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In the Matter of

ROGER J. WRIGHT d/b/a AGRICULTURAL MARKETING SERVICE d/b/a MICAH I INVESTMENT CLUB, BUCKEYE COUNTRYMARK, INC., PHILIP L. LUXENBURGER and A.G. EDWARDS & SONS, INC.,

Respondents.

FIFTH THIRD BANK,

Participant.

CFTC Docket No. 97-2

INITIAL DECISION

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OVERVIEW

This latest "chapter in the saga of 'flexible' or 'enhanced' hedge-to-arrive contracts"[1] is about as far flung as a Commission enforcement case gets. It began with a nine-count complaint and involves claims of offering illegal futures and options contracts, fraud, failures to register, failures to make Commission-mandated disclosures, failures to make and keep necessary records, and aiding and abetting. For the reasons set forth below, we find that the Division of Enforcement succeeded in proving that Roger J. Wright committed fraud in violation of the Commodity Exchange Act and Commission regulations as well as certain, fairly technical illegalities. In addition, we find that Wright's

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[1] Nagel v. ADM Investor Servs., Inc., 217 F.3d 436, 438 (7th Cir. 2000).

Since 1996, farmers, grain elevators and those with whom they dealt have fought over the issue of whether hedge-to-arrive contracts are enforceable. See Barz v. Geneva Elevator Co., 12 F. Supp. 2d 943, 945 (N.D. Iowa 1998) ("As these 'hedge-to-arrive' contract cases march through the state and federal courts, seemingly endless as the rows of corn in Iowa in July . . . ."). Intensified by the legal uncertainty surrounding hedge-to-arrive contracts, the disputes have sometimes resulted in the financial ruin of farmers and elevators, and may have led to at least one suicide. See, e.g., Anne Cook, Iowa case revives farmers' sour memories, News-Gazette (Champaign), Aug. 26, 2001, at C3 ("Four years ago, a controversy over hedge-to-arrive contracts tore apart the Douglas County farming community, creating a rift that hasn't healed."); Matt Kelly, Hedge-To-Arrive Deals Put Farmers In A Bind, Raise Crop Of Lawsuits, St. Louis Post-Dispatch, Apr. 3, 1997, at 4; James Walsh, Hurt by the hedge // Sustained high grain prices are costly for farmers, co-op, Star Trib. (Minneapolis-St. Paul), Aug. 18, 1996, at 1D.

futures commission merchant ("FCM"), A.G. Edwards & Sons, Inc., failed to comply with a Commission requirement to create and keep records concerning the trading control that Wright exercised over the accounts of others. As a result, we assess civil monetary penalties against Wright and Edwards, order each of them to cease and desist certain unlawful conduct and impose a permanent trading ban upon Wright.

As for the two other respondents, the Division fell short of establishing that Buckeye Countrymark Inc. (a grain elevator with which Wright and some of his clients did business) offered and dealt in illegal, off-exchange futures and options (although it came tantalizingly close on one of the counts). In addition, it did not meet its burden of proof on whether Philip L. Luxenburger aided and abetted the wrongdoing of his employer (Edwards) and his client (Wright).

This case is too wide-ranging for the type of metanarrative that can ordinarily bring most of the cases before us into focus. However, the parties (and those affected by the parties' acts) can draw several lessons from this case and the events leading up to it. First, dealing with Wright is risky business. In addition, proving that a respondent aided and abetted another is often more difficult than proving that the related primary violation occurred. Finally, and this should come as no surprise, loose business practices can land you in hot water regardless of what you intended.

BACKGROUND

Our initial account of the relevant, underlying facts will be incomplete. This choice of structure stems from the multiplicity of claims[2] and a desire to avoid weighing down the initial narrative with divergent story lines that meet only with the initiation of this litigation. It also results from the judicial admissions that the parties made and their potential to establish multiple versions of the same events.[3] Accordingly, we will

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[2] See infra text accompanying notes 82-89.

[3] In enforcement proceedings, parties may conclusively establish matters of fact and mixed matters of fact and law through admissions pursuant to Rule 10.42(c), 17 C.F.R. §10.42(c), and conclusively establish matters of fact through stipulations governed by Rule 10.43, 17 C.F.R. §10.43. Cf. Carney v. IRS (In re Carney), 258 F.3d 415, 418-19 (5th Cir. 2001) ("Rule 36 allows litigants to request admissions as to a broad range of matters, including ultimate facts, as well as applications of law to fact."); Todd Shipyards Corp. v. Secretary of Labor, 586 F.2d 683, 685 (9th Cir. 1978); In re Bamaodah, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,010 at 31,996 (CFTC Apr. 18, 1986) (finding guidance for the application of Rule 10.42(c) in Article III court applications of Federal Rule of Civil Procedure 36). See infra note 82. When a party is served with a proper request for admissions,

> [a] matter shall be considered to be admitted unless, within 15 days after service of the request, or within such other time as the Administrative Law Judge may allow, the party upon whom the request is directed serves upon the requesting party a sworn written answer or objection to the matter.

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17 C.F.R. §10.42(c)(2). Thus, a failure to respond to admission requests has the same effect as express, unqualified admissions. See Carney, 258 F.3d at 418-20; Hadley v. United States, 45 F.3d 1345, 1348 (9th Cir. 1995); United States v. 2204 Barbara Lane, 960 F.2d 126, 129-30 (11th Cir. 1992).

When a case involves multiple respondents, one respondent's admissions and stipulations may conclusively establish a version of events that binds less than all of the parties, varies from the evidence and varies from the judicial admissions of the other respondent(s). See 17 C.F.R. §10.43 ("Stipulations may be received in evidence at a hearing and when received in evidence shall be binding on the parties thereto."); United States v. Caldwell, 543 F.2d 1333, 1359 n.134 (D.C. Cir. 1974). For example, if the Commission issues a complaint that charges respondent A with primary fraud and respondent B with aiding and abetting the fraud and if the Division and respondent B stipulate to the primary fraud of A, it is possible that the Division would fail to prove the primary fraud as to A but prevail in its case against B through the stipulations that A's primary fraud occurred and evidence that, when combined with the stipulated facts, satisfies the elements of aiding and abetting. In the end, the complaint could be dismissed as to A for failure to prove he engaged in fraud but B may be sanctioned for aiding and abetting the unproven but stipulated fraud.

In this case, three of the four respondents entered into stipulations with the Division but each of those respondents stipulated to facts to which at least one of the other two did not. Amended Joint Prehearing Report - December 3, 1998, dated December 3, 1998 ("Amended Stipulations"). In addition, Wright filed no response to the request for admissions that the Division served upon him. Transcript of Oral Hearing, dated November 16, 1998 ("Tr. vol. 1"), at 9-10. Accordingly, he is deemed to have admitted to the matters of fact and mixed matters of law and fact set forth in the Division's request for admissions. Because these admissions and stipulations establish facts as to some but not all of the respondents, we may have to contend with more than one version of certain material facts.

review facts relating to the central claims in this proceeding and, as needed to resolve particular counts, range further afield and go deeper into the record.

Buckeye And Its Suppliers

From 1991 until 1996, Buckeye operated as a "[l]ocally farm owned cooperative"[4] with elevator facilities at six Ohio locations.[5] It supplied farmers and purchased their crops for resale.[6] Historically, Buckeye transacted most of its business in Ohio and with "member owners."[7]

Farmers, like those who sold their crops to Buckeye, face a daunting array of risks ranging from the physical risk associated with labor that involves heavy machinery[8] to the price

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[4] DX-150 at 27. Its board was comprised of grain and swine farmers. DX-121 at 9.

[5] At its Xenia location, Buckeye operated an elevator as well as a "store and drive thru feed building." Id. at 5. At Jefferson, it maintained a 1.5 million bushel elevator as well as an agronomy department that sold fertilizers, farm chemicals and feed. Id. Buckeye also maintained an elevator and a "petroleum bulk storage" building at two Washington Court House locations, a "[f]ull service agronomy plant" at "Good Hope Road" and an elevator used for excess storage at South Solon. Id. Its grain storage capacity exceeded 2.6 million bushels. Id.

[6] Transcript of Oral Hearing, dated November 18, 1998 ("Tr. vol. 3"), at 71, 127. See supra note 5.

[7] DX-121 at 4-6.

[8] Transcript of Oral Hearing, dated November 19, 1998 ("Tr. vol. 4"), at 28 ("One of those days that everything went wrong. About 6:30 that night, accidentally, I got my foot caught in an (continued..)

and production risk associated with factors beyond their control such as the weather.[9] Price risk and the desire to maximize profit have led producers to seek advice.[10] This advice can come from extension programs run by land-grant universities and other state actors, non-profit associations and for-profit consultants who specialize in the identification (or development) of

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eight-inch auger. Luckily enough, a shear pin sheared. I was there for almost 13 hours before somebody found me on a cold November morning.").

[9] Tr. vol. 4 at 151-52. Uncertainty concerning the possibility that, between the time they commit to produce a crop (through the incursion of sunk costs or otherwise) and when they can make delivery, the price of their crop will decline is referred to as price risk. See Warren F. Lee et al., Agricultural Finance 247-48 (8th ed. 1988). Farmers can address price risk through means that include entry into a traditional cash forward contract (i.e., a contract to deliver the commodity to another at a future date for a price that is set at the time of contracting and can be fulfilled only by delivering the commodity). Id. at 255-56. However, when a farmer enters into such an agreement, it tends to increase the significance of production risk. Joy Harwood et al., Managing Risk in Farming: Concepts, Research, and Analysis, at 26-27 (Agricultural Economic Report No. 774, 1999). Production risk is the possibility that a farmer may not be able to produce enough to satisfy his previously contracted delivery obligations and arises from the fact that crop yields depend on factors that lay beyond the ability of farmers to control, vary from year to year and often cannot be accurately predicted months in advance. Id. at 8, 26-27.

[10] See Darrel L. Good et al., 1998 Pricing Performance of Market Advisory Services for Corn and Soybeans, at 1 (AgMAS Project Research Report 2000-01, 2000); Prepared Statement of Jerry Slocum Before the Senate Agriculture, Nutrition and Forestry Committee, Federal News Service, May 5, 1999.

marketing and hedging opportunities. One such for-profit advisor stands at the center of this proceeding.

Wright And His Firm

Wright is a former Commission registrant who[11] operated a firm by the name of Agricultural Marketing Service ("AMS").[12] Farmers constituted a majority of Wright's clientele[13] and he advised them in the marketing of their crops, sought out and developed commercial opportunities for them and, sometimes, made marketing decisions on their behalf.[14]

Wright's marketing advice took three general forms. He published a newsletter that all of his clients received.[15] This newsletter regularly followed certain grain and livestock markets, and often provided advice related to the marketing of commodities

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[11] DX-143 at 70-71.

[12] Tr. vol. 3 at 94; DX-143 at 4. AMS operated as a partnership and evolved into a proprietorship and trade name for Wright. DX-143 at 4.

[13] Tr. vol. 1 at 22.

[14] Tr. vol. 1 at 22, 30, 32-33; DX-3 at 1-22; DX-46 at 1; DX-123 at 4.

[15] Tr. vol. 1 at 90, 177-78; Transcript of Oral Hearing, dated November 17, 1998 ("Tr. vol. 2"), at 45-46, 216-17; Tr. vol. 4 at 230, 277; Transcript of Oral Hearing, dated November 20, 1998 ("Tr. vol. 5"), at 67; DX-143 at 101-02.

as well as the purchase of supplies.[16] In addition, Wright provided personalized advice his full-service clients[17] and occasionally placed futures and options orders on their behalf.[18] Finally, Wright conducted regular group meetings at which he and his clients would discuss market conditions, marketing opportunities and other matters of concern.[19]

By the mid-1990s, elevators throughout the Midwest[20] were purchasing grain through agreements commonly referred to as "Hedge-To-Arrive" contracts ("HTA").[21] Wright advised a number of

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[16] DX-123 at 6-444.

[17] Tr. vol. 2 at 216-17; DX-143 at 99-101.

[18] See infra text accompanying note 504.

[19] Tr. vol. 4 at 230, 277-78; Tr. vol. 5 at 67-68; DX-143 at 101-02.

[20] The geographical prevalence of these contracts is reflected in areas where hedge-to-arrive contracts litigation has been initiated. See infra notes 104-05.

[21] The "Hedge" in hedge-to-arrive "comes from the fact that the contract price is a price specified in a futures contract that the merchant buys on a commodity exchange and that expires in the month specified for delivery under the merchant's contract with the farmer (the HTA contract)." Nagel, 217 F.3d at 438. The "To-Arrive" is an apparent reference to the contract's general nature as a cash commodity agreement and reflects the ancient practice of selling cargoes still at sea for delivery to occur upon the arrival of the vessel. Agricultural Futures and Options xxii (Richard Duncan ed., 1992) ("Agricultural Futures"). In its simplest form, an HTA is designed to eliminate much of the price risk a farmer faces.

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A simple HTA is generally a contract in which one person agrees to deliver a commodity at a price that is the sum of two components, one determined at time of entry into the contract and one set later. Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 987 (8th Cir. 1999) ("Kar Kim Farms"). The "reference price" is set at the time a farmer enters into an HTA. See id. Generally, the reference price is the price of the futures contract that corresponds to the commodity and time of delivery specified in the contract. For example, if a farmer enters into an HTA to deliver corn in December 1995, the reference price is the price for December 1995 corn futures that prevails at the time the farmer entered into the HTA. The second aspect of the price is the "basis." Id. The basis is "the market price of a certain lot of physical goods, of a given real quality, in a given real geographical location and for a given real date of availability, relative to the appropriate futures price at the same moment in time." Agricultural Futures at 36. HTAs generally permit the supplier to set the basis at some time before delivery and, after election, the reference price is adjusted upward or downward depending on the basis at the time of election. Given this price structure, simple HTAs lock in much of the commodity price while permitting the farmer to speculate on the basis. Such contracts shifted much of the price risk to the elevator while imposing production risk upon the farmer.

Ordinarily, elevators hedge their HTA-related price risk by selling futures contracts for the type of grain purchased, that correspond in volume to the amount of grain contracted for in the HTA and that have corresponding delivery dates. Nagel, 217 F.3d at 438. Eventually, HTAs developed in a manner that permitted a supplier to take back some of the price risk in order to defer delivery.

Like their more elementary cousins, "flexible" HTAs are contracts by which parties agree to the sale of a commodity at a future time for a price composed of a reference price and a basis that are set in the same manner as simple HTAs. However, flexible HTAs are more complex. They allow suppliers to change ("roll") the date of delivery. Id. at 439. When a farmer rolls delivery, an elevator that hedged its price risk with a short futures position would tend to liquidate its hedge position corresponding to the initial delivery date (the "old month") and

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establish a short position corresponding to the new delivery date (the "new month"). Id.

As in most matters, this additional feature comes at a cost. First, elevators generally charge modest fees for rolling. In addition, rolling generally leads to an adjustment to the reference price that, from the elevator's perspective, negates the financial consequences of establishing and liquidating the initial hedge position. Transaction fees aside, this adjustment can be calculated in two ways that achieve the same arithmetic outcome. First, the change can be described as: (1) computing the difference in price, at the time of rolling, between the old month futures and the new month futures and (2) adding that amount to the initial reference price, if the price for the new month futures exceeded the old month futures (a condition known as a "carry" spread), or subtracting that amount from the initial reference price if the old month futures price exceeded the new month price (an "inverse" spread). In the alternative, the adjustment can be described as replacing the initial reference price with the new month futures price and then either (a) adding to the new month futures price the difference between the initial reference price and the old month futures price at the time of rolling if the current old month futures price is less than the initial reference price, or (b) subtracting from the new month futures price the difference between the initial reference price and the old month futures price at the time of rolling, if the current old month futures price exceeds the initial reference price. This latter method can be described as re-pricing the grain in the new month and shifting to the supplier the financial consequences associated with establishing and liquidating the elevator's initial hedge position. Under either method of calculation, a farmer that intends to roll or anticipates rolling bears a price risk associated with the roll.

The price risk associated with rolling can be expressed in two ways that depend on how one measures the "goodness" of the contract. Goodness can be measured in terms of an absolute price target (such as the initial reference price). In the alternative, it can be measured by comparing the reference price to the current price for the futures contract that relates to the commodity and then-contracted for month of delivery (i.e., comparing one's self to the market). From the first perspective, the risk is referred to as "spread risk" and is the

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his clients concerning simple HTAs, flexible HTAs and flexible HTAs that permitted limited options trading. Wright's experience with these contracts was not limited to his advisory endeavors.

Wright Does Business With Buckeye And A Conflict Develops

From time to time, Wright has operated as a cash grain dealer.[22] In September of 1994, Wright's dealing and advisory

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risk that the spread between the initial reference month and the month to which a roll is anticipated will become inverted or, if already inverted, will become more so. From the latter perspective, the risk is that the futures price for the initial reference month will rise after entry into the HTA. For example, assume that a supplier entered into an HTA in December 2002 for delivery of wheat in December 2003 and that the initial reference price (the then current price for December 2003 wheat futures) was \$3.00 per bushel. Assume further that the HTA included a 2-cent per bushel rolling fee and, in July 2003, the farmer decided to roll his HTA from December 2003 to December 2004 and, at the time he rolled, the price of December 2003 corn futures was \$3.10 and the price of December 2004 corn futures was \$2.60. After the roll, the adjusted reference price would be \$2.48 per bushel, calculated as \$3.00 + (\$2.60-\$3.10) - \$0.02 or \$2.60 + (\$3.00- \$3.10) - \$0.02. From either prospective this was not a great transaction. However, if \$3.00 is the benchmark of "good," the result is much worse than if the December 2004 futures price was the standard.

While it entails risk, the ability to roll delivery provides one method to address production risk. It also, for good or ill, permits farmers to speculate concerning the prices for futures and cash commodities. For example, _Nagel_ involved farmers who entered into flexible HTAs and, at the time of initially-contracted delivery, chose to sell their grain on the cash market, roll delivery and planned to purchase the grain necessary to satisfy delivery in the spot market at a price that, _ex ante_, they hoped would be lower than the adjusted HTA price. _Id._

[22] _See infra_ text accompanying notes 35, 293-97.

services merged. He received an invitation to address a number of farmers, most of whom were located in or near Preble County, Ohio ("Preble County farmers").[23] Wright planned to use the occasion to tout the use of HTAs combined with options to market crops.[24] With his decision to accept this invitation, the series of events leading up to this proceeding began.

Wright expected to interest some of the Preble County farmers in his program but feared that such an interest might quickly die if the farmers experienced substantial difficulty in finding an elevator that would permit the use of options in conjunction with HTAs.[25] In addition, he believed that the farmers would not be able to effect the program without his advice but felt that he lacked the time to advise each of them on a decision-by-decision basis.[26] Thus, prior to speaking to the Preble County farmers, Wright decided to prepare for the farmers' interest and contacted Buckeye.

He advised Buckeye that he was going to speak to farmers that might wish to market as many as 500,000 bushels of grain in conformity with Wright's HTA-and-options strategy and asked if it

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[23] Tr. vol. 1 at 1-102; DX-143 at 169, 173-74; DX-151 at 97.

[24] DX-143 at 169-71.

[25] DX-143 at 170-71.

[26] Tr. vol. 1 at 117-18.

would be interested in purchasing the grain under such an arrangement.[27] After Buckeye expressed its interest,[28] Wright lamented that he would not have time to service each of these suppliers and immediately proposed an arrangement that would place the supplier-related decisions in his hands.[29]

Wright suggested a series of contractual relationships in which the farmers would contract with him and he, in turn, would contract with Buckeye.[30] Much to its chagrin after the fact, Buckeye gave Wright's plan the green light, Wright made his pitch to the Preble County farmers[31] and the success of his effort exceeded his expectations.[32]

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27 DX-143 at 170.

28 DX-143 at 170.

29 DX-143 at 168-69, 171; Tr. vol. 1 at 103-05, 117-18.

30 DX-143 at 171; Tr. vol. 1 at 103-05, 117-18.

31 Wright not only pitched his marketing methods generally, he solicited the farmers to enter into the arrangement that he had cleared with Buckeye by telling them that Buckeye was the only elevator to his knowledge that permitted his coupling of options transactions to HTA prices and explaining the communication problems that might exist if Wright was required to consult with farmers before options transactions occurred. DX-143 at 171-72.

