read as a whole, it focused on allegations that Mertz intentionally failed to fill the relevant orders in the open market. Tab A-11. As a result, we are concerned that Mertz may not have received fair notice that his compliance with post-closing outtrade resolution procedures was to be a potential source of independent liability. Similarly, as the BCC itself noted, both parties "spent considerable time" describing what happened in the pit at the time the orders at issue were placed. Tab F-4. It stands to reason that Mertz could reasonably have thought that the proceedings were limited to the question of whether he intentionally failed to fill the relevant orders in the open market and presented his defense accordingly.

Despite our misgivings, the Commission believes that the record is insufficiently clear on this point to rule definitively. It is not clear on this record, for example, whether CME rules treat

failure to resolve outtrades properly as essentially a lesser included offense that need not be charged separately. *See U.S. v. Combs*, 634 F.2d 1295, 1303 (10th Cir. 1980) (noting that "better practice" is that lesser included offenses not be charged as separate counts of an indictment and that lesser included instruction be requested at trial); *cf. Willson v. Belleque*, 554 F.3d 816, 828 n.3 (9th Cir. 2009) (noting that under Oregon law, charging lesser included offense in a separate offense is "superfluous"). There may also be other portions of the record that demonstrate that Mertz received sufficient notice that the BCC was considering charges stemming from his handling of the outtrades. Thus, we order that the parties file supplemental briefs to clarify whether Mertz had sufficient notice that the BCC was considering imposing liability solely for Mertz's improper resolution of outtrades by not complying with Rule 527.A or Rule 527.C.

Prejudice

A finding of insufficient notice is not, by itself, dispositive. Our precedents require a showing of prejudice before relief can be granted in most instances. For example, in *In re Clark and Auciello*, all parties agreed that the exchange (through its parent company) and respondent's counsel entered into an agreement precluding counsel from representing respondent in proceedings against the exchange. *In the Matter of Clark*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,370 at 46,683; 1998 WL 422570, at *11-12 (C.F.T.C. July 22, 1998). The respondent argued that this agreement rendered the proceedings fundamentally unfair because he was limited in his ability to defend himself. *Id.* However, because the exchange reversed course and declined to enforce the agreement, and respondent's counsel did in fact represent him for a time, we found that he was not prejudiced. *Id.* at *12. Similarly in *Daiwa Sec. Am., Inc. v. Chicago Bd. of Trade*, respondents challenged the authority of the Board of Trade's Appellate Committee to *sua sponte* reverse the Hearing Committee's conclusion that

respondents' conduct did not amount to a violation of CBOT Rule 500. *Daiwa Securities America, et al. v. Board of Trade of the City of Chicago*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,103 at 41,645; 1994 WL 249800, at *5 (C.F.T.C. June 9, 1994). We declined to grant relief in that case because the factual issues underlying the Rule 500 violation were "essentially subsumed" by the factual issues relevant to the Hearing Committee's Rule 504 violation, which respondents did brief. *Id.* & n.11.

Our precedents are in harmony with the case law. Appellate courts will not disturb administrative proceedings on notice grounds unless there is evidence "a party is misled by an administrative complaint, resulting in 'prejudicial error[.]'" *Abercrombie v. Clark*, 920 F.2d 1351, 1360 (7th Cir. 1991) (quoting *L.G. Balfour Co. v. FTC*, 442 F.2d 1, 19 (7th Cir. 1971)); *St. Anthony Hosp. v. U.S. Dept. Health and Human Servs.*, 309 F.3d 680, 708 (10th Cir. 2002).

Both parties' briefs, however, are largely silent as to the issue of prejudice. Mertz argues repeatedly that the Charging Memorandum was deficient, but he does not explain how this deficiency harmed him; he does not suggest how he would have defended his post-closing handling of outtrades had he known this was at issue. Would he have presented additional or different witnesses or testimony? Would he have asked different or additional questions on cross examination? Were there any other ways in which he was prejudiced? For its part, CME does not address the question of prejudice, probably because it believes that Mertz received sufficient notice of the charges against him. Ordinarily, we would not excuse a failure to show prejudice. But because Mertz is proceeding *pro se* and there appears to be a serious question as to whether he received adequate notice, we believe supplemental briefing on the questions of notice and prejudice is consistent with fundamental fairness on the specific facts of this case.

Conclusion

Accordingly, we order the parties to submit supplemental briefs of no more than 7 double-spaced pages to be filed simultaneously no later than 30 days from the service of this order. The supplemental briefs should address whether Mertz received fair notice of the charges against him, and assuming he did not receive proper notice, whether he suffered any prejudice.

IT IS SO ORDERED.

By the Commission (Chairman GENSLER and Commissioners, CHILTON, O'MALIA, and WETJEN.)

Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission

Dated: January 3, 2014