



**U.S. COMMODITY FUTURES TRADING COMMISSION**

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In the Matter of \*  
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R&W TECHNICAL SERVICES, LTD. \*  
and GREGORY M. REAGAN, \*  
\*  
Respondents. \*  
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CFTC Docket No. 96-3

**INITIAL DECISION ON REMAND**

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Before: Bruce C. Levine, Administrative Law Judge

This order concerns a remand in which the Commission, at the direction of a court of appeals, charged us to assess new civil monetary penalties against the respondents. The Commission narrowed the scope of our fact finding by defining the issues to be tried but also by limiting types of relevant, reliable evidence that could be admitted. The matters to be resolved on remand were further narrowed when the parties stipulated to a number of material facts. As discussed below, the recomputed fines are significantly lighter than those first issued by the Commission, somewhat less severe than the Division of Enforcement wanted and much heavier than the respondents would prefer.

#### **Background**<sup>1</sup>

In March of 1999, the Commission held that respondents R&W

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<sup>1</sup> The Commission initiated this proceeding in March of 1996. Complaint and Notice of Hearing Pursuant to Sections 6(c), 6(d), 8a(3) and 8a(4) of the Commodity Exchange Act, as Amended, dated March 19, 1996 ("Complaint"). Consequently, we limit our discussion to that which is most pertinent to the issues on remand. For a more complete history of this case, see In re R&W Technical Servs., Ltd., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,706 (CFTC Mar. 4, 2004); In re R&W Technical Servs., Inc., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,556 (CFTC Aug. 6, 2003); R&W Technical Servs. Ltd. v. CFTC, 205 F.3d 165 (5th Cir. 2000); In re R&W Technical Servs., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,582 (CFTC Mar. 16, 1999); In re R&W Technical Servs., Ltd., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,193 (ALJ Dec. 1, 1997); In re R&W Technical Servs., Ltd., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,137 (ALJ Aug. 7, 1997); and In re R&W Technical Servs., Ltd., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,030 (ALJ Apr. 10, 1997).

Technical Services, Ltd. and Gregory M. Reagan<sup>2</sup> violated Sections 4b and 4o of the Commodity Exchange Act<sup>3</sup> and Commission Regulation 4.41(a)<sup>4</sup> by fraudulently inducing customers to purchase commodity futures trading software.<sup>5</sup> This ruling rested on determinations that, in advertisements distributed to the public, R&W and Reagan systematically misrepresented their own trading experience and the track record of their trading systems, and made "false promises" that use of the systems would generate "easy profits."<sup>6</sup> The Commission also found that the respondents' fraudulent conduct was intentional,<sup>7</sup> grave<sup>8</sup> and a substantial factor in causing roughly 950 customers to purchase R&W's software by paying a total of approximately \$2,375,000.<sup>9</sup> The

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<sup>2</sup> Reagan and former respondent Marshall L. Worsham formed R&W in "late 1992 or early 1993." R&W, [1998-1999 Transfer Binder] ¶27,582 at 47,728. During the period covered by the Complaint, R&W was a Texas limited liability company, and Reagan and Worsham were its owners. Id. Worsham died on September 13, 1996. Id. at 47,727. Sometime thereafter, Reagan acquired sole ownership of the firm. Agreed Stipulations, filed July 13, 2004 ("Stipulations"), ¶9.

<sup>3</sup> 7 U.S.C. §§6b, 6o.

<sup>4</sup> 17 C.F.R. §4.41(a).

<sup>5</sup> R&W, [1998-1999 Transfer Binder] ¶27,582 at 47,745, 47,750.

<sup>6</sup> Id. at 47,741.

<sup>7</sup> Id. at 47,743, 47,478.

<sup>8</sup> Id. at 47,748.

<sup>9</sup> Id. at 47,748 & n.60.

Commission sanctioned the respondents by imposing a cease and desist order,<sup>10</sup> and a joint and several civil monetary penalty of \$2,375,000, a figure that it found to be a "reasonable estimate" of the wrongfully-obtained revenue.<sup>11</sup>

The respondents appealed and, in February of 2000, the United States Court of Appeals for the Fifth Circuit affirmed the Commission's liability findings.<sup>12</sup> However, it found fault with two aspects of the Commission's monetary penalty assessment. The panel ruled that there must be a rational relationship between a civil fine and the underlying violations.<sup>13</sup> It observed that the Commission had intended to relate the respondents' fine to their wrongful gain and, at an abstract level, the court endorsed that approach.<sup>14</sup> Nonetheless, it deemed the Commission's penalty to be "unreasonably excessive" because revenue, not profits, had

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<sup>10</sup> Id. at 47,747.