32 DX-143 at 170; Tr. vol. 1 at 102-03, 117.

In early 1995, 18 Preble County farmers (three of which were located in Indiana and the remainder of which lived in Ohio)[33] granted AMS the authority to market more than 1 million bushels of their 1995 corn.[34] AMS, in turn, entered into HTAs with Buckeye in which it agreed to deliver the corn in late 1995.[35] AMS's obligations would soon increase.

Following his plan, Wright caused AMS to sell calls to (or through) Buckeye that corresponded with the number of bushels it had under contract with the elevator.[36] The calls were exercised and, as a result, AMS's delivery obligation doubled.[37] These new obligations took the form of additional HTAs that called for delivery in the fall of 1996.[38] A short time later, the deal began to unravel.

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[33] DX-151 at 59-61, 97-101, 105-09; Tr. vol. 1 at 102.

[34] Tr. vol 1 at 102-05, 117-19; DX-46 at 1; DX-108 at 1; DX-143 at 173.

[35] Tr. vol. 1 at 37, 104-05; Tr. vol. 3 at 94-95; DX-12 at 1-4. The HTA contracts into which AMS entered are hereafter referred to as the "AMS HTAs." Buckeye learned of the Preble County farmers' identities at the time it entered into the AMS HTAs. DX-142 at 115-16, 170-71; DX-151 at 59-61, 97-101, 105-09.

[36] Tr. vol. 1 at 37; DX-12 at 10.

[37] Tr. vol. 1 at 37; DX-12 at 10-15.

[38] DX-12 at 10-15.

When he set up the series of contractual relationships between the Preble County farmers, AMS and Buckeye, Wright had not only declined to bind the farmers directly to Buckeye,[39] he provided the Preble County farmers with a contractual right to withhold their grain.[40] In the summer of 1995, Wright placed option orders with Buckeye.[41] Several months later, he learned that they had not been executed, that Buckeye would not permit

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[39] Tr. vol. 1 at 136-37; DX-12 at 10-14.

[40] Tr. vol. 1 at 136-37. The AMS "Grain Marketing Agreement" executed by the Preble County farmers stated, in part, "I am not obligated to deliver any bushels of grain if I am not satisfied with the price or location of delivery." DX-108 at 1.

Wright often obtained new business through word of mouth. Tr. vol. 2 at 122; DX-143 at 173. As a result, he placed a high priority on retaining the goodwill of his clients even if it meant violating the law or infuriating elevators. See infra note 571. After the fact, Wright described this choice of terms to the Preble County farmers -- and touched on how elevators might react as price increases strained their ability to hedge HTAs while financing the option trades of HTA suppliers -- by writing,

> *I knew that the next time that grain prices rallied sharply, whether it be in 1995 or 2002, that Buckeye Countrymark would not follow through on the market plan.* Therefore, I put an "escape" clause in my agreement with you to protect you financially and John Halderman's and my reputation when Buckeye Countrymark breached their contract with me IF 1995 happened to be the year of the big run-up.

DX-135 at 1 (italics and emphasis in original).

[41] Tr. vol. 1 at 34, 38.

suppliers to write options and that it would only permit the purchase of options if AMS paid the premiums up front.[42] To Wright's mind, this was a material breach of the AMS HTAs.[43] He told the Preble County farmers that Buckeye breached its agreements and that the farmers had no obligation to deliver in fulfillment of the HTAs.[44] He must have been convincing (or the other marketing opportunities must have been relatively good) because every one of the Preble County farmers chose to withhold their grain.[45] Thus, AMS had no corn to deliver and Wright disclaimed any such obligation on grounds that Buckeye had breached the AMS HTAs.[46]

The Conflict Is Resolved, Temporarily

Wright's claim of breach and the structure of its agreement with AMS put Buckeye in a jam. When it entered into the AMS HTAs,

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[42] DX-132 at 1 ("We will buy the puts for your clients if they pay for the cost of puts plus a 1/2¢/per Bu. service charge."); DX-132 at 2 ("Bill Leach won't let Buckeye Countrymark write any more option (sic) for anybody at this time."); DX-135 at 1; Tr. vol. 1 at 34-35, 38.

[43] Tr. vol. 1 at 39.

[44] Tr. vol. 1 at 39, 119-20, 137; DX-144 at 58-59.

[45] Tr. vol. 1 at 119-20.

[46] Tr. vol. 1 at 39

Buckeye established hedge positions by selling corn futures.[47] After execution of the AMS HTAs, the futures prices for 1995 corn had risen.[48] This had two effects. First, it increased Buckeye's maintenance margin requirements.[49] It also meant that, if AMS did not deliver and the AMS HTAs could not be enforced,[50] Buckeye was likely to book a loss of more than $1 million resulting from the liquidation of its AMS HTA hedge position.[51]

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[47] Tr. vol. 3 at 73-75, 77-78, 142-44.

[48] See infra note 49.

[49] The minutes of Buckeye's board of directors meeting included the entry, "Bill Leach led a discussion on the HTA Contracts and the money necessary to meet margin calls. This is a real concern if the corn market continues to go up." DX-9 at 2. Similarly, Buckeye's auditor noted, "As a result of rising corn market prices, during the year and continuing subsequent to the year-end, the futures margin calls approximated $1,663,000 at August 31, 1995." DX-111 at 10.

[50] The lack of contractual privity between Buckeye and the Preble County farmers meant that Buckeye could only look to AMS for performance. See Decapua v. Lambacher, 663 N.E.2d 972, 973 (Ohio Ct. App. 1995) ("It is undisputed that there was no privity of contract between the parties. The action cannot, therefore, be predicated upon breach of contract . . . ."). In addition, the refusal to effect AMS's options orders may have barred enforcing the contract at all. See Miller v. Walker, No. 96APE08-1070, 1997 Ohio App. LEXIS 2531, at *7 (Ohio Ct. App. June 12, 1997) ("a material breach will relieve the other side of its obligations under the contract"). It may also have been doubtful that AMS could have paid a judgment that would have made Buckeye whole. Tr. vol. 5 at 173-76.

[51] DX-12 at 1-15; Post-Hearing Memorandum of the Division of Enforcement, dated February 26, 1999 ("Division Posthearing Memorandum"), exhibit B. See infra note 95.

Given these circumstances, Buckeye's management exhibited human nature when it kept the AMS HTAs on its books as it had prior to Wright's repudiation of the contracts.[52] If Buckeye did this to forestall a financial reckoning, it obtained a temporary success only.

At about the same time that Wright disclaimed his firm's obligations under the AMS HTAs, Buckeye was the subject of a routine audit.[53] The auditors determined that AMS was not a corn producer and, on that basis, issued a qualified audit report.[54] Buckeye's primary creditor, CoBank National Bank for Cooperatives ("CoBank"),[55] received the copy of the report and reacted swiftly. It froze Buckeye's line of credit (credit used for margining its hedge positions among other things)[56] and notified the elevator that, unless it found producers to cover AMS' delivery

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[52] Keeping the hedge position open, despite Wright's repudiation may have been a matter of policy. See DX-11 at 2-4.

[53] Tr. vol. 3 at 97-99, 130-31.

[54] DX-150 at 35.

[55] DX-111 at 11; Tr. vol. 3 at 113-14, 131.

[56] DX-9 at 5, 10; DX-142 at 67-68 ("They go back to the qualification in the audit of having bushels of HTAs on this nonproducer. COBANK came in and said that they would not fund any more money than was presently in Buckeye at that point."); Tr. vol. 3 at 98-99.

obligations, the credit line would remain frozen.[57] This brought Buckeye's general manager, William Leach,[58] to Wright's door looking for help.

Initially, Buckeye tried to its revive an amended version of its original agreement through renewed promises to comply with the new terms.[59] At Leach's request, Wright pitched this deal to the

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[57] DX-9 at 5, 10; Tr. vol. 1 at 40. However, the bank did not say that this action was certain to result in an expansion of credit. DX-9 at 13; DX-142 at 67-68 ("And then we said, what if we remove things from nonproducer to producer hands, and Ed said, yes, that's important. If we get that done, then we'll take another look at things at that point."). Indeed, even when Buckeye achieved complete supplier coverage, CoBank "still made recommendations on limiting capital and [did] not guarantee that they would fund the margin requirement." DX-142 at 68. See DX-9 at 14.

[58] DX-142 at 74; Tr. vol. 3 at 111.

[59] Tr. vol. 1 at 39-41. Wright sent a letter to the Preble County farmers that stated, in part,

> The management of Buckeye Countrymark has agreed to purchase puts on all bushels of corn on the books with them.
>
> They have allocated upto (sic) eight cents per bushel to be spent as directed on one or more puts as long as the total expense does not exceed eight cents. A service fee of one cent will be charged for each put exclusive of the eight cents. Buckeye Countrymark has agreed to buy another round of puts next spring or summer on all undelivered HTA contracts.
>
> . . . .

(continued..)

Preble County farmers.[60] They rejected it and this failure sent Leach and Wright back to the drawing board.[61]

In order to make the AMS HTAs more enticing, Leach and Wright fashioned an arrangement under which: (1) farmers would assume the delivery obligations of AMS; (2) the initial delivery would be deferred by at least one year; (3) the initial reference price would reflect the reference prices of the AMS HTAs (an average of just over $2.55 per bushel); (4) Buckeye would make a written promise to accept limited orders for the purchase of options and (5) the farmers would be permitted to cancel their delivery obligations by paying a fee of 10 cents per bushel plus or minus the difference between the HTAs' adjusted reference price and the

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(..continued)

> I will attempt to talk to each of you folks prior to the purchase of any puts as I am aware of your opportunities and other options of action, but this is very good news.

DX-128 at 5-8. Thus, Wright indicated that Buckeye had agreed to purchase aggregate premiums of eight cents per bushel of puts on behalf of AMS and to pay premiums and costs for the puts while holding AMS responsible for them through adjustments to the AMS HTAs' reference prices.

[60] See supra note 59.

[61] Tr. vol. 1 at 41.

price at which Buckeye offset its hedge position.[62] Having agreed to what he could sell and Buckeye could handle, Wright sent a letter to the Preble County farmers in which he extolled the virtues of the contract he had helped to draft, the Buckeye's "substitute HTA."[63]

This second effort fell far short and Wright immediately turned his powers of persuasion upon his regular clients.[64] In a short period of time,[65] Wright convinced 11 farmers, farming families and farming entities (the "substitute farmers") to enter into substitute HTAs and, thereby, cover his nominal delivery obligations.[66] The substitute farmers entered into contracts for

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62 DX-109 at 1-6; DX-143 at 191-92; Tr. vol. 1 at 31, 124, 128-29.

63 See infra text accompanying notes 342-47.

64 Tr. vol. 1 at 113-14, 116-17, 120; DX-123 at 2. See infra text accompanying notes 396-416.

65 After Buckeye and Wright finalized the terms for the new HTAs and Wright had "contacted a few of [his] clients," Buckeye offered to compensate Wright for efforts at a rate of "$250 per contract" and Wright accepted. Tr. vol. 1 at 50, 113-14. Wright's compensation from Buckeye eventually totaled $5,750. Tr. vol. 1 at 50; DX-128 at 18-19.

66 DX-11 at 120, 138; DX-37 at 1; DX-43 at 2; DX-46 at 7; DX-49 at 2; DX-53 at 132-33; DX-69 at 2; DX-70 at 3, 7; DX-84 at 2; DX-98 at 2; DX-109 at 2.

the delivery of various amounts of corn as early as the fall of 1996 and as late as 2000.[67]

As noted above, the substitute HTAs' initial reference price was not set in the usual manner.[68] Instead of reflecting the current futures prices for the months of planned delivery, they incorporated the adjusted reference price and reference contract month of the AMS HTAs when Wright disclaimed them, December

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[67] GAB Hamman Farms contracted for the January delivery of 100,000 bushels of corn in 1997 and 100,000 bushels in each of the three subsequent years. DX-46 at 7. Joseph Agle contracted for October-November-December ("OND") delivery of 60,000 bushels of corn in 1996 and identical amounts in 1997, 1998 and 1999. DX-11 at 120, 138; Tr. vol. 3 at 47. The Snell Brothers agreed to OND delivery of 50,000 bushels in 1996 and 60,000 bushels in 1997. DX-84 at 2. Richard and Joan Prince contracted for January-February-March ("JFM") delivery of 100,000 bushels in 1997 and an identical amount in 1998. DX-69 at 2. Thomas Prince also contracted for the 1997, 1998, 1999 and 2000 JFM delivery of 100,000 bushels. DX-70 at 3, 7. Fogelsong Brothers agreed to the JFM delivery of 40,000 bushels in 1997 and JFM delivery of the same amount in 1998. DX-37 at 1. Mark Grieser contracted for 1997 and 1998 JFM delivery of 25,000 bushels. DX-43 at 2. Matthew Jeffers contracted for OND delivery of 100,000 bushels in 1996, 125,000 bushels in 1997, 110,000 bushels in 1998 and 115,000 bushels in 1999. DX-53 at 132-33. Eugene Wagner agreed to OND delivery of 20,000 bushels in 1996 and an identical amount in 1997. DX-98 at 2. Howell Farms agreed to deliver 50,000 bushels, each, in January or February of 1997 and 1998. DX-49 at 2. Ron Spoerl contracted for OND delivery of 30,000 bushels in 1996 and 40,000 bushels in 1997. DX-109 at 2. Thus, Buckeye had agreed to take delivery of 675,000 bushels during the 1996 crop year, 720,000 bushels during the 1997 crop year, 370,000 bushels during crop year 1998 and 375,000 bushels during crop year 1999. These agreements more than covered the AMS HTAs. DX-10 at 1.

[68] <u>See</u> <u>supra</u> text accompanying note 62.

1995.[69] This meant that, at the time the substitute farmers entered into these agreements, their initial reference prices were significantly below the then-current price for December 1995 corn futures.[70] In addition, because the initial reference month was December 1995, the substitute farmers were required to roll the price of their contracts almost immediately after entering into them. If the then-current spreads held, this meant that the farmers would eventually have to rolled into an inverse.[71]

At Wright's suggestion, the farmers rolled their prices to March 1996, May 1996 and then July 1996 in hopes that the inverse spread between those months and December 1996 would narrow or, in the best case, reverse to a carry spread.[72] That did not happen and, by the Spring of 1996, the prices for old (i.e., 1995) corn were astronomical.[73] As a result, Buckeye was once again

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[69] See DX-12 at 1-15.

[70] See infra note 428.

[71] Division Posthearing Memorandum, exhibit B. See infra note 95.

[72] See, e.g., DX-46 at 9, 42; DX-49 at 2, 6, 8; DX-84 at 2, 6, 8; Tr. vol. 2 at 120-21, 154, 233-37; Tr. vol. 3 at 19-21, 23-24. See infra note 340.

[73] Tr. vol. 2 at 184-85; Tr. vol. 3 at 21; Tr. vol. 5 at 143-44, 150.

straining under its margin obligations and once again began refusing orders for option purchases.[74]

At the time that Buckeye's performance of its obligations again came into doubt, the Commission was actively investigating Wright, Buckeye and other related persons. As part of this investigation, it subpoenaed and deposed Wright, Buckeye employees as well as a number of other people that included the substitute farmers.[75] This confluence of events and the intervention of private counsel resulted in a situation wherein the substitute farmers neither delivered their corn to Buckeye, cancelled their delivery obligations nor rolled delivery.[76] At this point, the

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[74] Tr. vol. 5 at 85-86.

[75] DX-141 at 1-5; DX-142 at 1-5; DX-143 at 1-5; DX-144 at 1-5; DX-146 at 1-5; DX-147 at 1-6; DX-148 at 1-6; DX-149 at 1-7; DX-150 at 1-7; DX-151 at 1.

[76] Tr. vol. 2 at 189; Tr. vol. 3 at 40, 58 ("why should I deliver corn if I didn't know if I was as going to get my checks or not"); Tr. vol. 5 at 109.

When William Hamman received a Commission subpoena, he became worried that the Commission intended to prosecute him. Tr. vol. 2 at 165-66, 178. This caused him to place telephone calls with Wright and Leach wherein he immediately expressed his concern about the Commission's investigation and stated that he "wanted out" of the Buckeye HTAs. Tr. vol. 2 at 165-66. At that time, he learned that, if he used the cancellation provision, he would owe Buckeye more than $1 million. Tr. vol. 2 at 184. After being deposed by Division counsel, Hamman contacted counsel. Tr. 2 at 155. On the advice of counsel and as a result of the Commission's investigation, Hamman did not deliver corn to Buckeye. Tr. vol. 2 at 155-56. This triggered a dispute that, despite efforts to seek a resolution without

(continued..)

action began moving from commerce to the courts and this forum. Buckeye (and then its bankruptcy trustee) brought suit against some (and, possibly, all) of the substitute farmers,[77] Buckeye and Wright became respondents in this proceeding,[78] and Buckeye eventually ceased operations and filed for bankruptcy.[79]

The Commission Issues Its Complaint

On November 13, 1996, the Commission issued a nine-count complaint that named Wright, Buckeye, Philip Luxenburger and Edwards as respondents.[80] Roughly seven months later, the

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(..continued)

litigation, resulted in a lawsuit in which Buckeye (or the trustee of Buckeye's bankruptcy estate) sued Hamman and Hamman named Wright as a third-party defendant. Tr. vol. 2 at 181, 183-84.

77 For example, Buckeye sued Agle in an Ohio state court, seeking damages of more than $400,000 and specific performance of the Agle's substitute HTAs. DX-11 at 1-5.

78 In a tangentially-related matter Countrymark Cooperative, Inc. ("Countrymark") sued Wright, Agle, Thomas Prince and others in December of 1996. DX-11 at 31-36. The firm brought charges ranging from breach of contract to libel and slander. DX-11 at 72, 82-83.

79 Tr. vol. 2 at 150-51; Division of Enforcement's Notice Of Bankruptcy Petition By Buckeye Countrymark, Inc., dated September 5, 1997.

80 Complaint and Notice of Hearing Pursuant to Sections 6(c), 6(d), 8a(3) and 8a(4) of the Commodity Exchange Act, dated November 13, 1996 ("Complaint"). Edwards is and, during the 1991-1996 period, was a registered FCM. Amended Answer and Affirmative Defenses of Respondent Phillip L. Luxenburger, filed October 21, 1997 ("Luxenburger Answer"), ¶3; Amended Answer and
(continued..)

Commission amended the pleading.[81] The Amended Complaint alleges that: (1) Buckeye violated Sections 4(a) and 4c(b) of the Act,[82] 7 U.S.C. §§6(a), 6c(b), and Rule 32.2, 17 C.F.R. §32.2;[83] (2) Wright aided and abetted Buckeye's violations of Sections 4(a) and 4c(b), and Rule 32.2;[84] (3) Wright violated Section 4m(1), 7

(..continued)

Affirmative Defenses of Respondent A.G. Edwards & Sons, Inc., dated October 14, 1997 ("Edwards Answer"), ¶3; Response of Roger J. Wright to the Complaint and Notice of Hearing Pursuant to Sections 6(c), 6(d), 8a(3) and 8a(4) of the Commodity Exchange Act, dated December 16, 1996 ("Wright Answer"), ¶3. Luxenburger is and was an associated person of Edwards who serviced an account held by Wright as well as accounts held by some of Wright's clients. Luxenburger Answer, ¶4; Edwards Answer, ¶4; Wright Answer, ¶4; Tr. vol. 2 at 12-13.

[81] Amended Complaint and Notice of Hearing Pursuant to Sections 6(c), 6(d), 8a(3) and 8a(4) of the Commodity Exchange Act, dated June 30, 1997 ("Amended Complaint"). See infra note 492.

[82] The Complaint and Amended Complaint were filed before the Act was amended by the Commodity Futures Modernization Act of 2000 ("CFMA"), Pub. L. No. 106-554, 114 Stat. 2763 (2000). Unless otherwise indicated, all references and citations to the Act and to the United States Code are meant to designate them as they existed prior to the CFMA's enactment. Similarly, unless otherwise indicated, references to Commission rules and the Code of Federal Regulations are meant to designate them as they existed in 1996.