<sup>11</sup> Id. at 47,748-49.

<sup>12</sup> R&W, 205 F. 3d at 168, 172 (observing "it is clear that petitioners' advertising claims misrepresented the fundamental risk associated with commodity futures investments and trading systems"). The court left undisturbed, without discussion, the Commission's cease and desist orders. See R&W, [Current Transfer Binder] ¶29,556 at 55,390 n.7.

<sup>13</sup> R&W, 205 F.3d at 177.

<sup>14</sup> Id. at 178 ("In calculating a civil penalty, the financial benefit that accrued to the respondent and/or the loss suffered by customers as a result of the wrongdoing are especially pertinent factors." (internal quotation marks and footnote omitted)).

served as the measure of gain.<sup>15</sup> The court also held that this agency erred in failing to provide the respondents with a fair opportunity to present mitigation evidence tending to show that customers were satisfied with R&W's trading systems and had profited from their use.<sup>16</sup> Consequently, the Commission was directed to make "a new assessment of the penalty" that begins "with the petitioner's [sic] net profits, which then should be adjusted lower based upon any mitigating evidence the petitioners present with regard to customer satisfaction."<sup>17</sup>

Three and a half years later, the remand made its way down to us for a new penalty assessment and related fact-finding.<sup>18</sup>

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<sup>15</sup> Id. at 177-78.

<sup>16</sup> Id. at 176-178. In its 1999 opinion, the Commission acknowledged that evidence of the efficacy of R&W's software would have been material to the sanctions assessment but denied the respondents' motion to reopen the record to introduce efficacy evidence, finding that they had not established reasonable grounds for their failure to offer such evidence at the hearing. R&W, [1998-1999 Transfer Binder] ¶27,582 at 47,736-37. On review, however, the court found that the we "appear[ed] to have misled the petitioners as to the admissibility of this evidence," and, as a consequence, the Commission abused its discretion in failing to reopen the record to receive it. R&W, 205 F.3d at 176-77.

<sup>17</sup> Id. at 178.

<sup>18</sup> R&W, [Current Transfer Binder] ¶29,556 at 55,392. In March of 2004, the Commission issued a second order "clarifying" its initial directives to us on remand. R&W, [Current Transfer Binder] ¶29,706 at 56,001.

We convened a hearing in Houston, Texas on October 19, 2004.<sup>19</sup> There, we heard Reagan's testimony<sup>20</sup> and admitted the Division's exhibits into evidence.<sup>21</sup> After the hearing, the parties filed their briefs<sup>22</sup> and the case now is ready for decision.

### The Respondents' Ill-Gotten Profits

Consistent with the Commission's directives, we begin by determining the profit that R&W earned up to March 19, 1996 (the date upon which the Commission filed the Complaint),<sup>23</sup> and the

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<sup>19</sup> Transcript of Oral Hearing, dated October 25, 2004 ("2004 Tr.").

<sup>20</sup> 2004 Tr. at 15-24.

<sup>21</sup> 2004 Tr. at 6 (receiving Exhibits DX-1 through DX-5). The respondents sought to introduce what appeared to be the declarations of 177 R&W customers. 2004 Tr. at 6-7. However, we sustained the Division's objection to these documents. 2004 Tr. at 6-9.

<sup>22</sup> Division of Enforcement's Reply Brief, filed December 29, 2004 ("Division's Reply Brief"); Respondents' Post-Hearing Memorandum, dated December 8, 2004 ("Respondents' Post-Hearing Brief"); Respondents' Proposed Findings of Fact and Conclusions of Law, dated December 8, 2004; Division of Enforcement's Post Hearing Brief, filed November 12, 2004 ("Division's Post-Hearing Brief"); Division of Enforcement's Proposed Findings of Fact and Conclusions of Law, filed November 12, 2004.

<sup>23</sup> R&W's business was limited to the sale of the trading software at issue. Transcript of Oral Hearing, filed August 18, 1997 ("1997 Tr."), at 100-01. In calculating R&W's revenue for the purpose of determining its ill-gotten gains, the Commission purported to presume (but, really, inferred) that substantially all of R&W's customers during this period relied on the firm's deceptive claims in making their purchase decisions. R&W, [1998-1999 Transfer Binder] ¶27,582, at 47,748 n.60. The Fifth Circuit did not disturb this presumption nor did the Commission on remand. R&W, [Current Transfer Binder] ¶29,556 at 55,392.

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amount by which Reagan profited as a result of R&W's sales during the relevant period.<sup>24</sup> Although these calculations had the

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Accordingly, we retain it in determining the respondents' ill-gotten profits.