[83] Amended Complaint, ¶¶47, 50. Count I contained the Section 4(a) claims against Buckeye and Wright while Count II leveled the Section 4c(b) and Rule 32.2 charges against them.

[84] Amended Complaint, ¶¶48, 51.

U.S.C. §6m(1);[85] (4) Luxenburger and Edwards aided and abetted Wright's Section 4m(1) violations;[86] (5) Wright violated Sections 4b(a), 4c(b) and 4o(1)(A)-(B) of the Act, 7 U.S.C. §§6b, §6c(b), 6o(1)(A)-(B)), as well as Rules 4.13(b)(1)-(2), 4.31(a) and 33.10, 17 C.F.R. §§4.13(b)(1)-(2), 4.31(a), 33.10;[87] (6) Edwards violated Rule 1.37(a), 17 C.F.R. §1.37(a);[88] and (7) Wright and Luxenburger aided and abetted Edwards violations of Rule 1.37(a).[89] The respondents filed answers and none of them admitted to having engaged in the charged misconduct.[90]

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[85] Amended Complaint, ¶54. The Section 4m(1) allegations reside in Count III.

[86] Amended Complaint, ¶¶ 55-56.

[87] Amended Complaint, ¶¶57-69. Counts IV and V charged Wright with having violated Sections 4o(1) and 4b, respectively. The Commission placed the claim that Wright violated Section 4c(b) and Rule 33.10 in Count VI while Count VII charged Wright with having violated Rule 4.13(b). Finally, Count VIII included the allegation that Wright violated Rule 4.31(a).

[88] Amended Complaint, ¶¶71-72. Count IX of the Amended Complaint marked the change in the Division's theory of the case. Initially, Count IX alleged that Luxenburger engaged in unauthorized trading, in violation of 17 C.F.R. §166.2, that Wright aided and abetted the unlawful activity and that, as Luxenburger's employer, Edwards bore agency-based vicarious liability.

[89] Amended Complaint, ¶73.

[90] Luxenburger Answer; Edwards Answer; Wright Answer; Answer and Affirmative Defenses of Respondent Buckeye Countrymark, Inc., dated December 17, 1996.

After an eventful prehearing development,[91] we presided over a five-day trial in Columbus, Ohio at which we received evidence and heard testimony.[92] After the hearing, the parties filed amended stipulations,[93] proposed findings of fact and conclusions of law, and posthearing briefs.[94] There being only one more

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[91] See, e.g., Order, dated October 1, 1998; Order Denying Fifth Third Bank's Motion to Intervene and Granting its Alternative Motion for Leave to be Heard, dated April 23, 2998; In re Grain Land Coop., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,144 (CFTC Sept. 12, 1997); In re Wright, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,019 (ALJ Apr. 22, 1997); In re Wright, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,012 (ALJ Apr. 2, 1997).

[92] Tr. vol. 1; Tr. vol. 2; Tr. vol. 3; Tr. vol. 4; Tr. vol. 5.

[93] Amended Stipulations.

[94] Respondent A.G. Edwards & Sons, Inc.'s Brief in Support of Proposed Findings of Fact and Conclusions of Law, filed April 26, 2002 ("Edwards Posthearing Memorandum"); Respondent A.G. Edwards & Sons, Inc.'s Proposed Findings of Fact and Conclusions of Law, filed April 26, 1999; Posthearing Memorandum of Roger J. Wright, dated April 26, 1999 ("Wright Posthearing Memorandum"); Proposed Findings of Fact & Conclusions of Law of John Paul Rieser, Chapter 7 Bankruptcy Trustee for Buckeye Countrymark, Inc., and the Fifth Third Bank, dated April 23, 1999; Joint Post-Hearing Memorandum of John Paul Rieser, Chapter 7 Bankruptcy Trustee for Buckeye Countrymark, Inc., and the Fifth Third Bank, dated April 23, 1999 ("Buckeye Posthearing Memorandum"); Proposed Findings of Fact and Conclusions of Law of Respondent Philip L. Luxenburger, dated April 26, 1999; Post-Hearing Memorandum of Respondent, Philip Luxenburger, dated April 23, 1999; Proposed Findings of Fact & Conclusions of Law of the Division of Enforcement, dated February 26, 1999 ("Division Proposed Findings"); Division Posthearing Memorandum.

procedural matter to resolve,[95] we now turn to the merits of this proceeding.

THE CLAIMS THAT BUCKEYE DEALT IN ILLEGAL CONTRACTS AND WRIGHT AIDED AND ABETTED THAT ACTIVITY

Much of this case focuses on Buckeye's HTAs and related practices. The first two counts of the complaint charged Buckeye with offering and dealing in illegal, off-exchange futures and options, and alleged that Wright aided and abetted

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[95] After the hearing, the Division requested that we take official notice of certain corn futures prices. Division Proposed Findings at 40 n.226. We hereby **GRANT** that request. We have also taken notice of a number of other prices as well as some general facts. "When an agency decision rests on official notice of a material fact not appearing in the evidence in the record, a party is entitled, on timely request, to show the contrary." 5 U.S.C. §556(e). With respect to this right, we establish the following procedures.

Should a party wish to contest a fact as to which we took official notice, that party must notify the court of the intention to do so on or before March 11, 2003. In the notice, the party must clearly and succinctly state: (1) the fact that the party wishes to contest, (2) the page and, if appropriate, footnote of this initial decision upon which the fact is stated, (3) the basis upon which the party will rest its contestation of the fact and (4) the evidence upon which the party will rely in contesting the fact.

If we receive timely, compliant notices indicating that one or more parties wishes to contest facts of which we take official notice, we will establish appropriate procedures. The opportunity to file a notice of intent to contest facts of which we took official notice shall not be a means of contesting: (a) findings that we based on the evidence of this proceeding or the inferences that we drew from that evidence, (b) findings that we based on judicial admissions and/or stipulations in this proceeding or the inferences that we drew from such admissions and/or stipulations, or (c) constructions of statutes or regulations.

those violations. This portion of the case presented one very close question and several legal issues that garnered no attention from the parties despite their dispositive nature. For the reasons set forth below, the Division failed to prove that Buckeye committed the primary violations with which it was charged and that Wright should be sanctioned for aiding and abetting.

The Division Failed To Prove That Buckeye Violated Section 4(a)

Count I of the Amended Complaint alleged that Buckeye violated Section 4(a) "from 1991 through at least December 1995 . . . in connection with the marketing, offer and sale of certain HTAs" that included, but were not limited to the substitute HTAs.[96] In its prehearing memorandum, the Division stated an intention to establish that these violations occurred over the entire period set forth in the complaint.[97] However, at the hearing, the Division narrowed its case when it notified the Court (and, more importantly, the other parties) that it only intended to prove Section 4(a) violations "from 1995."[98] In its

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[96] Amended Complaint, ¶¶27-39, 46-47.

[97] Prehearing Memorandum of the Division of Enforcement, dated June 8, 1998 ("Division Prehearing Memorandum"), at 6.

[98] The Division objected to an attempt to elicit testimony concerning the terms of Buckeye HTAs during a period preceding 1995. Tr. vol. 3 at 117-18. In doing so, it raised the issue of whether it intended to prove that Buckeye violated Section (continued..)

post-hearing filings, the Division limited its Section 4(a) discussion to the issue of whether Buckeye violated the provision when it offered and entered into the substitute HTAs.[99]

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4(a) prior to 1995. Tr. vol. 3 at 118-21 ("Your Honor, we can safely say that the evidence that [the Division] will provide to the Court at the conclusion of our case will not have any producers who entered into HTA contracts before 1995. . . . As to Buckeye, your Honor, we're going to be able prove contracts from 1995."). The discussion of this issued ended with the following exchange.

> [The Court:] But your allegations under 4(a) with respect to these hedge-to-arrive contracts, your proof of violations, you seek to prove violations of 4(a) with respect to the hedge-to-arrive contracts dating back from 1995; is that correct?
>
> [Division Counsel:] That is correct, your Honor.
>
> [The Court:] Okay. Well, that's very helpful in clarifying the extent of the issues in dispute in this proceeding. That's very helpful and also is helpful perhaps in narrowing some of the cross-examination.
>
> [Division Counsel:] Thank you, your Honor.

Tr. vol. 3 at 121.

[99] Division Posthearing Memorandum at 59-75 ("In sum, an examination of the Substitute HTAs reveals that they were risk shifting rather than merchandising transactions . . . . As such, the Substitute HTAs cannot, by any interpretation of Commission law, be viewed as cash forward contracts; rather they must be seen for what they were -- futures."); Division Proposed Findings at 41-44.

Accordingly, we only consider whether Buckeye's offering of and entry into the substitute HTAs violated the prohibition of Section 4(a).

Section 4(a) generally prohibits persons from offering or entering into "a contract for the purchase or sale of a commodity for future delivery" unless they do so "on or subject to the rules of a board of trade which has been designated by the Commission as a 'contract market.'"[100] Apparently because the phrase "contract for the purchase or sale of a commodity for future delivery" is drafted in seemingly plain terms, the Act provides little guidance for its construction. However, Section 1a(11) states, "The term 'future delivery' does not include any sale of any cash commodity for deferred shipment or delivery."[101]

An educated reader without knowledge of the commodity markets and the legislative history of the Act might be puzzled by the distinction between a contract "for the future delivery" of a "commodity" and one for the "deferred . . . delivery" of a "cash commodity." However, the legislative history of Sections 4(a) and 1a(11) make clear (and seemingly all tribunals that have considered the question agree) that Sections 4(a) and 1a(11) were intended to prohibit off-exchange trading in "futures" contracts

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[100] 7 U.S.C. §6(a).

[101] 7 U.S.C. §1a(11).

while placing "cash forward" (or "forward") contracts beyond the reach of the Act and Commission jurisdiction.[102] Our task in this case is to determine the side on which the Buckeye substitute HTAs fall or, more accurately, to determine whether the Division has proven the substitute HTAs constitute futures as the Act defines them (i.e., as contracts for future delivery of a commodity but

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[102] See, e.g., Top of Iowa Coop. v. Sime Farms, Inc., 608 N.W.2d 454, 460-61 (Iowa 2000). See infra note 108. We will not detail the legislative history of Section 1a(11) as many excellent summaries have been published. With respect to the futures-forward distinction, Judge Posner explained,

> Although futures contracts specify delivery as a possible method of satisfying the short's obligations, it is much more common for such contracts to be closed out by the "buyer's" taking an offsetting position in a new contract identical but for its price. This option for getting out enables people who are not agriculturalists, and wouldn't know an ear of corn from a soybean if it slapped them in the face, to speculate in the prices of commodities. In other words, these contracts are really a type of security, like common stock, rather than a means of fixing the terms by which farmers ship their output to grain elevators and other agricultural middlemen. It is because commodity-futures contracts are a type of security that Congress has seen fit to subject them to a regulatory scheme, the Commodity Exchange Act, which parallels that administered by the SEC for trading in corporate stock. There was no intention of regulating the commerce in agricultural commodities itself.

Nagel, 217 F.3d at 440.

not contracts for the deferred delivery of a cash commodity).[103] In performing this task, we have the benefit of well-developed case law but are forced to grapple with an unwieldy rule.

In late 1998, Judge Painter commented on the "dearth" of case law applying Sections 4(a) and 1a(11) to HTAs.[104] Since then,

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[103] 5 U.S.C. §556(d). Cf. Patten Farms, Ltd. v. Farmers Coop. Co., 4-97-CV-90599, 2000 U.S. Dist. LEXIS 21650, at *4-11 (S.D. Iowa June 1, 2000).

> In order to establish violations of the Act and Commission regulations, the Division must prove each necessary element by a preponderance of the evidence. In other words, "[i]t must establish that 'the existence of [the necessary] factual elements is more probable than their nonexistence."' This means that the Division must not only surmount one potential, exculpatory theory of the case, it must overcome all plausible, exculpatory theories in combination. Otherwise, it has not demonstrated that the existence of a necessary ultimate fact is more probable than its nonexistence. Rather, the Division would prove only that the existence of ultimate facts is more probable than nonexistence when compared to each, but not necessarily all, plausible alternative versions of events, a substantially lesser standard.

In re Gorski, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,742 at 48,490 (CFTC Aug. 23, 1999) (footnotes omitted).

[104] In re Grain Land Coop., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,459 at 47,190 (CFTC Nov. 6, 1998). Although we take it at face value, this observation is open to question since, before Judge Painter issued Grain Land, courts in Ohio, Indiana, Iowa, Michigan, and Minnesota had addressed the issue of whether the HTAs before them qualified as cash (continued..)

federal courts in three circuits as well as state courts in Iowa, Nebraska and Ohio have considered whether HTAs are forwards or futures.[105] Although not in complete agreement, an overwhelming

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forward contracts or futures. See Lachmund v. ADM Investor Servs., Inc., 26 F. Supp. 2d 1107, 1118-19 (N.D. Ind. 1998) ("In the present case, no matter what label Lachmund might use, the court finds that the grain contracts were cash forward contracts as a matter of law."); Johnson v. Land O'Lakes, Inc., 18 F. Supp. 985, 994-97 (N.D. Iowa 1998) (holding that the HTAs in question were, as a matter of law, cash forward contracts); Barz, 12 F. Supp. 2d at 952-57 ("the HTAs here are valid cash forward contracts"); Top of Iowa Coop. v. Schewe, 6 F. Supp. 2d 843, 858-59 (N.D. Iowa 1998) (holding that the HTAs in question were "valid 'cash forward' contracts . . rather than illegal off-exchange 'futures'"); Andersons, Inc. v. Croster, 7 F. Supp. 2d 931, 933-36 (W.D. Mich. 1998) (finding that HTAs were cash forward contracts not subject to the Act); Oeltjenbrun v. CSA Investors, Inc., 3 F. Supp. 2d 1024, 1029, 1033-47 (N.D. Iowa 1998) (finding that flexible HTAs were cash forward contracts); In re Grain Land Coop Cases, 978 F. Supp. 1267, 1277 (D. Minn. 1997) ("In short, the Court concludes that the HTA contracts are forward contracts excluded from regulation under the CEA."); Eby v. Producers Co-op, Inc., 959 F. Supp. 428, 433 (W.D. Mich. 1997); Couyntrymark Coop., Inc. v. Smith, 705 N.E.2d 738, 742-46 (Ohio Ct. App. 1997) (corrected May 20, 1999) (overruling assignment of error that the trial court erroneously concluded that defendant had failed to create a genuine issue of fact as to whether the HTAs at issue was an illegal off-exchange futures contracts).

[105] See Abels v. Farmers Commodities, Corp., 259 F.3d 910, 917 (8th Cir. 2001); Nagel, 217 F.3d at 438-42 (affirming the trial court's dismissal of a complaint on grounds that the flexible HTAs in question were cash forward contracts); Kar Kim Farms, Inc., 199 F.3d at 996 ("To sum up: we agree with the district court that Grain Land's HTAs with Obermeyer were contracts for the sale of a cash commodity for deferred delivery and therefore not subject to the CEA."); Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 785-90 (7th Cir. 1999) ("We hold . . . that the HTA contracts at issue in this case are cash forward contracts exempt from the purview of the CEA . . . ."); Haren v.

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majority of the federal courts determined that the HTAs before

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Conrad Coop., 198 F.3d 683, 683 (8th Cir. 1999) (affirming a decision that held HTAs to be cash forwards not subject to governance by the Act); Andersons, Inc. v. Horton Farms, Inc., 166 F.3d 308, 317-22 (6th Cir. 1998) (holding that HTAs were cash forward contracts); Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d 1144, 1165 (N.D. Iowa 2001) (holding that the HTAs at issue are cash forward contracts); Gunderson v. ADM Investor Servs., Inc., No. C96-3148-MWB, 2001 U.S. Dist. LEXIS 3383, at *38-42 (N.D. Iowa Feb. 13, 2001) (holding that the question of whether the HTAs at issue constituted futures or forwards was too fact intensive to resolve in a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6)); Gunderson v. ADM Investor Servs., Inc., 85 F. Supp. 2d 892, 913 (N.D. Iowa 2000) (holding that the question of whether the HTAs at issue constituted futures or forwards was too fact intensive to resolve in a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6)); Patten Farms, 2000 U.S. Dist. LEXIS 21650, at *6-11 (holding that, as a matter of law, certain HTAs that permitted indefinite rolling and included a provision that permitted cancellation upon proof of an inability to deliver constituted forwards that were not subject to the Act); CoBank, ACB Corp. v. Alexander, Case No. 3:96CV7687, 1999 U.S. Dist. LEXIS 17288, at *30-31 (N.D. Ohio July 27, 1999) (holding that the HTAs before it constituted "valid cash forward contracts"); In re Gray, 252 B.R. 689, 698-700 (Bankr. S.D. Ohio 2000) (finding that most, but not all, of the HTAs before it were forwards); Sack Bros. v. Great Plains Coop., Inc., 616 N.W.2d 796, 800-09 (Neb. 2000) (affirming decisions that HTAs were cash forward contracts); Top of Iowa Coop., 608 N.W.2d at 457-65 (holding that flexible HTAs constituted forwards); Maynard Coop. Co. v. Recker, No. 1-436 / 00-1104, 2001 Iowa App. LEXIS 705, at *3-5 (Iowa Ct. App. Nov. 28, 2001) ("The authorities conclusively hold HTA contracts with roll forward provisions are legal cash forward contracts, exempt from the CEA."); Blanchard Valley Farmers Coop., Inc. v. Rossman, 761 N.E.2d 1156, 1161-62 (Ohio Ct. App. 2001) (affirming a trial court finding that flexible HTAs were forward contracts not entered into in violation of Section 4(a)); Blanchard Valley Farmers Coop., Inc. v. Carl Niese & Sons Farms, Inc., 758 N.E.2d 1238, 1242 (Ohio Ct. App. 2001) (affirming portion of order granting summary judgment on grounds that the HTAs in question was cash forward contracts).

them (even HTAs with seemingly opened-ended rolling provisions) constituted forward contracts and not futures.[106] In reaching those conclusions, the courts have demonstrated an analytic consensus.

Relying on the legislative history of Section 1a(11) and earlier interpretations thereof,[107] courts generally hold that the contract parties' contemplation of actual physical delivery of the commodity, the sale or purchase of which is the subject of the contract in question, distinguishes cash forwards from futures.[108]

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[106] See supra notes 104-05. In addition, despite the controversy surrounding them, HTAs are still considered useful contracts. See Sherry Collins, When They Pull The Trigger, Soybean Dig., Sept. 1, 2002, at 21 ("Drees regularly uses hedge-to-arrive contracts . . . ."); James Ritchie, Hired Selling Solutions, Soybean Dig., February 1, 2002; Dan Looker, Does your broker pool your grain?: Most do not, but pulling together larger lots for delivery can improve the basis, a Missouri firm has learned, Successful Farming, Feb. 1, 2002, at 14; Larry Stalcup, Farmer-Feeder Covers His Bases, Soybean Dig., February 28, 2001; Larry Stalcup, Don't Be Afraid Of Hedge-To-Arrive, Soybean Dig., January 30, 2000.

[107] See supra note 102; see infra note 108.

[108] For example, the Eighth Circuit explained,

> Although the . . . [Act] excludes from its reach "any sale of any cash commodity for deferred shipment or delivery," 7 U.S.C. §1a(11), it offers no further guidance in distinguishing between an unregulated cash-forward contract and a CFTC-regulated futures contract. Nevertheless, the legislative history of the CEA and its predecessors points to a congressional distinction between the standardized and

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> transferable commodities futures contracts traded on markets like the CBOT and the contracts used by producers and distributors or processors to fix in the present a price for a delivery in the future. It was transactions of the former category, which usually do not result in the physical transfer of any of the underlying commodity and are vulnerable to manipulation and excessive speculation, that Congress sought to regulate through the CEA and its predecessors. See CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573-577-79 & nn. 4-6 (9th Cir. 1982) (tracing legislative history of cash-forward exception) . . . . Thus, it is the contemplation of physical delivery of the subject commodity that is the hallmark of an unregulated cash-forward contract. In order to determine whether a transaction is an unregulated cash-forward contract, we must decide whether there is a legitimate expectation that physical delivery of the actual commodity by the seller to the original contracting buyer will occur in the future.

Kar Kim Farms, 199 F.3d at 990-91 (footnote, quotations and citations omitted). Accord Lachmund, 191 F.3d at 786-87. The Sixth Circuit similarly opined,

> The purpose of this "cash forward" exception is to permit those parties who contemplate physical transfer of the commodity to set up contracts that (1) defer shipment but guarantee to sellers that they will have buyers and *visa versa*, and (2) reduce the risk of price fluctuations, without subjecting the parties to burdensome regulations. These contracts are not subject to the CFTC regulations because those regulations are intended to govern only speculative markets; they are not meant to cover contracts wherein the commodity in question has an "inherent value" to the

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In determining the contemplation of the contract entrants, the federal courts and the Commission tend to follow a "multifactor approach" wherein they examine the terms of an HTA as well as extrinsic factors relating to the HTA parties.[109] We did the same in an earlier enforcement proceeding concerning the legality of non-HTA agricultural marketing contracts, In re Cargill, Inc., [2000-2002 Transfer Binder] Com. Fut. L. Rep. (CCH) ¶28,425 (CFTC Nov. 22, 2000).[110] The law on this point has not changed and,

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> transacting parties. *See Co Petro*, 680 F.2d at 577-79 (describing history of the cash forward exclusion) . . . . We hold that in determining whether a particular commodities contract falls within the cash forward exception, courts must focus on whether there is a legitimate expectation that physical delivery of the actual commodity by the seller to the original contracting buyer will occur in the future.

Andersons, 166 F.3d at 318 (citations and footnote omitted, italics in original).

[109] Nagel, 217 F.3d at 440-41; Andersons, 166 F.3d at 319-21; Patten Farms, 2000 U.S. Dist. LEXIS 21650, at *6-8; Motzek v. Monex Int'l Ltd., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,095 at 41,625-26 (CFTC June 1, 1994). This approach seems calculated to prevent parties from evading regulation through the use of "magic" words. It also reflects the fact that futures contracts contain delivery provisions and, as a result, "it isn't always easy to determine just from the language of a contract for the sale of a commodity whether it is a futures contract or a forward contract." Nagel, 217 F.3d at 440.

[110] In Cargill, the respondent faced charges that it was offering and entering into illegal off-exchange option contracts. [2000-
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2002 Transfer Binder] ¶28,425 at 51,214-15. It responded, in part, by asserting that the contracts in question were cash forwards. Id. at 51,216. Following the consensus approach of the federal courts and the Commission (as opposed to Commission staff who have published non-binding guidance), we engaged in the requisite multifactor inquiry. Id. at 51,224-31. Thus, we held that the "general difference between futures and forwards" was "[w]hether the parties and the contract anticipate delivery" and that, to determine the expectation, we could give no factor dispositive weight. Id. at 51,227.

While the choice of legal rules was clear, it was not unproblematic. We explained,

> Although the Commission recognizes that the [multifactor] approach's "holism" lacks clarity in application, it has continued (as recently as September 2000), to steadfastly defend it. The resulting uncertainty of the approach leaves in question the enforceability of all new contracts not specifically approved, thus increasing the costs of experimentation. This is something more than an academic concern.
>
> The recent [wave] of lawsuits arising out of Hedge-To-Arrive ("HTA") contracts demonstrates the high costs associated with experimenting under the uncertain law surrounding that forward contract exclusion. Over the last few years, producers who entered into HTA contracts have attempted to eliminate their obligations under these contracts by claiming that they are unenforceable as unregulated futures contracts in violation of the Act. Although the courts have been thwarting the producers' opportunistic behavior, the social costs associated with the commercial disruption and the eruption of litigation spawned by the producers' efforts are unrecoverable.

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> The HTA lesson has prompted some harsh criticism of . . . [this] approach to distinguishing forwards from futures, and not just from commentators.
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> . . . .
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> In his affirming opinion, Chief Judge Posner joined Judge Easterbrook [who presided at the trial level by designation] in agreeing that:
>
> > The totality of the circumstances approach invites criticism as placing a cloud over forward contracts by placing them at risk of being classified as futures contracts traded off-exchange and therefore illegal.

[2000-2002 Transfer Binder] ¶28,425 at 51,225-27. (quotation marks, brackets and footnotes omitted).

In choosing the multi-factor inquiry, we eschewed a test that would remove most of the prospective uncertainty concerning HTAs, that employed by Judge Easterbrook in Nagel. When faced with the issue of whether HTAs were futures or forwards, he wrote,

> In futures markets, people buy and sell contracts, not commodities. Terms are standardized, and each party's obligation runs to an intermediary, the clearing corporation. Clearing houses eliminate counterparty credit risk. Standard terms and an absence of counterparty-specific risk make the contracts fungible, which in turn makes it possible to close a position by buying an offsetting contract. All contracts that expire in a given month are identical; each calls for delivery of the same commodity in the same place on the same day. Forward contracts under §1a(11), by contrast, call for sale of the commodity; no

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thus, our inquiry will not differ in any significant respect from that of Cargill.[111]

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> one deals "in the contract"; it is not possible to close a position by buying an offsetting position, because there are no fungible promises; delivery is idiosyncratic rather than centralized. *Co Petro*, the case that invented the multi-factor approach, dealt with a fungible contract, see 680 F.2d at 579-81, and trading did occur "in the contract." That should have been enough to resolve the case.
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> . . . .
>
> Recognition that futures markets are characterized by trading "in the contract" leads to an easy answer for cases such as ours. Flex HTA agreements are not fungible; they can't be settled by buying offsetting positions; the trade is securely "in the commodity" rather than "in the contract." *Cf. Marine Bank v. Weaver*, 455 U.S. 551, 71 L. Ed. 2d 409, 102 S. Ct. 1220 (1982) (a non-fungible contract that could not be traded on an exchange is not a security) . . . . To put this in statutory terms, I read "contract for future delivery" with an emphasis on "contract," and "sale of any cash commodity for deferred shipment or delivery with an emphasis on "sale"; this adequately separates the domains of futures and forward transactions.

Nagel v. ADM Investor Servs., Inc., 65 F. Supp. 2d 740, 751-53 (N.D. Ill. 1999) (italics in original).

[111] In reviewing the Cargill contracts, we considered: (1) whether the contract at issue obligated the seller to make delivery; (2) whether the contract obligated the purchaser to take delivery; (3) whether the contract parties were commercial entities; (4) whether the material terms of the contracts, such

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While our approach mirrors that of the federal courts, our task differs in one material respect. Generally, the federal courts have evaluated HTAs in the context of private disputes.[112] Perhaps as a result, their "contemplation of delivery" analysis has tended to consider the expectations of the specific contract parties before them rather than those concerning the class of HTAs as a whole.[113] We, on the other hand, must affix a label to a

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as price and volume, were negotiated; and (5) whether the contracts could be cancelled, offset or rolled in a manner that affects the delivery obligation. [2000-2002 Transfer Binder] ¶28,425 at 51,230-31. With respect to contract standardization, we held, "The fact that the [contract at issue] uses a preprinted form with blanks for dates and prices does not make it the sort of 'standardized' contract traded on exchanges. . . . exchange-traded contracts use uniform quantities, quality, pricing and delivery conditions to create fungibility in the contract." Id. at 51,231 n.120.

In their determination of whether HTAs are futures or forwards, courts have considered these factors as well as: (6) whether, on their faces, the contracts were clearly grain marketing instruments, tools to accomplish the actual delivery of grain in exchange for money; (7) whether delivery and payment routinely occurred between the parties in the past; and (8) whether the suppliers received cash payment on the contracts only upon delivery of the actual commodity. Lachmund, 191 F.3d at 787-88; Andersons, 166 F.3d at 320.

112 See, e.g., Kar Kim Farms, 199 F.3d at 988.

113 See, e.g., id. at 992 n.7. ("There is evidence . . . that Grain Land permitted . . . farmers to cancel their HTAs . . . . Although this evidence may be relevant to whether those particular contracts were futures contracts, we do not believe it is relevant here, inasmuch as it sheds no light on the course of dealing between Obermeyer and Grain Land.").

class of contracts.[114] When one describes a class of contracts as a whole, it becomes necessary to admit that determinations based on contract party contemplation are really based on the expectations of some critical mass of the contract parties.[115]

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[114] By "class of contracts," we mean a particular contract offered by a certain firm, such as the substitute HTAs in this proceeding, rather than a general type of contract such as HTAs or flexible HTAs as a whole.

[115] For example, at least one court has described the "ultimate focus" in the futures-forward inquiry as "whether the contracts in question contemplated actual, physical delivery of the commodity." Andersons, 166 F.3d at 320. The clear implication of such a statement is that forwards contemplate delivery and futures do not. See id. at 318-20. Taken literally and without qualification, this principle cannot be squared with reality. Although an overwhelming majority of persons enter into futures contracts without any expectation of making or taking delivery, agricultural commodity futures contracts generally "contemplate" delivery in the sense that they include delivery terms (albeit delivery that can be avoided by offsetting open positions) and modern commercial participants still use corn futures contracts as a means of delivering tens of millions of bushels per year. Thomas Lee Hazen, Rational Investments, Speculation, or Gambling? -- Derivatives, Securities and Financial Futures and Their Effect on the Underlying Capital Markets, 86 Nw. U.L. Rev. 987, 1017 (1992); Chicago Board of Trade Statistical Annual Supplement 90 (1992). Thus, in terms of delivery contemplation, futures are better described as contracts as to which a critical mass of contract parties do not contemplate making or taking delivery. Conversely, forwards can be described as agreements concerning which a critical mass of contract parties contemplate making or taking delivery. Thus, when evaluating contracts as a class and looking to delivery contemplation, a small percentage of contract parties do not define the contract for all.

The Substitute HTAs' Terms

Our analysis of any contract begins with the "words of the contract itself."[116] This analysis is complicated by the fact that the substitute HTAs appear to have contemplated an attachment that was not, in fact, made part of the contract.[117]

The Substitute HTA Includes Terms That Appear To Contemplate Delivery

Perhaps because the "Grain Purchase Contract and Confirmation" was not attached, the substitute HTAs include no express promises to make or take delivery.[118] This fact supports the inference that delivery was not in the forefront of the contract parties' minds. However, the contracts include a number of references that evidence a contemplation of delivery.[119]

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116 Lachmund, 191 F.3d at 787.

117 The substitute HTAs appear to combine two documents, the "Flex Hedge to Arrive Contract" and the attached "Appendix to Buckeye Countrymark Contract." DX-109 at 1-2. The Flex Hedge to Arrive Contract referred to another attachment, the "Grain Purchase Contract and Confirmation." DX-109 at 2. However, the evidence indicates that Buckeye did not attach the Grain Purchase Contract and Confirmation to any of the substitute HTAs. Tr. vol. 2 at 160-61; Tr. vol. 4 at 202-03.

118 DX-109 at 1-2.

119 The contracts refer to a delivery date, an alternative delivery fee related to delivery to another elevator for Buckeye's benefit, the requirement to set the basis of the corn "before any delivery," the provision that "[d]elivery of corn can be made before the scheduled delivery period," and a promise that "[n]o funds will be held from delivered corn to cover margin on undelivered bushels." DX-109 at 1-2. In addition,
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The Substitute HTAs Are Not So Standardized As To Make Them Fungible

HTAs are generally form contracts. This comes as no surprise since "[t]he use of standard form contracts is common practice in commercial transactions."[120] Thus, when courts consider contract standardization as it relates to the futures/forward issue, they look to whether the "key contractual terms were . . . standardized."[121] The purpose of this inquiry seems to go to the issue of fungibility. Futures contracts are fungible and the market for trading in these contracts is enhanced by standardized terms.[122]

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the contract included the agreement that "[s]eller will advise buyer of adverse weather conditions affecting crop production." DX-109 at 1. This last provision indicates a contemplation of delivery since, if delivery was not contemplated, Buckeye would appear to have little interest in whether a particular supplier was experiencing bad weather or troublesome production.

120 Seibel v. A.O. Smith Corp., 97-C-0874-S, 1998 U.S. Dist. LEXIS 19903, at *18 (W.D. Wis. Apr. 2, 1998). Accord Daniel T. Ostas, Postmodern Economic Analysis of Law: Extending the Pragmatic Visions of Richard A. Posner, 36 Am. Bus. L.J. 193, 231 (1998) ("Form contracts are common in transactions between merchants as well.").

121 Patten Farms, 2000 U.S. Dist. LEXIS 21650, at *8.

122 See supra note 110.

The substitute HTAs were form contracts and, in fact, more standardized than ordinary HTAs.[123] However, this stems from the fact that the substitute HTAs were engineered to pass a nominal, preexisting obligation from AMS to the substitute farmers. The level of standardization did not result in contracts that would appear to be so fungible so as to create a market "in the contract." For example, if a substitute farmer wished to contract for 30,000 bushels of his 1996 crop and 40,000 bushels of 1997 corn, he executed one contract rather than multiple 5,000 bushel contracts.[124] Thus, to the degree he wished to somehow transfer the HTA to some other person,[125] success would involve finding a

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[123] For example, the initial reference prices, the commodity involved and the commodity grade were standardized in the substitute HTAs but, for reasons discussed above, unique to them among Buckeye HTAs. DX-109 at 2.

[124] DX-109 at 2; Tr. vol. 3 at 145.

[125] Transfer would not necessarily extinguish the obligation to perform. Under Ohio law, if person A enters into a contract with person B and then transfers (delegates) its obligations under the contract to person C who adopts the agreement, person A remains obligated to person B for performance under the contract unless: (1) the contract initially provided that, if A delegated his contractual obligations, he would no longer be responsible; (2) persons A and B execute a novation to the contract or (3) person B otherwise consents. Illinois Controls, Inc. v. Langham, 639 N.E.2d 771, 781 (Ohio 1994); Kuhens v. Weaver, Case No. 643, 1996 Ohio App. LEXIS 1446, at *10-11 (Ohio Ct. App. April 5, 1996) ("Absent a clause making delegation ineffective, a party may generally delegate his . . . duties under the contract. However, it is a basic tenet of contract law that absent a novation, the delegator remains liable on the contract."). The substitute HTAs were silent on the topic of (continued..)

person interested in entering into a two-year, 70,000 bushel contract rather than persons interested in one or more 5,000 bushel agreements. Thus, while it is true that the substitute farmers were required to contract in increments of 5,000 bushels,[126] this fact provides as much support for the inference that such a rule was meant to facilitate Buckeye's hedging[127] as it does for the inference that Buckeye anticipated creating or inadvertently created a fungible contract.

The Substitute HTAs Included Provisions For Cancellation And Rolling

Much of the Division's case centers on the fact that the substitute HTAs permitted rolling of delivery and included written terms that would permit a farmer to cancel his delivery obligations at the cost of a 10 cent per bushel fee "plus or minus cancelled price of the futures and the contract price."[128]

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contract assignments and delegations. Accordingly, transferring the duties under the substitute HTAs from a substitute farmer to some other person would not extinguish the substitute farmer's obligations under the agreement.

126 Tr. vol. 3 at 75.

127 Tr. vol. 1 at 238-39 ("I would suspect that it's done on the even 5,000 unit amounts to facilitate using the futures contracts -- to offset the risk of these contracts."); Tr. vol. 3 at 75.

128 Division Posthearing Memorandum at 70-74. <u>See</u> DX-109 at 2; Tr. vol. 3 at 85.

Generally, courts have held that an inescapable obligation to deliver is not necessary for a contract to qualify as a cash-forward.[129] Because we must determine what the parties contemplated, rather than what they could have accomplished, we treat it as a non-dispositive factor as well.

In this case, the cancellation provision differs from a liquidated damages clause in that, depending on the relevant prices, a farmer could cancel delivery and receive payment from Buckeye. Thus, a person could have used the substitute HTAs for price speculation without any more contemplation of delivering grain than that harbored by the average retail corn futures trader. This fact supports the inference that the HTAs were futures. However, it is not inconsistent with the contemplation of eventual delivery. First, the cancellation fee provides a strong incentive to deliver grain rather than cashing out.[130] In addition, the ability to cancel under these terms serves a commercial purpose related to a farmers' production risk by fixing the terms under which a farmer who failed to meet expected

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[129] Kar Kim Farms, 199 F.3d at 992; Haren, 198 F.3d at 684, quoted in Patten Farms, 2000 U.S. Dist. LEXIS 21650, at *7.

[130] In the context of the substitute HTAs' initial reference price, the cancellation fee amounts to a discount of just under four percent. To farmers entering into contracts covering tens of thousands of bushels, four percent adds up to real money. For example, if Hamman Farms exercised the cancellation provision, the aggregate cancellation fee would have amounted to $40,000. DX-46 at 7.

production levels could avoid default without incurring the risks associated with rolling and avoid default in the event of a catastrophic event that disabled the farmer from delivering the crop from his own present (and expected) production or purchasing the commodity from other sources. Thus, the existence of a cancellation provision is not inconsistent with either an ex ante intent to make eventual delivery or an intent to use the HTA as a purely speculative vehicle. The same can be said with respect to the rolling clause.

There is no doubt that the ability to roll delivery over a number of years permits farmers to engage in price speculation to the point of imprudence. However, rolling also serves a valid commercial use by giving the farmer another option to deal with instances where production risk is realized.[131] Thus, entry into

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[131] This fact is reflected in the case law. Suppliers (as the Division does here) have tended to argue that HTAs do not contemplate actual delivery when they provide for potentially open-ended rolling. See, e.g., Andersons, 166 F.3d at 320. Courts have generally refused to find the possibility of such rolling to be dispositive and, thus, have concluded that entry into a contract that permits potentially infinite rolling is not inconsistent with an expectation of making delivery. Nagel, 217 F.3d at 440-41; Andersons, 166 F.3d at 321 & n.20 ("Furthermore, the fact that speculative futures contract are often 'rolled' does not foreclose the use of such term to move forward an actual delivery date in contracts that are not futures contracts."); Oeltjenbrun, 3 F. Supp. 2d at 1042-43 ("Nor does the fact that rolling these contracts might require futures transactions without parallel physical transactions somehow transform these contracts for physical delivery into speculative futures transactions."). Indeed, courts tend to hold that, when a supplier must pay a fee each time it rolls delivery and risks (continued..)

an HTA that permits open-ended rolling has generally not been found to be inconsistent with an expectation to deliver.[132]

On The Whole, The Substitute HTA Terms Do Not Indicate An Absence Of Delivery Contemplation

If the futures/forward distinction turned on the question of how contracts may be used (i.e., whether they permitted pure price speculation), then this case would be easy and we would find that the Division satisfied its burden of proof. However, as it has developed, the law requires us to consider how the farmers and elevator anticipated the contracts would be used and not their abstract potential. On this point, the substitute HTAs provide no definitive answer. Accordingly, we must look beyond the contract language.

The Substitute HTA Parties Were Commercial Actors

In making the futures/forward inquiry, courts find it relevant to consider whether the parties to the HTAs were

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a downward adjustment of the reference price, the costs effectively limit rolling even if there is no contractual limit on the number of rolls that might occur. Nagel, 217 F.3d at 441; Barz, 12 F. Supp. 2d at 956-57.

132 See supra notes 104-05. Indeed, the ability to roll can buttress the inference that a farmer intended to make delivery. For example, the Northern District of Illinois observed that, when a supplier contracts under a flexible HTA to deliver more than it can produce, then the farmer has not necessarily contracted beyond his capacity since the ability to defer delivery across crop years effectively increased the supplier's ability to make delivery. Johnson, 18 F. Supp. 2d at 992.

commercial actors with respect to the commodity in question (i.e., engaged in the business of selling and buying the commodity for which they contracted) or members of the public at large.[133] The presence of commercial parties supports the inferences that the underlying commodity had value to the contract parties, which would distinguish them from the mean agricultural futures contract entrant, and that the parties entered into the contract for a commercial purpose, to effect a transaction in the cash commodity.[134]

In this case, the buyer under the contracts in question was Buckeye, a firm that engaged in the business of buying and selling grains (including corn) that had the capacity to receive and store more than 2.6 million bushels.[135] The sellers were farmers engaged in the business of growing and selling corn.[136] Thus, the substitute HTA parties were commercial parties and the corn underlying the substitute HTAs had value to them. These facts support the inference that the substitute HTAs memorialized

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[133] Kar Kim Farms, 199 F.3d at 991-92; Andersons, 166 F.3d at 320.