<sup>24</sup> In remanding the case to us, the Commission stated,

In directing the Commission to begin with net profits, the court did not distinguish between the two respondents remaining in this case. While the type of joint civil money penalty we initially imposed may be appropriate in circumstances establishing a basis for disregarding the corporate form and effectively merging the identities of a business and its owner, the record here does not establish circumstances where we can reasonably infer that R&W's "gain" from its wrongdoing was the same as respondent Reagan's "gain." Indeed, based on the current record, it seems likely that R&W's gain was divided in some manner between Reagan and Worsham.

We cannot resolve these questions on the current record. To ensure a complete record, however, the ALJ shall determine net profit for each respondent individually. Put simply, respondent Reagan shall not be deemed to have derived gain from R&W that actually flowed to [Worsham].

R&W, [Current Transfer Binder] ¶29,556 at 55,392 (footnote omitted).

The respondents assert that two of the Commission's more recent decisions, In re Staryk, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,826 (CFTC July 23, 2004), and In re Miller, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,825 (CFTC July 23, 2004), should guide us. Respondents' Post-Hearing Brief at 6-7. In effect, they ask us to employ a holistic assessment in calculating the fines by "pulling a number  
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from thin air after ruminating over facts that, for the most part, can never signal the propriety of any particular penalty." In re Yost, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,828 at 56,471 (CFTC Aug. 4, 2004). See Staryk, [Current Transfer Binder] ¶29,826 at 56,453-56; Miller, [Current Transfer Binder] ¶29,825 at 56,438. This method does not square with Commission's observation that we are bound to conduct this remand in accordance with the Fifth Circuit's instructions to "begin[] with . . . respondents' net profits, which then should be adjusted lower based upon any mitigating evidence the respondents present with regard to customer satisfaction." R&W, [Current Transfer Binder] ¶29,556 at 55,390 (brackets omitted) (quoting R&W, 205 F.3d at 178). We, of course, cannot disregard the Commission's orders and, given the record development, there is no need to consider doing so. See infra text accompanying notes 26-37.

In connection with the plea for a holistic computation of their fines, the respondents claim that, "[o]n the correct assumption that customers were not harmed, the Fifth Circuit suggested a maximum penalty of \$100,000." Respondents' Post-Hearing Brief at 7-8. We find no such suggestion. True, the panel observed, "At oral argument, counsel for the Commission was unable to say that there had ever been a fine greater than \$100,000 in a case in which there had been no demonstration of harm to others." R&W, 205 F.3d at 178. However, rather than hinting that any particular dollar amount would be an appropriate ceiling, it directed the Commission to start with profits and then reduce the fines based on mitigation evidence relating to customer satisfaction. See supra text accompanying note 17. In other words, if there were large profits (and, as discussed below, there were), the Fifth Circuit suggested that there would have to be evidence of large scale mitigation to mark the fines down to \$100,000. In addition, even if the attorney who represented the Commission at the oral argument was unable to say that this agency has issued fines of more than \$100,000 for violations that were not found to have resulted in customer harm, we can. See, e.g., In re First Commercial Fin. Group, Inc., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,648 at 48,090 (CFTC May 20, 1999) (fining a firm and two individuals, respectively, \$400,000, \$400,000 and \$200,000 for violations of net capital and reporting requirements); In re New York Currency Research, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,311 at 46,397 (CFTC Mar. 31, 1998) (fining a firm \$110,000  
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potential to mire us in accounting and tax law issues,<sup>25</sup> the parties greatly eased our burden. They stipulated that, for the relevant period, R&W's profits totaled \$1,217,240.50 and Reagan's share of these profits was no less than \$408,620.25.<sup>26</sup> The only gains-related dispute concerns whether an additional payment from R&W should be attributed to Reagan as profit.

In its 1996 tax return, R&W reported a "guaranteed payment" to Reagan of \$400,000.<sup>27</sup> The parties agree that R&W did not actually disburse these funds to Reagan.<sup>28</sup> Rather, the money was paid to Worsham's estate in order to "liquidate Worsham's interest in the partnership."<sup>29</sup> Because the money was directed to the estate of his former partner, Reagan argues that the payment should be counted as Worsham's gain, not his.<sup>30</sup> Taking

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for a failure to comply with record production requirements); In re Glass, [1996-1998 Transfer Binder] Comm. Fut. L. (CCH) ¶27,337 at 46,561-9 (CFTC Apr. 27, 1998) (imposing fines of \$300,000 and \$500,000 upon two individuals for a small number of wash sales).

<sup>25</sup> See R&W, [Current Transfer Binder] ¶29,556 at 55,391-92.

<sup>26</sup> Stipulations, ¶¶1-8.

<sup>27</sup> Exhibit DX-4-8.

<sup>28</sup> Stipulations, ¶9.

<sup>29</sup> Stipulations, ¶9.

<sup>30</sup> Respondents' Post-Hearing Brief at 3.

R&W's tax records at face value, the Division disagrees.<sup>31</sup> As it turns out, we need not resolve this dispute.

Our penalty assessments and, thus, our profit calculations are time-bound by the Complaint. As noted above, the Complaint was filed on March 19, 1996. Worsham died on September 13, 1996,<sup>32</sup> and there is no dispute that R&W distributed the \$400,000 to Worsham's estate sometime thereafter.<sup>33</sup> Thus, for any portion of this payment to serve as a basis for our penalty calculation, the record must allow us to connect the \$400,000 with revenue that R&W earned six (or more) months before the distribution.<sup>34</sup>

Even if we find the necessary relationship, it will be difficult to include even a portion of the \$400,000 in our profit calculation. When it remanded this proceeding, the Commission mandated that profit calculations must be performed with "reasonable precision" and it explicitly prohibited the use of estimates, even "broadly reliable" ones.<sup>35</sup> Consequently, we cannot attribute all or part of the \$400,000 to revenue earned

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<sup>31</sup> Division's Post-Hearing Brief at 3.

<sup>32</sup> See supra note 2.

<sup>33</sup> Respondents' Post-Hearing Brief at 3; Division's Post-Hearing Brief at 2-3.

<sup>34</sup> The Division concedes this point. Division's Post-Hearing Brief at 3.

<sup>35</sup> R&W, [Current Transfer Binder] ¶29,556 at 55,391.

during the pre-complaint period on the basis of assumptions or inferences that are not well established.

The record suggests that some portion of the \$400,000 payment flowed from revenue that R&W earned on or before March 19, 1996. However, it neither confirms this fact nor permits us to quantify the relevant share. The Division has recognized this and, as a solution, proposes that we attribute \$86,338.80 of the \$400,000 payment to revenue accruing on or before March 19th.<sup>36</sup> In other words, it asks us to adopt the apportionment that seems to underlie the parties' stipulation concerning other 1996 payments from R&W to Reagan (a prorated allocation of funds over the calendar year).<sup>37</sup> The Division's estimate seems reasonable to us and we cannot come up with a better one. However, the Division has not brought to our attention nor have we found evidence to support the inference that the stipulation's underlying facts (and/or assumptions) related to the lump-sum payment. The lack of such evidence precludes us from adopting the Division's proposal. Because we have located no evidence that would permit us to say, with the requisite precision, what

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<sup>36</sup> Division's Post-Hearing Brief at 3. This reflects a retreat by the Division from its prehearing position that the entire \$400,000 should be counted as profits earned during the period covered by the Complaint. Division of Enforcement's Prehearing Memorandum, filed September 9, 2004, at 6.

<sup>37</sup> Division's Post-Hearing Brief at 3; Respondents' Prehearing Memorandum, filed September 24, 2004, at 4.

part of the \$400,000 resulted from the malfeasance that we are to sanction, we cannot include any of it in Reagan's profit calculation. Accordingly, we find that Reagan's ill-gotten profits totaled \$408,620.25.

#### Mitigating Evidence

Having determined the baseline of the penalties to be assessed,<sup>38</sup> it is time to consider whether these amounts should be adjusted downward. To this end, the remand instructions narrowed the scope of our inquiry. The Fifth Circuit directed that profit-based fines be adjusted downward "based on any mitigating evidence the petitioners present with regard to customer satisfaction" with the respondents' fraudulently marketed trading systems.<sup>39</sup> The Commission then instructed us to consider two types of what it termed "evidence relating to efficacy of the system:"<sup>40</sup> "subjective evidence of customer satisfaction"<sup>41</sup> and evidence of "actual trading success (or

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<sup>38</sup> See R&W, [Current Transfer Binder] ¶29,706 at 56,000. See supra note 24.

<sup>39</sup> R&W, 205 F.3d at 178.

<sup>40</sup> R&W, [Current Transfer Binder] ¶29,706 at 56,001.

<sup>41</sup> The Commission opined,

In our view, the more pertinent point is how fully informed purchasers valued their level of satisfaction. For example, if customers were sufficiently satisfied that, even after learning of respondents' deception, they

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failure) with the system."<sup>42</sup> Although they bore the burden of

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would value R&W's software at or near their purchase price of approximately \$2,500, then respondents could reasonably claim that the profits arising out of their sales to these customers were not a product of their deceptive conduct and that their deception did not harm those satisfied customers.