[134] CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573, 578 (9th Cir. 1982).

[135] Tr. vol. 3 at 127, 145-46. See supra note 5.

[136] Tr. vol. 1 at 175-76; Tr. vol. 2 at 117, 122, 127, 130-31, 214; Tr. vol. 3 at 6, 175; Tr. vol. 4 at 7, 63-65; Tr. vol. 5 at 65-66.

transactions in the corn rather than, as in the case with fungible futures contracts, in the contracts.[137] However, once again, the inferences we can draw are attenuated by recognition that the parties' status is not inconsistent with an intent to engage in price speculation without delivery.

Buckeye Carried The Substitute HTAs As Forwards On Its Books

Although this may not be the most reliable indicator, one of the factors in determining how Buckeye really viewed its HTAs is how it accounted for them financially. The Division has presented evidence that, on its balance sheet, Buckeye reported HTA positions as "part of grain inventory," the same way that it reported traditional forward contracts.[138]

Events Intervened Concerning Delivery

Perhaps the best indicator of an *ex ante* expectation of delivery is whether it eventually occurs.[139] However, the strength of this indicator depends, in large part, on the absence of intervening factors that could drive a wedge between prior expectation and subsequent action. In this case, it appears that none of the substitute farmers ever delivered on the substitute

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[137] *See supra* notes 102, 110.

[138] DX-150 at 30.

[139] *Cf.* *Kar Kim Farms*, 199 F.3d at 989; *Johnson v. Sherrer*, 29 S.E.2d 581, 586 (Ga. 1944).

HTAs. However, it also seems that none of them rolled delivery or exercised the cancellation clause either. The fact that they took none of these acts seems to have resulted from a confluence of events that post-dated the substitute farmers' entry into the HTAs: Buckeye's cessation of operations related to its bankruptcy, the Commission's investigation of Wright and Buckeye, and private attorneys counseling the substitute farmers that they had no obligation to perform under the agreements.[140] As a result of these circumstances, we can draw no substantial inferences as to the ex ante delivery expectations from the absence of delivery.

We Cannot Resolve The Issue Of Delivery Contemplation Without The Consideration Of Testimony

The objective circumstances lend support to both sides of this proceeding and are not inconsistent with either. Thus, while we cannot find for the Division on the basis of the objective factors discussed above, we cannot yet say that it failed to make its case. Thus, we now turn to the testimony of fact witnesses.[141]

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[140] See supra notes 75-79.

[141] In addition to its lay witnesses, the Division presented Gregory J. Kuserk as a an expert on the issues of whether the Buckeye HTAs constituted futures or forwards, and whether Buckeye offered and entered into illegal off-exchange options. DX-133 at 1-3; Tr. vol. 1 at 200-01. As we noted in Gorski, litigants tend not seek or present experts to give a disinterested view of the facts. [1998-1999 Transfer Binder] ¶27,742 at 48,504. Rather, they seek expert testimony that casts their cases in the best light. Sometimes, a happy coincidence of disinterested inquiry and the facts of a case can produce such results. However, experts have demonstrated a tendency to provide testimony that (continued..)

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favors the party footing his or her bill (or employing him or her) even if doing so requires gross factual distortions. See, e.g., Id. at 48,504-07. See L. Timothy Perrin, Expert Witness Testimony: Back to the Future, 29 U. Rich. L. Rev. 1389, 1389-90 (1995). For this and other reasons, determining the weight to accord an expert's opinion depends, in addition to the general factors bearing on witness credibility, on the manner in which the expert reached his opinion rather than the opinion's facial plausibility or the impressiveness of his or her resume. Id. at 48,501-04.

With respect to issues that Count I implicated, we need not delve into whether Kuserk's involvement in this case appears to stem from the best, worst or middling types of expert witness retention. Similarly, there is no need to describe his pallor, voice or physiological reactions on the stand. Moreover, there is no reason to consider whether Kuserk's analysis took into account the commercial purposes that "suspicious" substitute HTA features might serve. This is all true because following Kurserk's analysis to reach the ultimate fact determination that the substitute HTAs are futures or forwards would require us to deviate from the legal test and point of emphasis that we adopted above.

Kurserk's opinion, that the substitute HTAs were futures, turned on whether they necessarily required suppliers to assume price risks not implicated in traditional forward contracts and whether they could be used for price speculation in a manner that was similar to traditional futures. DX-131 at 8-10. If our analysis placed either of these inquiries at the pivot, we would agree with Kuserk that the Buckeye HTAs are futures and do so with a high degree of confidence. However, as we have discussed above, neither the traditional futures-forward analysis nor its HTA-specific variant turns on the issue of whether the contract at issue could be used primarily, predominantly or exclusively for price speculation. Rather, the contemplation of eventual, physical deliver is the decisive fact. Thus, taken at face value, Kuserk's opinion does not really help us in classifying the contract at issue. For this reason, we have no reason to make credibility findings.

Leach's Testimony

Leach was the only present or former Buckeye officer to take the stand at the hearing.[142] He testified that Buckeye began offering HTAs by 1991 and, from that year through 1994, no farmer failed to deliver on their HTAs nor was he aware of any supplier having cancelled delivery.[143] He also stated that, when it entered into the substitute HTAs, Buckeye had planned for the farmers to deliver to one of its elevators or deliver, for its benefit, to another elevator.[144] Moreover, Leach testified that Buckeye would not have entered into substitute HTAs with farmers who did not intend to deliver.[145]

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[142] See supra text accompanying notes 58-61.

[143] Tr. vol. 3 at 124-25.

[144] Tr. vol. 3 at 89, 133. The substitute HTAs permitted alternative delivery. Under alternate delivery, the supplier could deliver grain to an elevator other than the one with which it had contracted but for the benefit of that elevator. DX-143 at 166. The elevator taking delivery would compensate the elevator with whom the supplier contracted as though it had made the delivery and the elevator with whom the supplier contracted would then compensate the supplier in accordance with the contract under which the supplier made alternative delivery. Id. We have located nothing in the record that indicates whether the alternative delivery was unusual in cash grain marketing. Thus, we view it as the rough equivalent of ordinary delivery.

[145] Tr. vol. 3 at 133.

Testimony Offered By Some Of The Substitute Farmers

We heard 10 of Wright's farmer clients testify: William Hamman, Terry Howell, Lee Snell, Bill Fogelsong, Thomas Prince, Darryl Klein, Doug Funderberg, Bob Finkbine, Mark Grieser and Ron Spoerl.[146] Seven of these farmers (Hamman, Howell, Snell, Fogelsong, Thomas Prince, Grieser and Spoerl) either entered into or owned entities that entered into substitute HTAs.[147] This subset of the substitute farmers shared common experiences beyond their entry into the substitute HTAs and their act of testifying. As a result, they have a common interest that could affect their credibility (if we need to evaluate it).

Buckeye and, later, the trustees of its bankruptcy estate have sought to enforce the substitute HTAs against the testifying substitute farmers and continue to do so.[148] When they testified, the farmers knew of these efforts and that, if we found against Buckeye on the Section 4(a) claim, they might

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[146] See infra text accompanying notes 153-59. The Division also introduced the deposition transcripts of substitute farmers Jeffers and Agle. DX-147 at 1; DX-148 at 1. Although neither deponent appeared for cross-examination and there was no claim or showing that they were unavailable to testify, we received the depositions transcripts into evidence before the hearing and without objection. Order, dated October 1, 1999, at 3-21.

[147] See supra note 67.

[148] Tr. vol. 2 at 128, 245-46; Tr. vol. 3 at 42-43; Tr. vol. 4 at 43-45, 95-97; Tr. vol. 5 at 23-24, 110. In addition, Buckeye brought suit against Agle. DX-11 at 1.

benefit.[149] Thus, they hoped that the Division would prevail in proving that the substitute HTAs constituted futures contracts.[150] In other words, the testifying substitute farmers had an interest related to the outcome of this proceeding[151] that would tend to result in a pro-Division leaning as their testimony relates to the substitute HTAs.[152]

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149 See supra note 148.

150 Tr. vol. 2 at 128-29, 246-46; Tr. vol. 3 at 42-43; Tr. vol. 4 at 43-45, 95-97; Tr. vol. 5 at 23-24, 110.

151 This interest arises from the potential use of non-mutual collateral estoppel against Buckeye (and those in privity with Buckeye) on the issue of whether the substitute HTAs were unlawful and, therefore, unenforceable. See Bendet v. Sandoz Pharm. Corp., 308 F.3d 907, 910-11 (8th Cir. 2002).

152 In a dissenting opinion involving the review of a trial court's curtailment of questioning calculated to elicit testimony concerning a witness' interest in a criminal prosecution arising from a parallel litigation, Judge Mikva observed that such evidence "has long been regarded as highly probative in impeaching a complaining witness" and explained,

> Three reasons are commonly given for allowing impeachment of one party's witness through evidence of his litigation against the opposing party. The first is interest: where the outcome of the cause at issue may affect the witness' recovery in parallel litigation, the pecuniary interest may motivate the witness to distort his testimony. . . .
>
> A second and broader rationale is based on a view of litigation as an occurrence likely to brood hostility between opposing parties. Like the inference from interest in a related suit, this theory relies on a

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Despite the existence of this interest, the substitute farmers did not provide uniform testimony on the issue of delivery contemplation. Thomas Prince and Howell were both called by the Division and testified that, when they entered the contracts, they did not intend to deliver on the substitute HTAs.[153] Hamman and Fogelsong, both Division witnesses,[154] testified that, when they entered into the substitute HTAs, they intended to make delivery.[155] Another one of the Division's

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> "prospectant" deduction of partiality from circumstances likely to cause it. This second rationale goes beyond the first, however, and justifies an inference of partiality on the basis of litigation that is wholly unrelated to the case at bar.

United States v. Gambler, 662 F.2d 834, 843-45 (D.C. Cir. 1981) (Mikva, J. dissenting) (footnotes omitted). Accord Gorski, [1998-1999 Transfer Binder] ¶27,742 at 48,494 n.71. Interest in a proceeding, of course, does not disqualify persons from testifying nor does it render their testimony incredible per se. See id. at 48,505.

[153] Tr. vol. 2 at 228, 264; Tr. vol. 4 at 62, 110.

[154] Tr. vol. 2 at 115; Tr. vol. 4 at 5-6.

[155] Tr. vol. 2 at 153, 162; Tr. vol. 4 at 22. In his investigative testimony, Hamman indicated that he entered into the substitute HTAs with the intention of delivering that grain he grew that was not necessary to feed his livestock. DX-144 at 61. In addition, he testified that, when it became clear that he would not be able to grow enough corn to satisfy his initial delivery obligation, he placed a call to Leach to notify him as called for in the substitute HTA appendix. Tr. vol. 2 at 157.

witnesses (Snell)[156] and one of Buckeye's (Spoerl) testified that they anticipated delivering on the substitute HTAs via the alternative delivery provision but Snell later recanted in part.[157] Yet another Division witness, Grieser,[158] also revealed that he entered the contracts contemplating delivery.[159] Thus,

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156 Tr. vol. 3 at 4-5.

157 Tr. vol. 1 at 175-76 ("A[:] That was one of the . . . contract specifications, we could . . . choose where we delivered. . . . Q[:] And when you entered into the contracts, you intended to deliver the grain that was due on the HTAs with Buckeye at one of those other elevators? A[:] That's right."); Tr. vol. 3 at 33 ("Q[:] Did you intend to deliver grain in satisfaction of your Buckeye HTA to a different location? A[:] Yes, I could have."). Snell later recanted, saying that he did not intend to deliver his 1996 crop and would have delivered his 1997 crop if the price was right. Tr. vol. 3 at 34-35. Of course, as the Division argues and common sense dictates, the substitute farmers entered into these contracts because they thought the price would be right.

158 Tr. vol. 5 at 64.

159 The Division argues that Grieser testified he intended to profit by delivering under the alternative delivery provision "if he had the grain." Division Posthearing Memorandum at 35. This begs the question of whether Grieser expected to "ha[ve] the grain." The testimony to which the Division refers does not shed light on that issue. Tr. vol. 5 at 105-06; Division Posthearing Memorandum at 35 n.182. However, Grieser did testify that he contracted for a number of bushels that he expected to have the capacity to deliver (while satisfying other obligations) and that, if he grew sufficient corn to satisfy the contract, he would likely deliver. Tr. vol. 5 at 80, 107. In other words, the testimony indicates that Grieser viewed the cancellation provision as a means of addressing production risk. This would be consistent with an <u>ex ante</u> contemplation of making delivery. The inference that Grieser expected to make delivery is strengthened by his testimony that he preferred entering into the substitute HTAs as opposed to another contract because the

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credibility aside, four of the seven substitute-farmer witnesses contemplated making complete delivery of some sort, one anticipated making delivery in satisfaction of some but not all of his obligations and two did not anticipate making delivery.

Before turning to issues of credibility, we first consider the necessity of such an inquiry.[160] To be more precise, we will

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elevator offering the other "didn't have the alternative delivery clause in their contracts that I wanted." Tr. vol. 5 at 126-27, 129-30. Had Grieser not expected to deliver on the substitute HTAs, it seems unlikely that he would have cared about the existence of the alternate delivery provision.

160 By credibility, we mean both minimal credibility as well as relative credibility to the degree that testimony conflicts with other evidence. See Gorski, [1998-1999 Transfer Binder] ¶27,742 at 48,510 & n.236, 48,513 & n.271. On matters of credibility as it relates to whether unlawful conduct occurred, the Division bears the burden of persuasion concerning the minimal credibility of its witnesses as well as the relative credibility of witnesses the testimony of whom support its case. Id. Credibility assessments include consideration of issues relating to testimonial capacity such as powers of recollection, the existence of factors bearing on cognition and veracity such as bias arising from associations or an interest in the outcome of a proceeding, the consistency of testimony and the witnesses' demeanor while testifying. See id. at 48,500-14.

Should credibility assessments become necessary, we will have to grapple with potential credibility flaws beyond the substitute farmers' interest in this proceeding. For example, Howell's testimony includes at least one material inconsistency. He claimed to have executed a substitute HTA, in part, because he believed that, as a result of the cancellation clause, he had no more than 10 cents per bushel at risk (the cancellation fee). Tr. vol. 2 at 228. In other words, he claims to have understood that canceling the agreement would result only in the assessment of a 10-cent fee. Tr. vol. 2 at 228, 239-40. However, he also said that he understood spread risk and was very concerned when

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consider whether, assuming that Thomas Prince, Howell and Snell were credible, the Division has established that a critical mass of farmers entered into the substitute HTAs without the contemplation of making eventual delivery. The Division could satisfy its burden on the issue of delivery-related expectation by presenting the testimony of a critical mass of farmers credibly showing that they did not contemplate making delivery, or presenting such testimony from less than a critical mass and combining that with evidence tending to show that this testimony should be imputed to some portion of those who did not take the stand.

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he rolled the price of his substitute HTA into an inverse. Tr. vol. 2 at 230-31, 237. This begs a question. If Howell believed that his maximum exposure to loss, upon cancellation, was 10 cents per bushel, it is difficult to explain how he would have been concerned about rolling into a substantial inverse. Howell provided no explanation. This was not the only inconsistent testimony on this point. Howell also testified that he had no intent to deliver and, instead, intended to simply cancel the contract when he could do so profitably. Tr. vol. 2 at 264. If he believed that the only consequence of cancellation of a contract was the assessment of a 10-cent fee, then cancellation would not vary in terms of profitability. When combined with evidence that he has an interest in this proceeding, Howell's unexplained, inconsistent testimony could render his testimony of having no intent to deliver, because he intended to cash out when it was profitable to do so, too incredible to credit. Tr. vol. 2 at 245-48.

In this case, the substitute farmer testimony, taken arguendo as credible,[161] did not establish that a critical mass of farmers entered the substitute HTAs without an expectation of making delivery. In addition, the testimony was not accompanied by credible evidence that would provide a basis for imputing the expectations of Thomas Prince, Howell and Snell to a sufficient number of the non-testifying farmers such that we could reliably conclude a critical mass of the substitute farmers entered into the HTAs without an expectation of making delivery.[162] Read

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[161] "When the testimony of a witness is not believed, the trier of fact may simply disregard it. Normally the discredited testimony is not considered a sufficient basis for drawing a contrary conclusion." Bose Corp. v. Consumers Union of United States, Inc., 466 U.S. 485, 512 (1984). When sufficient testimony is negated on credibility grounds (and other evidence does not provide an adequate substitute), the burden of proof decides the matter. Cf. New York Life Ins. Co. v. Kaufman, 78 F.2d 398, 400 (9th Cir. 1935).

[162] The Division argues that Wright testified to the effect that (1) none of the substitute farmers intended to deliver under the substitute HTAs and (2) the substitute farmers indicated that they would not have to deliver. Division Posthearing Memorandum at 42. In support of the second point, the Division cites to line 22 of page 52 of the November 16, 1998 transcript through line 3 of page 53. Id. at 42 n.226. In reality, Wright testified that "some" of the farmers indicated that they did not intend to deliver on the HTAs. Tr. vol. 1 at 52-53, 72-73. However, the testimony that immediately followed cast into doubt whether Wright was referring to an intent not to deliver at all or an intent to delivery to an elevator other than Buckeye but for Buckeye's benefit under the alternative delivery provision. Tr. vol. 1 at 74-75. Alternative delivery did not involve cancellation of the contract. Tr. vol. 1 at 75.

The Division is correct in stating that Wright testified, "I know that many of these folks had no intentions of physically

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uncritically, the additional evidence suggests that only one additional substitute farmer did not expect to eventually make delivery on the substitute HTAs when he entered into them.[163]

As the discussion above indicates, this is a very close case on the issue of whether Buckeye violated Section 4(a). However, we must decide. Taking the circumstances as a whole, we find that the Division did not establish, by a preponderance of the evidence, that a sufficient number of persons entered into the substitute HTAs without the contemplation that they

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delivering the commodity for a variety of reasons." Tr. vol. 1 at 79; Division Posthearing Memorandum at 42 n.225. However, the testimony is hard to credit. First, we are not so sure that the 11 farmers and farming entities that entered in the contracts would be "many." In addition, five of the seven testifying substitute farmers indicated that they anticipated making some delivery under the substitute HTAs either to Buckeye or for Buckeye pursuant to alternative delivery provision. <u>See supra</u> notes 153-59. Thus, it appears that, at the very most, less than half of the substitute farmers entered into the HTAs without some expectation of making delivery. Given the fact that Wright's testimony seems like puffery, the small number of farmers who entered into substitute HTAs, the fact that substitute farmers had an incentive to testify that they did not contemplate delivery and the likelihood that they knew their own minds better than Wright did, we do not credit Wright's testimony on this point.

[163] As noted above, the Division introduced the investigative testimony of substitute farmers Jeffers and Agle. Jeffers testified that he did not intend to make delivery when he entered into the substitute HTAs. DX-148 at 75-76. Agle testified that he intended to deliver on the first substitute HTA into which he entered and, as to the second, he was unclear but declined to affirm the leading question that he did not intend to deliver on the second substitute HTA. DX-147 at 58.

would eventually make delivery on contracts such that the HTAs should be classified as futures. For that reason primarily, we conclude that the Division did not establish that Buckeye violated Section 4(a) and we dismiss this claim as to the elevator. This, however, does not fully resolve Count I or the matter of the substitute HTAs' legality.

The Division Has Not Proven That Wright Aided And Abetted Buckeye's Alleged Violations Of Section 4(a)

The complaint charged Wright with aiding and abetting Buckeye's violations of Section 4(a). Ordinarily, the failure to prove that Buckeye committed direct violations of the statute would preclude any need to consider the aiding and abetting claim further.[164] However, this is not an ordinary case. The record in the case against Wright includes stipulations into which Buckeye did not enter[165] and Wright is deemed to have admitted to every request for admission that the Division served upon him.[166] We must therefore consider whether, with this new material,[167] the Division established Buckeye's primary

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[164] See In re FSI Futures, Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,150 at 45,502 n.35 (CFTC Aug. 1, 1997).