R&W, [Current Transfer Binder] ¶29,556 at 55,390 (footnotes omitted). Thus, it suggests that we should use customer testimony of satisfaction to estimate the profits which "were not a product" of respondents' fraud and adjust any penalties downward by those amounts.

<sup>42</sup> R&W, [Current Transfer Binder] ¶29,706 at 56,001. The respondents would have us consider other factors. First, they point to that portion of the first remand order in which the Commission stated, "In effect, respondents' customers purchased partially tested software that was theoretically successful with the false understanding that it was fully tested and successful in a real world setting," and, thereby, argue that the Commission has already determined R&W's software to be efficacious on the basis of testing or some other evaluation of its code. Respondents' Post-Hearing Brief at 4; R&W, [Current Transfer Binder] ¶29,556 at 55,589. We disagree.

There is no indication that the Commission has made an extrajudicial evaluation of R&W's software. As for the record in this proceeding, the only evidence of software testing was Reagan's testimony at the 1997 hearing. Like us, the Commission found Reagan to be incredible concerning a number of material issues and it ruled that the respondents "have not developed a credible record that supports their description of R&W's simulated testing." R&W, [1998-1999 Transfer Binder] ¶27,582 at 47,742. Since then, no party has introduced evidence of testing and there is no clear indication that the Commission has considered whether the respondents' case somehow became stronger in hindsight. Thus, it seems unlikely that the Commission's unfortunate choice of words was meant to communicate the results of a judicial or extra-judicial evaluation. The Commission's  
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production,<sup>43</sup> the respondents failed to introduce any admissible new evidence<sup>44</sup> at the hearing that fell into either of these categories. Instead, they ended up resting on the record as it existed before the remand.<sup>45</sup>

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procedural determinations further undermine the respondents' argument.

As discussed above, the Commission first limited the scope of our mitigation analysis on remand to evidence of "how a fully informed purchaser of R&W's software would have valued the software," and then expanded it to include the degree to which customers using the software experienced trading success. R&W, [Current Transfer Binder] ¶29,706 at 56,001; R&W, [Current Transfer Binder] ¶29,556 at 55,391. It emphasized the limited nature of permissible mitigation evidence by explicitly prohibiting the introduction of hypothetical or theoretical evidence of efficacy. R&W, [Current Transfer Binder] ¶29,706 at 56,001 ("evidence relating to the efficacy of the system should be informed by customers who used the system rather than studies or modeled behavior"). Consequently, we think that, by describing the software as "theoretically successful," the Commission meant to indicate that it was possibly effective in the manner that any software might be so considered before efficacy is demonstrated or disproved.

<sup>43</sup> R&W, [Current Transfer Binder] ¶29,556 at 55,391 n.13.

<sup>44</sup> See supra note 21.

<sup>45</sup> Respondents' Post-Hearing Brief at 3-4. There are two notable exceptions. One is the Commission's reference to theoretical success discussed above. See supra note 42. The other is Reagan's testimony as it relates to two issues. The respondents have asked us to reduce the civil monetary penalties so as to account for the market spillover effect of the Commission's findings that they engaged in fraud (*i.e.*, R&W's failure as a business after the findings were publicized). Respondents' Post-Hearing Brief at 6. See Richard A. Bierschbach & Alex Stein, Overenforcement, 93 *Geo. L.J.* (forthcoming 2005). Although academic literature recognizes that law enforcement may lead to

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market spillovers that amount to extralegal sanctions and, therefore, result in over-deterrence of activities that confer social benefits, the concern is less acute with respect to criminal activity such as fraud. See Bierschbach & Stein. See, e.g., Ackerman v. Schwartz, 947 F.2d 841, 847 (7th Cir. 1991) ("The optimal amount of fraud is zero . . . ."). In addition, Commission precedent teaches that, when the wrongdoing is serious, large fines are appropriate even when they are accompanied by non-monetary sanctions that effectively shut down a business or expel an individual from his chosen profession. First Commercial, [1998-1999 Transfer Binder] ¶27,648 at 48,090; Glass, [1996-1998 Transfer Binder] ¶27,337 at 46,561-8-61-9. Moreover, a rule that would generally require us to take into account extralegal economic consequences is simply not workable in most of our cases since we usually impose fines at the time of making liability findings and, thus, determinations of market spillover would rest on speculation concerning the reactions of a great many others (i.e., customers, potential customers, vendors, lenders, etc.). Bierschbach & Stein. Finally and most conclusively, the Commission has limited the scope of our fact finding on remand and it does not include consideration of market spillover.

In addition to the evidence of market spillover, the respondents ask us to credit the statement of remorse that Reagan made during the post-remand hearing. Respondents' Post-Hearing Brief at 4. The Commission has held that "expressions of contrition following detection only deserve significant weight if the wrongful nature of the conduct was unclear at the time of the violations." In re Mosky, [1996-1998 Transfer Binder] Comm. Fut. Rep. (CCH) ¶27,097 at 45,188 (CFTC June 25, 1997). Claims that willful violations were unintentional undermine expressions of remorse and the assumption of responsibility for wrongful acts. In re Schneider, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,959 at 44,657 (CFTC Feb. 13, 1997). The context and content of Reagan's act of contrition leave us unconvinced that it deserves any substantial probative weight.

Reagan expressed regret after the Commission detected his wrongdoing. Indeed, he did so after the findings of violations had been affirmed and the only matter to be considered was the size of the fines. Given this timing, his claim of regret will have no significant probative value unless the wrongful nature of his violations was unclear at the time of the wrongdoing. In

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this context, knowledge of the offenses' wrongful nature does not mean awareness of the precise laws violated. Rather, it means knowledge that the acts underlying the violations were illegal, injurious, reckless or unfair. Cf. In re Wright, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,412 at 54,766 (CFTC Feb. 25, 2003). The record undermines any inference that the wicked nature of Reagan's misconduct was unclear.

The Commission found Reagan and his firm to have "intentionally crafted R&W's advertisements to create a false picture of the trading system in the minds of prospective consumers" by: (1) affirmatively misrepresenting that the respondents had achieved positive results by using the software in actual trading, (2) falsely representing that they continued to trade, (3) misrepresenting Reagan's professional experience and (4) misrepresenting the risks inherent in futures trading. R&W, [1998-1999 Transfer Binder] ¶27,582 at 47,741 & n.45, 47,743. In other words, Reagan was found to have knowingly engaged in acts of traditional fraud, misdeeds that were inherently wrongful. Omagah v. Ashcroft, 288 F.3d 254, 260 (5th Cir. 2002). See Wright, [Current Transfer Binder] ¶29,412 at 54,765 n.180. He did not need awareness of the Act, Commission regulations or any other federal law to know, at the time of his violations, that he and his firm were acting wrongfully and it is inconceivable that he lacked such knowledge given his intentional malfeasance. Consequently, even if Reagan had made the most superficially convincing statement of remorse, it would have lacked significant probative value. As it turns out, Reagan's act of contrition rings hollow because he continues to mischaracterize the fundamental nature of the violations.

At the hearing on remand, Reagan tended to portray his violations as unintentional technical missteps. For example, he testified,

I would also like to say that I did not know precisely what I had done wrong until the 5th Circuit succinctly laid it out, that I didn't put a disclaimer in my ad. And I've already stated that I know that's wrong.

Notwithstanding, I had no way of knowing that. I wasn't a registered agent. If someone had said to me, put in a disclosure

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The respondents argue that our penalty assessment should give substantial weight to the 1997 testimony of one of the Division's two broker witnesses, Thomas Otten.<sup>46</sup> Otten testified that he liked R&W's software, found it "more consistently profitable" than other trading systems that he had used, and, over a one year period, he earned a trading profit of approximately \$60,000 following the signals generated by R&W's software.<sup>47</sup>

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statement in my ad, I would have put it there in a heartbeat. I didn't [want to] hurt my business.

It's something that even my attorney wasn't aware of until we came and realized that, you know, this was something that the CFTC deemed necessary and they could deem me a CTA and that's that. And you would affirm that.

So with that said, I want you to take into consideration that this was not premeditatively left out. I certainly would have -- your know, and should have, okay, placed that disclosure statement in there.

2004 Tr. at 22-23. This characterization stands in stark contrast to the affirmed findings of the Commission. Thus, Reagan's continued inability to own up to his fraud makes it virtually impossible to believe that he regrets anything other than getting caught.

<sup>46</sup> Respondents' Post-Hearing Brief at 3-4.

<sup>47</sup> 1997 Tr. at 17-18, 23-26, 40. He testified to having used the R&W software to trade on behalf of two groups of customers. 1997 Tr. at 21-22, 36-37, 47-48. For those customers who had purchased the R&W software themselves (in an arrangement under  
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Giving full credit to Otten's testimony, we may infer that he would have valued R&W's trading systems even if he had been fully informed of the respondents' misrepresentations. Otten was a seasoned, professional trader by the time that he purchased R&W's systems.<sup>48</sup> Consequently, it is implausible that Otten ever believed, much less relied on, R&W's more extravagant claims

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which they had no need to unwrap it), Otten followed the signals generated by the software without discretion. 1997 Tr. at 21-22, 36-37, 47-48. With respect to other customers on whose behalf he traded, Otten used the R&W software but did not necessarily follow the signals. 1997 Tr. at 21-22, 36-37, 47-48. Otten testified that one of his customers asked him why his profits for a particular year during the relevant period did not match the profits R&W reported. 1997 Tr. at 46-47. It was in the process of delving into this matter that he determined that the customer had earned \$60,000. 1997 Tr. at 20-24, 44, 47. In its reply brief, the Division characterized Otten as testifying that the \$60,000 in profit was generated in the account of a customer concerning which Otten did not always follow the program's trading signals. Division's Reply Brief at 3. This description is understandable but probably mistaken.