[165] Amended Stipulations at 2.

[166] See supra note 3.

[167] This additional material is not all that it seems at first glance. "[A]mbiguities in admission requests are construed (continued..)

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against the drafter." In re Prudential Sec., Inc., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,132 at 53,919 (CFTC Aug. 8, 2002) (citing Talley v. United States, 990 F.2d 695, 699 (1st Cir. 1993); Harris v. Oil Reclaiming Co., Ltd., 190 F.R.D. 674, 678-79 (D. Kan. 1999)). In this case, that means that, to the degree the requests to which Wright is deemed to have admitted are ambiguous, we will construe them in a manner that is reasonable but least favorable to the Division.

The first ambiguity with which we must contend is temporal. The Division did not generally specify the time period covered by its requests. Division of Enforcement's First Request for Admissions By Respondent Roger J. Wright d/b/a Agricultural Marketing Service, dated December 17, 1997 ("Division Requests to Wright"), at 1-5. Thus, unless a request refers to a time period or made any other reference to circumstances that would unambiguously fix it in time, the request could be read as referring to a relevant time but might also be read as referring to periods that predate or postdate the 1991-1996 period or 1995-1996 span relevant to this count. Construction of this ambiguity against the Division means that we will read such requests as referring to time periods not relevant to this proceeding and as far removed from this proceeding as reasonable.

Division requests including, but not limited to, 54 through 56, 79, 80, 83, 86 through 90, 97, 98, 171 through 174, and 178 described acts attributed to Buckeye and/or Wright. Id. at 1, 4-5, 15-16, 21-24, 39-40. However, they make no reference to dates or other circumstances that would unambiguously relate them to the 1991-1996 time period. Id. Request number 85 refers to persons with whom Buckeye "contracted" but does not refer to a time period and does not designate the "contract[]" entered into. Id. at 22. These flaws rob Wright's deemed admissions of probity in this proceeding.

The second general ambiguity stems from the Division's use of very inclusive definitions with respect to entities. When drafting interrogatories, document requests and subpoenas, attorneys often define firms and other persons in exceptionally broad terms so as to avoid the frustration of their efforts by narrow constructions. If employed in the wrong context, this approach can backfire. It does so here.

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The Division defined "Buckeye" in manner that seems calculated to cast the net as wide as possible by stating,

> The term "Buckeye" refers to respondent Buckeye Countrymark, Inc. and any corporation, partnership, joint venture or other entity owned, controlled or operated by Buckeye, or in which Buckeye has ever been a director, officer, shareholder, agent or signatory, or otherwise had a legal or equitable interest.

Id. at 2. In other words, a request that describes an act performed by "Buckeye" could be reasonably interpreted as referring to an act performed by some firm other than "respondent Buckeye Countrymark, Inc."

This is not mere conjecture. The Division has introduced evidence that, in 1995, Buckeye owned capital stock and other equity in another elevator (Countrymark, Inc.), its then-present bank (CoBank) and "[o]ther" firms. DX-111 at 4, 10. Accordingly, every request that refers to "Buckeye" may be reasonable construed as not referring to a respondent in this proceeding but, rather, as designating another elevator, Buckeye's bank, or undesignated "[o]ther firms" in which Buckeye ever had a legal or equitable interest.

This ambiguity renders admission requests that mention "Buckeye" ambiguous and, in this proceeding, such requests will be read as referring to firms that are not respondent Buckeye. In addition, definitions that refer to "Buckeye" are ambiguous for the same reason as are requests that include those ambiguously defined terms. Thus, the Division's fearfully broad definition of "Buckeye" renders ambiguous the Division's definitions of "HTA" and "substitute HTAs." Division Requests to Wright at 2, 4-5. As a result of ambiguously defining the term "Buckeye" the Division rendered, requests 1 through 4, 54 through 56, 83 through 95, 97 through 102, 104, 105, 107 through 148, 150 through 153, 155 through 170, 173 through 177, 179, and 181 through 188 ineffectual in this proceeding to establish affirmative acts (and/or affirmative knowledge) on the part of respondent Buckeye. See id at 5-6, 15-16, 21-43.

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The Division's reference to "Buckeye" was not the only instance in which it used an otherwise proper definition in the wrong context. The Division directed a number of requests to Wright that referred to "Edwards." The Division defined "Edwards" as,

> respondent A.G. Edwards & Sons, Inc. and any corporation, partnership, joint venture or other entity owned, controlled or operated by Edwards, or in which Edwards has ever been a director, officer, shareholder, agent or signatory, or otherwise had legal or equitable interest.

Id. at 4. Thus, to the degree that Edwards had ownership interest in other firms, those other firms qualify as "Edwards" regardless of whether respondent Edwards controlled them.

Once again, the Division's definition would seem to include firms that had no connection to this proceeding other than Edwards's legal ownership of their stock. Edwards was a securities broker-dealer as well as an FCM. DX-136 at 1; Tr. vol. 2 at 30. As a result, it is likely that Edwards owned the stock of a great many firms during the time period relevant to this proceeding (as well as at other times designated by the "has ever been" language of the above-quoted definition). See Stephan J. Choi, Selective Disclosures in Public Capital Markets, 35 U.C. Davis L. Rev. 533, 549 n.70 (2002) ("Short sales involve the sale of securities that the seller does not own. Instead, the seller first borrows stock from a broker and sells the borrowed stock into the securities market."); David C. Worley, The Regulation of Short Sales: the Long and Short of it, 55 Brooklyn L. Rev. 1255, 1281 n.86 (1990) ("'Street name' refers to the practice used by broker-dealers for holding customer securities in the broker's own name for the purpose of facilitating quick transfer of those securities in the case of a resale or other transaction in those securities."). Accordingly, each term in the Division Requests to Wright that the Division defined by reference to "Edwards" and every request that refers to "Edwards" could reasonably be read as referring not to respondent Edwards but to some firm in which Edwards once held stock. Thus, requests 5 through 13, 41 through 43, 47 through 49, 62 through 66, and 70 through 82 are read as referring to firms other than respondent Edwards. See Division (continued..)

violations. Before determining whether the Division has done so however, we will consider whether Wright would be liable for any such wrongdoing.

The Commission Requires Proof Of A High Level Of Culpability For Aiding And Abetting Liability

The Act codified vicarious responsibility based on aiding and abetting in Section 13(a), 7 U.S.C. §13c(a). It states,

> Any person who commits, or who willfully aids, abets, counsels, commands, induces, or procures the commission of, a violation of any of the provisions of this chapter, or any of the rules, regulations, or orders issued pursuant to this chapter, or who acts in combination or concert with any other person in any such violation, or who willfully causes an act to be done or omitted which if directly performed or omitted by him or another would be a violation of the provisions of this chapter or any of such rules, regulations, or orders may be held responsible for such violation as a principal.[168]

This provision has been applied in enforcement and private administrative actions.[169] As a result, there is a large body of

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Requests to Wright at 6-7, 13-14, 17-21. As a result, Wright's deemed admissions to these requests establish facts of no importance to this proceeding. These are not the only manners in which some the above-listed requests are ambiguous. However, they are reason enough to show that Wright's deemed admissions are not all they appeared at first blush.

[168] 7 U.S.C. § 13c(a).

[169] <u>See</u>, <u>e.g.</u>, <u>In re Richardson Sec., Inc.</u>, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,145 at 24,642-43 (CFTC Jan. 27, 1981); <u>Webster v. Refco, Inc.</u>, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,578 at 47,702 & n.380 (ALJ Feb. 1,
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case law explaining the elements of aiding and abetting under the Act.[170]

The Commission provided a definitive construction of Section 13(a)'s "willfully aids, abets" language in Richardson. There, the Commission reviewed the legislative history of Section 13(a) and observed,

> The section was modeled after the federal criminal aiding and abetting statute, 18 U.S.C. §2. . . . The express intent of the drafters of §13(a) in doing so was to emphasize that, as under 18 U.S.C. §2, proof of specific unlawful intent to further the underlying violation is necessary before one can be found liable for aiding and abetting a violation of the Act.[171]

Having made this observation, it opined,

> By far the most important element of aiding and abetting is the sharing of the intent of the principal . . . . However, mere association between the principal and those accused of aiding and abetting is not sufficient to establish guilt; nor is mere presence at the scene and knowledge that a crime was to be committed sufficient to establish aiding and abetting. . . . Furthermore, while it is not necessary to prove that an aider and abettor participated in every phase

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1999), aff'd sub nom., Schneider v. Aiello, CFTC Docket No. 98-R009, 2000 CFTC LEXIS 212 (CFTC Sept. 29, 2000).

170 See, e.g., In re Lincolnwood Commodities, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 (CFTC Jan. 31, 1984); FSI Futures, [1996-1998 Transfer Binder] ¶27,150.

171 Richardson, [1980-1982 Transfer Binder] ¶21,145 at 24,642.

> of the criminal venture . . . he must share in the principal's essential criminal intent.[172]

On the basis of this reasoning, the Commission rejected arguments that actual knowledge of the of the primary violations need not be proven to establish liability and that "specific intent to further the underlying unlawful venture" is not a necessary element.[173] Rather, it held, "in order to violate §13(a) of the Commodity Exchange Act, one must [1] knowingly associate himself with an unlawful venture, [2] participate in it as something that he wishes to bring about and [3] seek by his actions to make it succeed."[174]

After prescribing the elements of liability under Section 13(a) (other than those concerning the primary violations), the Commission turned to the issue of whether the level of culpability necessary to establish an underlying violation affected the elements of Section 13(a) aiding and abetting.[175] It instructed, "We further conclude, based on the legislative history of Section 13(a) that only those who knowingly participate in a violation of the Act may be held to be aiders

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172 Id. at 24,643-44 (citations, quotation marks and brackets omitted).

173 Id. at 24,645-46.

174 Id. at 24,646.

175 Id. at 24,646 n.14.

and abettors, that proof of unlawful intent is necessary regardless of the mens rea required for underlying violations of the Act."[176] A short time later, the Commission reaffirmed its rejection of the notion that recklessness is sufficient culpability for aiding and abetting.[177] Thus, the culpability necessary to commit a primary violation does not reduce that necessary to incur aiding and abetting liability.[178] This begs

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[176] Id.

[177] In re Earl K. Riley Co., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,854 at 27,583-84 & n.4 (CFTC Nov. 24, 1981) (finding that Congress had intended that Section 13(a) liability "require proof of unlawful intent" and, on that basis, holding that reckless conduct "may not form the basis of aiding and abetting liability under §13(a) of the Commodity Exchange Act"). The Commission has not deviated from this holding in subsequent cases. See, e.g., In re Commodities Int'l Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,943 at 44,564 (CFTC Jan. 14, 1997); In re Murlas Commodities, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,485 at 43,160 n.42 (CFTC Sept. 1, 1995); In re Dillon-Gage, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,574 at 30,481 (CFTC June 20, 1984); Lincolnwood, [1982-1984 Transfer Binder] ¶21,986 at 28,253-55.

[178] In Lincolnwood, the Commission again considered the level of culpability for aiding and abetting under the Act and whether the standard for it depended, in any way, on the elements that would have to be proven to establish the primary violation at issue. [1982-1984 Transfer Binder] ¶21,986 at 28,253-55 & n.106. It held that Section 13(a) had an independent element of scienter that was not affected by whether or the degree to which liability for the primary violation required a showing of culpability. Id. Recognizing that it was adopting a criminal-law-like standard for aiding and abetting in a civil proceeding where criminal standards did not actually apply, it explained,

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> It may appear somewhat incongruous to employ a standard derived from criminal law in proving aiding and abetting in civil proceedings enforcing a remedial statute like the Commodity Exchange Act, particularly in those cases where the underlying violation may be established without proof of any elements of *scienter*. . . .
>
> Irrespective of the level of proof required to establish the primary violation, however, the evidentiary standards of aiding and abetting imposed by Section 13(a) are designed to assure that remedial sanctions will not be imposed against a secondary respondent who intentionally assists a primary wrongdoer but lacks knowledge of the unlawful conduct. Knowing participation thus becomes a critical focus of the inquiry and strikes a balance between punishment of the principal wrongdoer and protection of those who unknowingly assist unlawful conduct. As stated by a leading commentator in discussing aiding and abetting in the context of securities law fraud cases:
>
>> If all that is required in order to impose liability for aiding and abetting is that illegal activity under the securities laws exists and that a secondary defendant, such as a bank, gave aid to that illegal activity, the act of loaning funds to the market manipulator would clearly fall within that category and would expose the bank to liability for aiding and abetting. Imposition of such liability upon banks would virtually make them insurers regarding the conduct of insiders to whom they loan money. If it is assumed that an illegal

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the question of what Richardson's reference to "shar[ing] in the principal's essential criminal intent" means when the principal committed a primary violation without "criminal intent."

By 1984, the Commission had well-established that aiding and abetting liability required proof of knowledge and intent but the law would continue to develop on the "critical" element of knowledge as it related to "knowing participation." In Lincolnwood, the Commission stated, "Nothing in *Richardson* or *Earl K. Riley* suggests that knowing participation and intentional assistance require the Commission to establish that the aider and abettor knew the principal's activity was

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> scheme existed and that the bank's loan or other activity provided assistance to that scheme, some remaining distinguishing factor must be found in order to prevent such automatic liability.

Id. at 28,254 (quoting David S. Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution, 120 U. Pa. L. Rev. 598, 630 (1972)) (footnote omitted, emphasis added and italics in original). Accord Camp v. Dema, 948 F.2d 455, 459 (8th Cir. 1991). Based on this reasoning, the Commission held that Section 13(a) violations are distinguished by "knowing participation in and intentional assistance of unlawful conduct." Lincolnwood, [1982-1984 Transfer Binder] ¶21,986 at 28,254. It also taught that this standard applied even when establishing the existence of the primary violation at issue did not require proof of such a mental state. Id. at 28,255 n.106.

unlawful."[179] In holding that ignorance of law was no defense against an aiding and abetting charge, Lincolnwood seemed to leave the door open for concluding that, in order to aid and abet, one need not know anything other than the acts and omissions that formed the primary violation even if the acts were not patently improper or wrongful.[180] However, that possibility seems to have been foreclosed.

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[179] Id. at 28,255 (italics in original).

[180] Often, a potential aider and abettor need know nothing more than a primary wrongdoer's acts and the non-legal circumstances under which they occur to conclude that the primary actor is behaving wrongfully. Stated another way, some primary violations are the type of offenses that involve moral turpitude and are considered mala in se (i.e., inherently wrongful or naturally evil). See Jordan v. De George, 341 U.S. 223, 236 & n.10 (1951); Watson v. Murray, 23 N.J. Eq. 257, 261 (1872); Erik Luna, Principled Enforcement of Penal Codes, 4 Buff. Crim. L.R. 515, 525 n.42 (2000); John T. Parry, Culpability, Mistake, and Official Interpretations of Law, 25 Am. J. Crim. L. 1, 11 (1997); Stuart P. Green, Why It's a Crime to Tear the Tag Off a Mattress: Overcriminalization and the Moral Content of Regulatory Offenses, 46 Emory L.J. 1533, 1571 (1997) ("The term malum in se now refers to criminalized acts that would be viewed by society as morally wrongful regardless of whether they were prohibited by law.").

Some portions of the Act and Commission regulations draw technical distinctions between acts deemed proper and those considered unlawful. See, e.g., 17 C.F.R. §1.55(a) (requiring that FCMs and, sometimes, introducing brokers furnish customers with separate written disclosure statements "containing only the language set forth in paragraph (b) of this section (except for nonsubstantive additions such as captions)"). Thus, certain acts or omissions may run afoul of the law without creating an impression of impropriety in the minds of those who are not well-versed in the law as codified and judicially developed, acts or omissions that are properly classified as mala prohibita (offenses that generally do not involve moral turpitude or

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In 1991, the Commission considered the propriety of a finding that five respondents aided and abetted the non-competitive execution of wash sales.[181] In determining whether two of those respondents engaged in the "knowing participation" that could render them liable as aiders and abettors, it opined, "evidence must provide a reliable basis for inferring that, more likely than not, the facilitating respondent knew of the wrongful nature of the challenged trade at the time of his

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dereliction). See United States v. Urfer, 287 F.3d 663, 666 (7th Cir. 2002). Cf. Patrick Daugherty, Rethinking the Ban on General Solicitation, 38 Emory L.J. 67, 124 (1989); C. Boyden Gray et al., "Attempted" Environmental Crimes: a Flawed Concept, 14 J. L. & Politics 363, 378-79 (1998). To the degree that the Commission deemed it important to distinguish between the sufficiently ill willed and those who were not (but may have been negligent or even reckless) in assigning aiding and abetting liability, the distinction between mala prohibita and mala in se primary violations matters a great deal.

One could argue that the mala in se-mala prohibita distinction has less importance when a respondent is a government-licensed participant in an industry as heavily regulated as the one over which the Commission presides. This assertion would rest on the notion that industry registrants are presumed to know the law. The Commission has rejected the presumption that registrants know the law in the context of determining whether the Division proved knowing participation by an alleged aider and abettor. In re Buckwalter, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,995 at 37,679, 37,686 (CFTC Jan, 25, 1991). Moreover, Wright was not an industry registrant during the relevant time.

181 In re Bear Stearns & Co., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,994 at 37,665 (CFTC Jan. 25, 1991).

participation."[182] Finding insufficient evidence in the record to support an inference of such knowledge on the part of two respondents, the Commission dismissed the aiding and abetting claims against them.[183]

Bear Stearns did not explain precisely what it meant by "wrongful." In light of Lincolnwood's guidance that ignorance of the law is generally no excuse and the lack of any indication in Bear Stearns that the Commission intended to abrogate the older case law, we take the Bear Stearns reference to "wrongful" to comport with the lawyer's understanding of the term and to mean illegal, injurious, heedless, unjust, reckless or unfair.[184]

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182 Id.

183 Id. at 37,665-66. In re Mayer, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 at 46,137 (CFTC Feb. 25, 1998), considered whether the Division had succeeded in proving that a respondent, charged with facilitating another in bucketing a trade, had engaged in "knowing participation in the illegal trades." Examining the proven circumstances and relying on Bear Stearns, the Commission found "an adequate basis for concluding that [the respondent] knew of the wrongful nature of the challenged trade at the time of his participation." Mayer, ¶27,259 at 46,137. Thus, it still seems that the Commission adheres to the principal that aiding and abetting liability depends on proof that the alleged aider and abettor knew that the person who committed the primary violation was acting in a wrongful manner.

184 Black's Law Dictionary 1446 (5th ed. 1979). It seems that Bear Stearns took a page from securities law. Until fairly recently, the Securities Exchange Act of 1934 did not contain an aiding and abetting provision. Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 182 (1994); SEC v. Fehn, 97 F.3d 1276, 1282-83 (9th Cir. 1997). See Private

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When a primary violation is not inherently unlawful, oppressive or otherwise injurious, proof that a respondent knew the acts that constituted the primary violation were wrongful may be difficult to present.

In its posthearing brief, Division limited its argument on the issue of whether Wright aided and abetted violations of Section 4(a) to the following:

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Securities Litigation Reform Act of 1995, Pub. L. 104-67, §104, 109 Stat. 737 (1995). Before the Supreme Court held to the contrary, federal courts read the federal securities law as providing an implied private right of action for aiding and abetting securities fraud. Central Bank, 511 U.S. at 192 (Stevens, J., dissenting). In determining the elements of aiding and abetting violations of the 1934 Act, the courts looked to the common law concepts embodied in Section 876(b) of the Restatement (Second) of Torts and 18 U.S.C. §2, two aiding and abetting provisions that have been described as roughly similar. Central Bank, 511 U.S. at 181; SEC v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974); Landy v. FDIC, 486 F.2d 139, 162-64 (3rd Cir. 1973); Brown v. Senex Corp., No. 74-80, 1975 U.S. Dist. LEXIS 16422, at *5 (E.D. Ky. Aug. 27, 1975). Section 876(b) reserves aiding and abetting liability for a person who knows the primary wrongdoer's "conduct constitutes a breach of duty." Restatement (Second) of Torts §876(b) (1979). As a result, a number of the federal courts required a defendant to have awareness that his acts in furtherance of a primary securities law violation were part of an overall activity that was "improper" in order for him to be held responsible for aiding and abetting a securities law violation. Cleary v. Perfectune, Inc., 700 F.2d 774, 777-78 (1st Cir. 1983) ("The plaintiffs have failed to offer any indication that the defendants had actual awareness of the impropriety of McHugh's activity . . . ."); Investors Research Corp. v. SEC, 628 F.2d 168, 178 (D.C. Cir. 1980); Woodward v. Metro Bank of Dallas, 522 F.2d 84, 95 (5th Cir. 1975); Coffey, 493 F.2d at 1316.