During most of his testimony, Otten was unclear as to whether the profit in question was the result of following the software's guidance without exception or exercising some discretion. However, on redirect examination, the Division's counsel caused Otten to clarify his testimony. She asked whether the inquiry that brought the \$60,000 in profit to Otten's attention "was . . . for a customer who was trading the program verbatim." 1997 Tr. at 47-48. Otten replied, "Yes." 1997 Tr. at 48.

<sup>48</sup> He was a registered commodities trading advisor who traded for his own account as well as for clients, he had been a stockbroker and an associated person of Prudential Securities since 1989 and he had worked in the commodities industry since 1978. 1997 Tr. at 9-11.

promising fantastic profits from futures trading at virtually no risk.<sup>49</sup> Moreover, Otten approached R&W's claims for its products skeptically. Prior to his giving his testimony, Otten matched his trading results for a one year period to R&W's claims and found that the respondents had overstated the systems' profitability by 50 percent.<sup>50</sup> He also came to believe that R&W had misrepresented the amount of capital required to successfully trade using R&W's software.<sup>51</sup> Nonetheless, Otten was apparently unphased by these misrepresentations.<sup>52</sup> For him, the proof of

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<sup>49</sup> For example, one of R&W's promotional brochures authored by Reagan, entitled "Money...Money...Money... Commodity Futures Trading -- A Disciplined, Challenging Way To Achieve High Profits!," states,

Futures are, in actuality, less risky than equities. They produce much less volatility in one's capital than equal amounts invested in stock. One can be wrong 50-60 percent of the time and still make a fortune.

Exhibit DX-18.

<sup>50</sup> 1997 Tr. at 20-24, 44, 47.

<sup>51</sup> 1997 Tr. at 18-19. He explained,

[T]hey're in the business of selling software so they're making percentages very good. I'm in the business of trading, you know, in the real world, so I think it takes more money than they claim it takes to do it comfortably, and so naturally the percentages would be less on a larger amount of money.

1997 Tr. at 19.

<sup>52</sup> See supra note 51. This is not to say that Otten disbelieved all of the respondents' misrepresentations. In personal  
(continued..)

the pudding remained in the eating and, having apparently profited from use of the software, he valued it.<sup>53</sup> However, this finding does not allow us to quantify mitigation in the manner the Commission suggested.<sup>54</sup> In addition, a lack of evidence prevents us from resting broad inferences on Otten's testimony.

Otten's claim of satisfaction raises the issue of whether the record permits us to conclude others shared it (or would have shared it) after they received substantially full information. Perhaps because the respondents chose not to submit admissible evidence on this issue after the remand, we have no direct evidence that anyone else shared Otten's view.<sup>55</sup> In addition, the record does not permit us to find that any of Otten's

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(..continued)

solicitations, Reagan falsely told Otten that he had profitably traded using the R&W software for a number of years. 1997 Tr. at 20; R&W, [1998-1999 Transfer Binder] ¶27,582, at 47,730-31. The record provides no indication as to whether Otten ever discovered that this representation was false. However, given Otten's general skepticism and disregard of R&W's performance claims, it is unlikely that he put much stock in Reagan's other claims of experience, expertise or trading success.

<sup>53</sup> See supra text accompanying note 47.

<sup>54</sup> See supra note 41.

<sup>55</sup> At the 1997 hearing, the only R&W customer who testified, other than Otten, was John Cullen. 1997 Tr. at 80-90. Like Otten, Cullen was an experienced broker. 1997 Tr. 81-82. However, the record does not reflect his informed valuation of R&W's software.

customers or any other retail trader<sup>56</sup> who purchased the software knows (or ever knew) anything close to the whole truth about the respondents misrepresentations nor is there any basis upon which to infer that any retail customer discounted or disbelieved the respondents' false statements. Consequently, even if we could conclude that some of R&W's customers (other than Otten) were generally pleased with the product because its use seemed to result in profitable trading, the respondents have not met their burden of producing evidence that would permit us to infer that any of these customer were sufficiently informed to credit such evidence as it relates to subjective customer satisfaction.<sup>57</sup> This lack of evidence minimizes the probative value of Otten's testimony as it relates to satisfaction. To a lesser extent, the same is true with respect to the evidence of trading success.

No party introduced records tending to show that R&W customers traded profitably while using the firm's software. While we have Otten's credible testimony that, on behalf of his clients, he experienced "actual trading success" in using R&W's products, he did not say how many clients profited from this trading nor did he quantify the profit earned in a manner that

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<sup>56</sup> Cullen testified, "Many people that use [R&W's trading systems] did not have any kind of long history trading commodities." 1997 Tr. at 91.

<sup>57</sup> See R&W, [Current Transfer Binder] ¶29,556 at 55,391 n.13.

would permit us to impute it to others.<sup>58</sup> Cullen testified that it would be impossible to impute the results from one R&W customer account to any other.<sup>59</sup> While this statement may be too strong,<sup>60</sup> ascribing Otten's success to customers with whom he did not deal faces additional hurdles that the respondents failed to negotiate.

R&W's software was written to accommodate trading in more than 20 commodity contracts and the record does not reliably indicate that the success in trading any one type of contract was shared by customers who traded others.<sup>61</sup> In addition, the programs were designed so that that users could change variables such as the stop-loss amount.<sup>62</sup> Consequently, two customers using the same software to trade the same contracts by opening positions at the same time and price could experience different

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<sup>58</sup> As discussed above, he referred to a customer for whom had earned \$60,000 in profit over an unidentified year. 1997 Tr. at 38, 44. However, Otten could not recall if the \$60,000 figure included transaction costs and he did not indicate the amount of money that was placed at risk to generate the profit. 1997 Tr. at 38, 44.

<sup>59</sup> 1997 Tr. at 97.

<sup>60</sup> If a group of accounts were traded by placing block orders, all of the accounts' owners were likely to experience similar outcomes.

<sup>61</sup> 1997 Tr. at 13-14, 22.

<sup>62</sup> 1997 Tr. at 29-30.

results.<sup>63</sup> Moreover, customers varied in their risk preferences, their willingness to weather losing trades that resulted from following the signals generated by the software and their financial ability to do so.<sup>64</sup> Indeed, there is evidence that at least one R&W customer experienced a net loss by trading in accordance with the program.<sup>65</sup> Accordingly, not only does the thin record preclude us from determining the rate of return Otten's customers earned, it does not support reliable inferences that other R&W customers shared in the success to the same degree (or at all).

Because we have evidence of substantial mitigation in the sense of exceeding a de minimis level, the civil monetary penalties will be some amount less than the respondents' ill-gotten profits. Given the findings above, any determination of how much less is doomed to imprecision. There is insufficient

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<sup>63</sup> For example, if one customer changed his stop-loss setting, he might liquidate a position that fell in value at a different time than another R&W customer and, consequently, the result of his trade would likely vary from the customer who did not change the initial settings.

<sup>64</sup> With respect to following the trading signals generated by R&W's software, Otten testified, "[T]he drawdowns are substantial and so it takes a substantial amount of money to trade it and you have to be willing to ride those up and down equity runs to do it." 1997 Tr. at 18. See infra note 65.

<sup>65</sup> Cullen testified that some R&W customers experienced losses in their first trades and one of these customers closed his account after having lost on his first (and last) three trades. 1997 Tr. at 96.

evidence from which to infer that mitigation (in the form of well-informed satisfaction or trading success) was widely shared or that its magnitude was great with respect to more than a few R&W customers. Consequently, we find that each of the respondents should be fined an amount that represents their respective profits during the relevant period minus a small percentage, approximately five percent.

**Conclusion**

For the reasons stated above, it is **ORDERED** that, within 30 days of the effective date of this order, respondent R&W Technical Services, Ltd. **PAY** a civil monetary penalty of \$1,156,400.00 and respondent Gregory M. Reagan **PAY** a civil monetary penalty of \$388,200.00.<sup>66</sup>

**IT IS SO ORDERED.**

On this 11th day of January, 2005



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Bruce C. Levine  
Administrative Law Judge

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<sup>66</sup> Any party may appeal this initial decision to the Commission by serving upon all other parties and filing with the Proceedings Clerk a notice of appeal within 15 days after service of the initial decision. 17 C.F.R. §§10.12, 10.102(a) (1996). If no party properly files a notice of appeal and the Commission does not place the case on its own docket for review, this initial decision shall become the final decision of the Commission 30 days after service of the initial decision. 17 C.F.R. §10.84(c) (1996).