> Since Wright, among other things, formulated the terms of Buckeye's plan, drafted the Appendix, and solicited the [s]ubstitute HTAs, he knowingly participated in Buckeye's illegal venture and sought by his actions to make it succeed. Therefore he aided and abetted Buckeye's violation of Section 4(a) and is liable for that violation pursuant to Section 13(a) of the Act.[185]

This claim that Wright "knowingly participated in Buckeye's illegal venture" rests on one of two notions,[186] that Wright knew the substitute HTAs were futures or that it was not necessary for him to know they were futures provided he was aware of the facts that would support a conclusion that the contracts were futures.[187] The latter idea we reject on legal grounds. As for whether Wright knew the contracts were, in fact futures, we turn to the record.

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185 Division Posthearing Memorandum at 75. The Division makes a nearly identical and terse argument in its proposed findings. Division Proposed Findings at 44.

186 The argument could also rest on the proposition that an aider and abettor need merely know that acts he performs are assisting a venture, regardless of whether he knows the nature of the venture or the ultimate facts that would establish the venture's illegality. Such an argument would be plainly wrong in light of Commission precedent.

187 As the preceding discussion indicates, applying the relevant law to an HTA to determine its nature does not automatically lead to a conclusion on the issue of whether the contract was a forward or futures. Thus, the inability to use ignorance of the law as an excuse is different than claiming not to have put two and two together to reach a conclusion on the topic.

The Division does not direct us to evidence supporting the inference that, in late 1995 and early 1996, Wright knew the substitute HTAs were futures.[188] Thus, it seems to think the fact was obvious. As touched on above, HTAs are not futures _per se_ nor are they obviously futures. In addition, there is no evidence that HTAs were widely held out as such.[189] Moreover, the Buckeye substitute HTAs did not purport to be futures on

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[188] _See_ Division Posthearing Memorandum at 75; Division Proposed Findings at 44. In his answer, Wright was ambiguous on the topic. On the issue of the cancellation clause, he first stated, "Wright frequently told his clients and two elevator managers that as far as he understood the regulations and laws of the state and federal origin, [various practices of canceling delivery contracts for cash settlement, regardless of whether cancellation was privately negotiated or a right provided by contract,] were illegal unless the transfer of the title of grain also was exchanged." Wright Answer at 6 (emphasis omitted). However, he also wrote,

> In November, 1995, Wright solicited farmers for Buckeye to sign HTA contracts that included a cash settlement provision, which Wright had come to believe was not to be illegal because such cash settlement provisions had become widespread throughout the industry . . . . Given that all the elevators were operating under the auspices of the Commission and respective [s]tate [d]epartments of [a]griculture and that it was common knowledge that cash settlement had become a frequent marketing tool, Wright concluded that such cash settlements were not a violation of the Act.

_Id._ at 24.

[189] We do not equate holding HTAs out as futures with holding them out as contracts that include features that might lead a court to conclude they were futures.

their face and the elevator did not hold them out as nominal futures. Finally, the Division did not produce evidence sufficient to support the inference that, when Wright helped draft the substitute HTAs, pitched them to farmers or advised the substitute farmers on matters such as rolling the reference prices, he believed them to be futures or any other type of contract that was wrongfully offered or entered into on a farmer-to-elevator basis. There being insufficient evidence to establish the necessary knowledge on Wright's part, our analysis need go no further and, for the reasons set forth above, we **DISMISS** Count I of the Amended Complaint as it relates Wright.

The Division Failed To Prove That Buckeye Offered Or Entered Into Illegal, Off-Exchange Options

Our dismissal of the Section 4(a) claims does not fully dispose of the charges related to Buckeye's HTA program. The Amended Complaint alleges that Buckeye violated Section 4c(b) of the Act and Rule 32.2 by offering and entering into off-exchange agricultural option contracts in connection with its HTAs and charges Wright with aiding and abetting those violations.[190] The resolution of this count turns on issues that the parties largely overlooked but we cannot ignore.

[190] Amended Complaint, ¶¶49-51.

Congress and Commission combined to make the offering of and entry into off-exchange agricultural options per se illegal during the relevant period of time. Pursuant to Section 4c(b),

> [n]o person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this chapter which is of the character of, or is commonly known to the trade as, an "option", . . . "put", [or] "call", . . . contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe.[191]

During most of the relevant period, Commission Rule 32.2 stated,

> No person may offer to enter into, confirm the execution of, or maintain a position in, any transaction in interstate commerce involving wheat, cotton, rice, corn, . . . and frozen concentrated orange juice if the transaction is or is held out to be of the character of, or is commonly known to the trade as, an "option," "privilege," "indemnity," "bid," "offer," "put," "call," "advance guarantee," or "decline guarantee," . . . .[192]

Rule 32.1(a) provides an exception to this general prohibition for "commodity option transactions conducted or executed on or subject to the rules of a contract market or foreign board of

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[191] 7 U.S.C. §6c(b).

[192] 17 C.F.R. §32.2 (1994) (emphasis added); Restrictions on Exempt Commodity Options, 57 Fed. Reg. 27925, 27925-26 (1992). Prior to a 1992 amendment, Rule 32.2 prohibited transactions in options involving agricultural futures as well as those involving agricultural commodities. 17 C.F.R. §32.2 (1991). In this discussion, the term "agricultural options" serves as a general reference to contracts described in Rule 32.2.

trade."[193] Thus, to establish a violation of Section 4c(b) and Rule 32.2, the Division must prove that Buckeye offered to enter into, entered into, confirmed the execution of, or maintained a position in off-exchange[194] agricultural options.[195] The Division need not prove any level of culpability in order to establish a Rule 32.2 violation[196] but it must prove more than the existence of off-exchange agricultural options transactions.

Most of Buckeye's suppliers were located in Ohio.[197] This facet of the proceeding gives Rule 32.2's reference to

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193 17 C.F.R. §32.1(a).

194 The term "off-exchange" refers to transactions not conducted or executed on or subject to the rules of a contract market or foreign board of trade.

195 By options, we mean contracts that are commonly referred to as options or that have the character of options.

196 Rule 32.2 appears to impose an absolute prohibition and the Commission enacted no explicit or implicit exception based on lesser levels of culpability. Accordingly, we read Rule 32.2 as imposing strict liability.

197 DX-4 at 1-2; DX-7 at 3; DX-11 at 1; DX-12 at 1; DX-15 at 1; DX-16 at 7, 32; DX-17 at 1; DX-18 at 5; DX-19 at 51; DX-20 at 1, 16; DX-22 at 40; DX-23 at 15; DX-24 at 19; DX-26 at 1; Dx-27 at 1; DX-28 at 31; DX-29 at 3; DX-30 at 1; DX-31 at 19; DX-33 at 63; DX-36 at; DX-37 at 1; DX-38 at 1; DX-39 at 4; DX-41 at 8; DX-42 at 1; DX-43 at 2; DX-44 at 1; DX-45 at 1; DX-44 at 46; DX-47 at 10; DX-48 at 64; DX-49 at 2; DX-50 at 1; DX-52 at 4; DX-55 at 1; DX-57 at 41; DX-59 at 5; DX-62 at 1; DX-64 at 1; DX-65 at 15; DX-66 at 2; DX-67 at 64; DX-68 at 8; DX-69 at 2; DX-70 at 3; DX-71 at 12; DX-74 at 3; DX-75 at 5; DX-76 at 5; DX-77 at 1; DX-78 at 3; DX-81 at 32; DX-82 at 1; DX-83 at 1; DX-84 at 1; DX-85 at 1; DX-86 at 2; DX-87 at 2; DX-89 at 3; DX-90 at 1; DX-91 at 28; DX-93 at 1; Dx-95 at 1; DX-96 at 1; DX-97 at 1; DX-98 at 1;

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interstate commerce added importance. Thus, before considering whether Buckeye's options transactions with its suppliers and related offers constituted the offer of or entry into off-exchange options, we will assume that they did and consider whether such transactions were proven to occur in "interstate commerce."

Agricultural commodity transactions do not necessarily occur in interstate commerce.[198] Thus, in order to determine whether the transactions at issue have been proven to so occur in this proceeding, we must first determine the meaning of Rule 33.2's reference to "any transaction in interstate commerce." In its quasi-legislative capacity, the Commission ruled[199] that, for purposes of the Part 32 regulations, the term "'interstate commerce' shall be construed and have the same meaning as set

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DX-99 at 1; DX-100 at 4; DX-101 at 14; DX-102 at 5; DX-105 at 23; DX-121 at 4, 11; DX-151 at 59-61, 75, 97-101, 104-09.

[198] See, e.g., Big Sky v. S & H, Inc., PACA Doc. No. R-94-0225, 1996 WL 935369, at *11 (USDA Aug. 19, 1996). See infra note 204.

[199] When a lawmaker employs a term and defines it, we read the term to mean its literal definition. See In re New York Currency Research Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,222 at 45,907-11 (ALJ Jan. 12, 1998), rev'd, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,223 at 45,915 (CFTC Feb. 6, 1998), rev'd sub nom., New York Currency Research Corp. v. CFTC, 180 F.3d 83 (2d Cir. 1999).

forth in Sections 1a(13) and 2(b) of the Act."[200] Section 1a(13) defines "interstate commerce" as,

> commerce . . . (A) between any State, territory, or possession, or the District of Columbia, and any place outside thereof; or (B) between points within the same state, territory, or possession, or the District of Columbia, but through any place outside thereof, or within any territory or possession, or the District of Columbia.[201]

This definition excludes a great deal of commercial transactions and Congress apparently recognized this because it supplemented the definition with Section 2(b) of the Act. It states,

> For the purposes of this chapter (but not in any wise limiting the definition of interstate commerce in section 2 of this title) a transaction in respect to any article <u>shall be considered to be in interstate commerce if such article is part of that current of commerce usual in the commodity trade whereby commodities and commodity products and by-products thereof are sent from one State, with the expectation that they will end their transit, after purchase, in another</u>, including in addition to cases within the above general description, all cases where purchase or sale is either for shipment to another State, or for

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[200] 17 C.F.R. §32.1(b)(2). It is important to note that, when the Commission apparently intended to describe activity that did not necessarily occur in interstate commerce but that involved the means or instrumentalities of interstate commerce, it had no difficulty finding words that clearly expressed that intent. <u>See</u> 17 C.F.R. §30.9 ("It shall be unlawful for any person, by use of the mails or by any means or instrumentality of interstate commerce . . . ."); 17 C.F.R. §31.3 ("It shall be unlawful for any person, by use of the mails or by any means or instrumentality of interstate commerce . . . ."). We take this different language to reflect a difference in rulemaking intent. <u>See</u> <u>New York Currency</u>, [1996-1998 Transfer Binder] ¶27,222 at 45,908 & n.38, 45,910 & n.52.

[201] 7 U.S.C. §1a(13) (footnote omitted).

> manufacture within the State and the shipment outside the State of the products resulting from such manufacture. Articles normally in such current of commerce shall not be considered out of such commerce through resort being had to any means or device intended to remove transactions in respect thereto from the provisions of this chapter.[202]

A cursory reading of Section 2(b) reveals its lack of precision and the need for information concerning relevant market practices in order to apply its terms reliably. We have located no Commission guidance with respect to this supplemental definition. However, that does not mean we have nothing upon which to rely.

Congress first tried to regulate commodity futures trading through the Futures Trading Act of 1921.[203] The Supreme Court struck down this legislation as an unconstitutional exercise of taxation authority that was otherwise unsustainable on commerce clause grounds since, among other things, Congress did not purport to rest the 1921 Act on its interstate commerce authority.[204] The legislature almost immediately took another crack at regulating futures trading and, with the Grain Futures

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[202] 7 U.S.C. §3 (emphasis added).

[203] Pub. L. No. 67-66, 42 Stat. 187 (1921).

[204] _Hill v. Wallace_, 259 U.S. 44, 67-69 (1922). _Hill_ held that grain sales for future delivery are not _per se_ transactions in interstate commerce. _Id._ at 69.

Act of 1922, took pains to ensure that the next effort would pass judicial scrutiny on commerce clause grounds.

In drafting the 1922 Act, Congress made explicit findings concerning the relationship between commodity futures trading and interstate commerce and, thus, placed the topic within the ambit of its authority to act.[205] In addition, it defined "interstate commerce," with an eye to legislation that had passed constitutional scrutiny.[206] To be more precise, Congress borrowed from the then-recently upheld[207] Packers and Stockyard Act of 1921.[208] Over time, tribunals have resolved a number of disputes concerning the PACA and PSA definitions of "commerce" and "interstate commerce." In these decisions, we find the most

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[205] 7 U.S.C. §5. See Grain Futures Act: Hearings Before the Committee on Agriculture, 67th Cong 2 (1922) ("Hearings").

[206] Hearings at 2-4.

[207] Stafford v. Wallace, 258 U.S. 495, 524-27 (1922), citied in Hearings at 4.

[208] Hearings at 2-4, 9. The Packers and Stockyard Act ("PSA") employs the term "commerce" in the same fashion that the Act and Commission use "interstate commerce" and, as a result of congressional reliance on the PSA, the definition of "commerce" and the Section 2(b) definition of "interstate commerce" are nearly identical. Compare 7 U.S.C. §§1a(13), 3 with 7 U.S.C. §§182(a), 183. These were followed by similar and, by this time, tried and tested, definitions of "interstate commerce" in the Perishable Agricultural Commodities Act, 1930 ("PACA"). See 7 U.S.C. §499a(b); In re Fresh Approach, Inc., 44 Agric. Dec. 1546, 1563 (1985).

useful guidance for construing the Act's definitions of interstate commerce.

Generally, the government must prove the elements of a violation before a sanction can be imposed in an administrative proceeding.[209] This general rules appears to hold on the issue of whether a transaction occurred in interstate commerce. Bruhn's Freezer Meats of Chicago, Inc. v. USDA, 438 F.2d 1332, 1339 (8th Cir. 1971), considered, among other things, whether a USDA judicial officer had erred in finding that certain persons had violated the PSA. The appellants argued that they did not fall under the definition of "packer" as set forth in 7 U.S.C. §191, a definition that described a "packer" as a person who performed certain acts "in commerce."[210] The court found that the appellants engaged in the manufacturing or preparing of meats or meat food products which, if done "in commerce," would

[209] 5 U.S.C. §556(d).

[210] Bruhn's, 438 F.2d at 1336-39. At the time, 7 U.S.C. §191 (1970) defined a "packer" as,

> any person engaged in the business (a) of buying livestock in commerce for purposes of slaughter, or (b) of manufacturing or preparing meats or meat food products for sale in commerce, or (c) of manufacturing or preparing livestock products for sale or shipment in commerce, or (d) of marketing meats, meat food products, livestock products, diary products, poultry products . . . in commerce . . . .

fit the 7 U.S.C. §191(b) (1970) definition of "packer" but held, "An additional element must be proved however, in order to satisfy the definition of the term 'packer,' namely that petitioners' manufacturing or processing activities were performed on meats or meat food products 'for sale or shipment in commerce.'"[211] Thus, it ruled that, if Congress prescribes or proscribes activity that occurs in interstate commerce, an agency seeking to prove a violation of the statute through engagement in (or a failure to perform) the activity must prove that the violative conduct occurred in interstate commerce or in a manner that is considered by law as the equivalent of interstate commerce.[212] Seeing no authority to deviate from the general burden of proof rules, we hold that the Division must prove a respondent entered into, offered to enter into, confirmed the execution of, or maintained a position in an enumerated option "in interstate commerce" in order to establish that a violation of Rule 32.2 occurred.

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[211] Bruhn's, 438 F.2d at 1338-39.

[212] Bruhn's found that the appellants performed its packing activity "in commerce" based on the rule that, if post-sale transportation is incidental to a purchase or sale and it is understood by the purchaser and seller that the good was promptly going to be transported across state lines after the sale, then the sale itself was part of interstate commerce as much as if it occurred by the seller shipping the good across state lines to the purchaser. Id. at 1339-40.

One unusual aspect of the Act's definition of transactions that are considered to occur in interstate commerce is the dispositive role of a respondent's awareness of attendant circumstances in the determination of whether otherwise strict-liability offenses occurred.[213] As set forth above, the Act mandates that we consider a commodity transaction to occur in interstate commerce "if [the commodity] is part of the current of commerce usual in the commodity trade whereby commodities and commodity products and byproducts thereof are sent from one State, with the expectation that they will end their transit, after purchase, in another."[214] The reference to an

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213 It also bears noting that Congress chose not to include the phrases such as "affect interstate commerce," "affecting interstate commerce" or "affects interstate commerce" in Section 1a(13) or 2(b) even though, in other contexts, it has used such words to define the reach of substantive provisions. See, e.g., 18 U.S.C. §1510(d)(1)(A) (1994) ("Whoever . . . acting as . . . an officer . . . of a person engaged in the business of insurance whose activities affect interstate commerce . . . ."); 18 U.S.C. §1515(a)(1)(D) (1994) ("the term 'official proceeding' means . . . a proceeding involving the business of insurance whose activities affect interstate commerce"); 42 U.S.C. §274e(a) (1994) ("It shall be unlawful for any person to knowingly acquire, receive, or otherwise transfer any human organ for valuable consideration for use in human transplantation if the transfer affects interstate commerce."). Given this demonstrated ability to use words that clearly convey the intent to impose specific prohibitions or prescriptions upon persons or acts that merely "affect" interstate commerce, the use of more restrictive language in Sections 1a(13) and 2(b) support the inference that Congress had a different intent when it drafted them. Cf. New York Currency, 180 F.3d at 90.

214 7 U.S.C. §3.

"expectation" that goods will ultimately cross state lines in some form not only indicates a particular (though not necessarily heightened) state of mind,[215] it amounts to a double-edged blade. First, it requires us to consider transactions to occur "in interstate commerce" even though neither the transacted commodity, its product nor its byproduct ever cross a state lines if there was an expectation that some portion, product or byproduct of the commodity would do so. On the other hand, a sale would not be considered interstate commerce if there was insufficient proof of an expectation that that the commodities or its products or byproducts had or would cross state lines even if one of them ultimately did or had done so in a previous transaction.

While this expectation (or its absence) can prove dispositive, it is like most mental states, adducible from evidence of the relevant circumstances. However, the mere fact that a transaction involves a commodity that is often shipped in some form across state lines is an insufficient basis from which to infer the expectation of interstate shipment. For example, the Department of Agriculture considered whether a transaction occurred in "interstate or foreign commerce," as defined by

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[215] Cf. Fresh Approach, 44 Agric. Dec. at 1565.

PACA[216] in <u>DeBacker Potato Farms, Inc. v. Pellerito Foods, Inc.</u>, 57 Agric. Dec. 770, 770-772 (1998). In that case, the complainant shipped bulk loads of potatoes to a respondent for processing and distribution.[217] Turning to the jurisdictional issue of interstate commerce, the agency observed that PACA's definition of interstate commerce "is narrower in scope than the constitutional scope of commerce."[218] Observing that the potatoes moved between the parties in intrastate commerce and finding the record silent as to where they would be shipped following processing, the agency found no indication that it was contemplated the potatoes (or their products or byproducts) would move in interstate (or foreign) commerce.[219] On that grounds, it dismissed the complaint.[220]

<u>Jackson v. Harrisburg Daily Market, Inc.</u>, 198 F. Supp. 490 (M.D. Pa. 1961), illustrates one of the clearest instances when an intrastate sale is considered to occur in interstate commerce. It involved a sale of fruit between two persons located in Pennsylvania wherein the fruit was to be shipped from

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216 <u>See</u> <u>supra</u> note 208.

217 <u>DeBacker Potato</u>, 57 Agric. Dec. at 771-72.

218 <u>Id.</u> at 772.

219 <u>Id.</u> at 772-73.

220 <u>Id.</u> at 773-74.

a Pennsylvania orchard to a Pennsylvania cold storage facility.[221] The defendant argued that the sale did not constitute a transaction in interstate commerce.[222] The court disagreed based on a finding that, "at the time of the sale," that the buyer intended to ship the fruit to New York.[223] Thus, the court effectively deemed the intrastate transaction to occur in interstate commerce based on the seller's awareness that, as a result of the sale, the fruit would enter the stream of interstate commerce.

Intrastate transactions may be deemed to occur in interstate commerce even if the buyer never resells the products to a person that will ship them across state lines and, at the time of the purchase, knows this with complete certainty. For example, In re Fresh Approach, Inc., 51 B.R. 412, 414, 424-25 (Bankr. N.D. Tx. 1985), considered whether certain perishable commodity transactions between the debtor and third party that were both located in Texas and that involved shipments from one point in Dallas to another point in the same city occurred in interstate commerce for purposes of the PACA. Given the intrastate nature of the purchase at issue, this required a

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[221] 198 F. Supp. at 491.

[222] Id. at 492.

[223] Id. at 491-92.

determination of whether the transactions should be considered to have occurred in interstate commerce.[224] In making that determination, the Court considered (1) whether the debtor was one of the intermediaries in the stream of commerce flowing from the producers in various states to the consumers in Dallas, Texas, (2) whether the debtor contemplated that the transactions at issue would be part of that stream and (3) whether the dealings at issue were typical for the debtor and in the industry.[225] Finding the evidence sufficient to resolve all three issues in the affirmative,[226] the court concluded that the transactions were considered to have occurred in interstate commerce.[227]

Sometimes, the government can establish that specific transactions should be considered to occur in interstate commerce without presenting interstate-related evidence as to the specific transactions at issue. For example, a Court of

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224 See Fresh Approach, 51 B.R. at 425.

225 Id. at 426-27.

226 The Court referred to evidence that a majority of produce purchased by the debtor originated from out of state, evidence that the debtor had sought federal licensure that was necessary for such interstate business and was thus aware of the interstate nature of the purchases, and testimony that the manner in which the debtor tapped into the interstate produce market was typical of the industry. Id. at 426-27.

227 Id. at 427.

Appeals reviewed a Department of Agriculture ruling in which the agency found that certain intrastate fruit should have been considered to have occurred in interstate commerce because (1) the fruits in question regularly move in interstate commerce, (2) the respondent regularly engages in interstate purchases and sales of produce and (3) the respondent sold some of the fruits purchased in the transactions at issue to a national hotel chain.[228] The court held that, in order to establish that an intrastate transaction should be considered to have occurred in interstate commerce, the agency need not prove that a particular shipment was intended for interstate commerce if it has proven that the shipment is of the type that commonly moves in interstate commerce and the charged produce dealer who shipped it for resale does a substantial portion of its business in interstate commerce.[229]

In this case, the Division seemed to believe that whether or not it established the alleged options transactions to have taken place in interstate commerce was irrelevant.[230] As a result, it did not try to prove that Buckeye regularly did business with out-of-state suppliers or customers, regularly

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[228] Produce Place v. USDA, 91 F.3d 173, 175 (D.C. Cir. 1996).

[229] Id. at 175.

[230] See Division Posthearing Memorandum at 53-55.

received shipments of grain that originated from outside of Ohio, or regularly sold grain to people outside of the state or who resold Buckeye's grain (or its products or byproducts) out of state.[231] As a result, there is an insufficient basis upon which to adopt the Produce Place approach and presumptively consider each Buckeye grain transaction to have occurred in interstate commerce. In other words, whether Buckeye's options transactions occurred or are considered to have occurred in interstate commerce must be determined on a transaction-by-transaction basis.

The Division argues that Buckeye offered to enter into illegal, off-exchange options when it: (1) "orally offered in a conversation with Wright to enter into corn calls with AMS in February 1995;" (2) offered to enter into options as an inducement for prospective signatories of the substitute HTAs; (3) offered options to the substitute farmers after they entered into the substitute HTAs; and (4) confirmed the execution of option transactions to the substitute farmers; and (5)

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[231] The Division presented evidence that Buckeye sells some of its grain through Countrymark. DX-142 at 22. However, it also presented evidence that Countrymark's facilities included "a grain elevator . . in Hamilton County, Ohio." DX-11 at 32. Accordingly, the evidence falls short of providing sufficient support to the notion that sales made through Countrymark resulted in Ohio grain leaving the state in any form or that Countrymark's Ohio representative did not effect the transaction from an Ohio location.

maintained positions in options related to the substitute HTAs.[232] The options that garner most of its attention, those related to the substitute HTAs, raise the most problems for the Division.

The substitute farmers all resided in Ohio.[233] There is no indication that they or Buckeye contemplated that delivered grain might include some that came from outside of Ohio.[234] Thus, if Buckeye and the substitute farmers were option counter-parties, the transactions did not occur in interstate commerce as Congress defined it. It does not appear that they could be considered to have occurred in interstate commerce if the Division is correct in asserting that Buckeye was dealing in off-exchange options.

There is no evidence that either the substitute farmers or Buckeye contemplated that the options would result in the shipment of grain (in any form) across state lines (either

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[232] Division Posthearing Memorandum at 53-55 & n.253.

[233] DX-10 at 1; DX-11 at 113; DX-37 at 1-7; DX-43 at 2-6; DX-46 at 44; DX-49 at 2; DX-69 at 2-7; DX-70 at 3-21; DX-84 at 2-8; DX-98 at 2-8; DX-109 at 2-6; DX-136 at 66.

[234] As touched on above, the Division argues that the a number of the substitute farmers did not contemplate delivering grain to Buckeye. Division Posthearing Memorandum at 64. To the degree that the Division's argument is correct, those farmers did not contemplate making any delivery on HTAs or options and, therefore, did not contemplate making delivery with out of state corn.

upstream or downstream). To be more precise, there is no evidence that the substitute farmers wrote options in connection with the substitute HTAs or contemplated exercising the options they might purchase. Rather, the weight of the evidence indicates that the Buckeye provided the ability to purchase (and substitute farmers contemplated purchasing) puts for no reason other than price speculation.[235] Because the substitute HTA parties did not contemplate that the related options would result in the interstate shipment of grain in some fashion, we cannot consider purchases of those options to have occurred in interstate commerce if the farmers purchased the options directly from Buckeye.[236] Other Buckeye-related options, however, would be considered to have occurred in interstate commerce even if Buckeye was the suppliers' counter-party.

As discussed above, AMS wrote options and did not do so merely for purposes of price speculation.[237] If we assume that Buckeye was the purchaser of the calls, the evidence would lead us to conclude that Wright and Buckeye both understood the

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235 Tr. vol 1 at 33.

236 Even if it was contemplated that the substitute HTA suppliers would exercise their puts, there is no evidence that they intended to sell grain that originated from out of state.

237 DX-2 at 4-5.

possibility of option exercise[238] and that, if they were exercised, part of the grain that would be delivered in satisfaction of AMS' obligations would come from Indiana.[239] For these reasons the evidence supports the inference that the sale of the AMS options was part of that current of commerce in the commodity trade whereby commodities are sent from one state, with the expectation that they will end their transit, after purchase, in another.[240] In addition, the record supports the inference that shipments of grain from farmers (and brokers) to elevators was a common practice. Accordingly, if our assumption that AMS sold off-exchange options to Buckeye was proven, we would consider AMS' sale of options to have occurred in interstate commerce. In addition, there is another transaction that occurred in interstate commerce regardless of whether Buckeye dealt in off-exchange options.[241]

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[238] DX-2 at 4-5, 9; Tr. vol. 1 at 37.

[239] DX-142 at 115-16, 170; DX-151 at 59-61, 97-101, 105-09.

[240] For reasons discussed below, we assume but do not yet find that AMS wrote off-exchange options and Buckeye was the purchaser.

[241] In connection with a Buckeye HTA, an Indiana resident named Darryl Klein purchased puts. DX-56 at 1-2. This transaction, be it an order placed with Buckeye for its execution or a sale from Buckeye to Klein, was effected between parties located in different states and, thus, occurred in interstate commerce as the Act defines it. 7 U.S.C. §1a(13)(A).

For the reasons discussed above, the AMS option transactions as well as that with Klein could run afoul of Rule 32.2 but those with the substitute farmers could not as a result of their intrastate nature. Having narrowed the field, we now turn to the issue of whether Buckeye actually offered and entered into off-exchange agricultural options.

The parties seem to believe that the evidence supported only two theories, that Buckeye offered and entered into off-exchange options or that the option transactions in question were "embedded" in the HTAs.[242] However, the evidence supports an alternative theory, one that would bring all of Buckeye's option transactions into the realm of interstate commerce and indicate wrongdoing on the part of Buckeye but one that directly contradicts the Division's Rule 32.2 case. To be more precise, the Division's evidence lends a great deal of support to the theory that, rather than acting as the counter-party to its suppliers' option purchases and sales, Buckeye acted as an unregistered, non-clearing FCM that offered credit to its suppliers and effected the purchases and sales, on behalf of its suppliers, though its account carried at a registered FCM, and in options on futures contracts that were traded on and subject to the rules of the Chicago Board of Trade ("CBOT"), a

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[242] Division Posthearing Memorandum at 53-58; Buckeye Posthearing Memorandum at 34-37.

Commission-designated contract market.[243] For example, the Division introduced the following, transcribed colloquy between one of its attorneys and Leach.

> Q. Does Buckeye Countrymark incorporate the use of options as enhancements in its hedge-to-arrive program?
>
> A. Yes, sir.
>
> Q. Okay. And how does it do so?
>
> A. As you just described, basically, we will permit the buying and selling of options to enhance the final pricing of the grain.
>
> Q. Okay. And how do you go about doing that?
>
> A. The farmer says . . . this looks like something I think would help or give us some enhancement. After that's agreed upon, we would place an order and, as an example, buy the call.

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[243] Tr. vol. 1 at 32-34, 37-38; Tr. vol. 3 at 109; DX-53 at 157 (explaining how an options transaction results in a new HTA contract); DX-150 at 49; DX-151 at 55 (stating, in a letter from Buckeye to Wright, "We will buy puts for your clients if they pay for the cost of the put plus a 1/2¢/per Bu. service charge."). This evidence also took the form of account statements for what appears to be Buckeye's regulated futures and options account through which Buckeye bought and sold puts and calls and, sometimes, permitted options positions to stay open until exercised. DX-129 at 1, 66. Perhaps not realizing the import of such evidence, the Division adduced some of it through leading questions. Tr. vol. 1 at 32-33.

It comes as no surprise that Buckeye failed to embrace this theory. After all, claiming that it acted as an unlicensed broker could have prompted the Division to amend the complaint in this proceeding or simply initiate a second enforcement proceeding. Had the Division pled this claim, it might have placed itself in a no-lose situation as to Buckeye.

Q. With FCC[244] you'd place the order?

A. That is correct.

. . . .

Q. What about the selling of options? Does Buckeye Countrymark do that for a customer?

A. We have done that, yes.[245]

Buckeye's offer to perform option transactions for its Ohio and Indiana customers on the CBOT through its Iowa-based FCM[246] would amount to an offer to effect the purchase and/or sale of options in interstate commerce.[247] Similarly, the purchases and sales would have occurred in interstate commerce. However, such offers and transactions would not appear to violate Rule 32.2 since Rule 32.1(a) permits purchases and sales that occur on the floor of a Commission-designated contract market as well as

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244 "FCC" was Farmers Commodity Corporation, Buckeye's then-FCM. Tr. vol. 3 at 72.

245 DX-142 at 100-01. Accord Tr. vol. 3 at 150-51. Similarly, when Wright tried to convince the Preble County farmers to assume the delivery obligations of AMS, he discussed the purchase of puts and wrote, "A March put at $3+ will give you the right, but not the obligation to sell March corn futures at $3+ . . . ." DX-128 at 5.

246 Tr. vol. 3 at 72.

247 As its name indicates, the CBOT is located in Chicago, Illinois. Given this geography, even if the counter-party to a relevant option transaction effected on the CBOT also resided in Ohio, the transaction would occur through a "place outside thereof" and, therefore, occur in interstate commerce as defined in Section 1a(13). 7 U.S.C. §1a(13)(B).

offers to effect such transactions. Given the existence of this evidence, we must consider whether the weight of evidence supports the theory of wrongdoing that could lead to sanctions in this proceeding or the "exculpatory" alternative.

Perhaps because the parties thought there was no third option or perhaps because neither the Division nor Buckeye wished to broach it out of self-interest, there was no effort to refute the inferences most obviously drawn from the Division's evidence.[248] As a result, we cannot find that the Division has proven by a preponderance of the evidence that Buckeye offered or entered into off-exchange options in connection with its HTAs.[249] This finding disposes of the Division's Section 4c(b)

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[248] See supra note 243.

[249] There are two well-established facts that would tend to support the Division's theory, the exercise of options written by Buckeye suppliers that resulted in cash grain delivery obligations and the occasional odd-lot options order. However, the Division has the burden of proof and they both can be easily explained. As for the fact that options were exercised and resulted in new delivery obligations, it is possible that Buckeye bought or sold options on behalf of suppliers and, when short options were exercised, Buckeye covered the obligation arising from exercise and, rather than requiring the supplier to financially reimburse it for delivering the futures contracts, it would enter into one or more new HTAs with the supplier for the delivery of an appropriate amount of grain in the future. Similarly, it is possible that, for certain small suppliers, Buckeye permitted them to place odd-lot orders that Buckeye would block with other such orders (or effect by purchasing or selling enough options to cover the order) and hold the supplier responsible for the fraction of purchase or sale corresponding with its order. In addition, there is no indication that Buckeye engaged in odd-lot option transactions in connection
(continued..)

case against Buckeye. However, we must again turn to the issue of Wright's aiding and abetting liability cognizant of the fact that the Division's failure to prove Buckeye's Rule 32.2 violation as to the firm does not preclude its ability to do so as to Wright.

The Division Did Not Establish That Wright Aided And Abetted Rule 32.2 Violations

Just as with the Section 4(a) claims, the Division's case against Wright includes admissions and stipulations as well as the investigational testimony that could not be used against Buckeye. However, the deemed admissions of Wright that would be of most help in this proceeding, those referring to "Buckeye" are too ambiguous to be useful here.[250] This augmented record is also insufficient to establish that primary Rule 32.2 violations occurred.

The stipulations between Wright and the Division refer to "Buckeye" in a way that strongly suggests that they meant to identify the respondent in this proceeding and do not define the

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with its HTAs. Thus, it is possible that the odd-lot options transactions occurred only in the context of minimum price contracts (options transactions that the Division does not allege to have violated Section 4c or Rule 32.2).

[250] See supra note 167.

term in a manner that affirmatively renders it ambiguous.[251] This simple sentence would seem to eliminate the temporal vagueness that plagued many of the admission requests to which Wright implicitly admitted. However, they do not delve into the distinction between operating as an unlicensed broker as to exchange traded options and acting as the counter-party to its suppliers in off-exchange option transactions.[252] As a result,

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[251] Amended Stipulations at 2-3.

[252] Wright and the Division stipulated to the following.

> 19. Buckeye confirmed the execution of corn, wheat and soybean transactions, which it held out to be the character of "options," "calls" or "puts," with individuals and entities.
>
> 20. Buckeye confirmed the execution of corn, wheat and soybean transactions, which were "options," "calls" or "puts," with individuals and entities.
>
> 21. Buckeye confirmed the execution of corn, wheat and soybean transactions, which were commonly known to the trade as "options," "calls" or "puts," with individuals and entities.
>
> 22. Buckeye paid a fee or premium for any option, call or put it purchased.
>
> 23. Buckeye was paid a fee or premium for any option, call or put it sold.

Amended Stipulations at 5. Stipulations 19 through 21 indicate that Buckeye confirmed the execution of options transactions "with individuals and entities." However, they do not indicate whether the transactions took place on or subject to the rules of a Commission-designated contract market. Stipulations 22 and (continued..)

they really add nothing to the record. In addition, Jeffers's testimony does not shed any light on the issue.[253] Accordingly,

(..continued)

23 do not indicate whether the option purchases and sales described occurred on or subject to the rules of a contract market, or whether they involved Buckeye suppliers.

[253] Jeffers testified that he entered into the substitute HTAs, in part, because "Buckeye . . . said they'd buy puts." DX-148 at 71. This testimony, in light of the fact that substitute HTA suppliers could not write options through (or to) Buckeye, supports the inference that Buckeye was a broker for the farmers and not a counter-party. Later, Jeffers described his understanding of how put purchases would occur and stated, "I would just call [Leach] and say, Bill, we need to buy puts today and he would call -- you know, how elevators do it, they would pay for it and do it." DX-148 at 76. The Division then asked, "Call his broker or whatever?" and he responded, "Right." DX-148 at 76. Indeed, the Division's leading questions reflected the understanding that Buckeye was acting as a broker for suppliers and not entering into options with them. DX-148 at 72 ("Q. But aside from buying the puts through Buckeye or Buckeye buying the puts for you, you were still going further into a short position on the market? A. At that time, yes . . . .").

In its posthearing memorandum, the Division asserted that Spoerl testified to having purchased "from Buckeye a put option." Division Posthearing Memorandum at 55. It did not direct us to evidence of this statement. Id. However, we have located testimony wherein the Division asked, "After you entered into the Buckeye contract, you purchased an option, didn't you, with Buckeye?" and the witness responded, "Yes." Tr. vol. 1 at 180 (emphasis added). When the Division used the phrase "with Buckeye" in its leading question, it did not communicate that it meant "from Buckeye" nor did it's follow-up questions shed light on that issue. Tr. vol. 1 at 180-82. The term "with" provides as much support to the inference that Spoerl and Buckeye were on the same side of the above referenced transaction -- with Buckeye acting for Spoerl -- as it does to the inference that they were counter-parties in the option purchase. Thus, the Division seems to have overstated the content of Spoerl's one-word response to its question. See Tr. vol. 1 at 180.

we find that the Division has not established Buckeye's direct violations of Rule 32.2 in its case against Wright. As a result, we have no need to consider the elements of aiding and abetting as they relate to this count. For the reasons set forth above, we **DISMISS** Count II in its entirety.

WRIGHT WAS A CTA

Before proceeding further, we will consider an issue germane to no less than three of the remaining counts, whether Wright was a commodity trading advisor ("CTA") during the 1991-1996 period.[254] Congress and the Commission generally define a CTA as a person who, for compensation or profit, engages in the business of advising others as to the value of or the advisability of trading in: (1) exchange-traded futures, (2) Commission-authorized options or (3) authorized leverage contracts.[255] Neither Wright nor Luxenburger really dispute that

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[254] Counts III, IV and VIII charge Wright with failing to register as a CTA, violating an anti-fraud provision that applies to CTAs and failing to provide required CTA disclosure documents to his clients. Amended Complaint, ¶¶52-54, 58-59, 68-69. The complaint also charges Luxenburger with aiding and abetting Wright's failure to register as a CTA and alleges that Edwards is vicariously liable for Luxenburger's misdeeds. Amended Complaint, ¶¶55-56.

[255] Section 1a(5) defines a CTA as,

> any person who--
>
> (i) for compensation or profit, engages in the business of advising others, either directly or through

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publications, writings, or electronic media, as to the value of or the advisability of trading in--

(I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market;

(II) any commodity option authorized under section 6c of this title; or

(III) any leverage transaction authorized under section 23 of this title; or

(ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).

(B) . . . Subject to subparagraph (C), the term "commodity trading advisor" does not include--

(i) any bank or trust company or any person acting as an employee thereof;

(ii) any news reporter, news columnist, or news editor of the print or electronic media, or any lawyer, accountant, or teacher;

(iii) any floor broker or futures commission merchant;

(iv) the publisher or producer of any print or electronic data of general and regular dissemination, including its employees;

(continued..)

Wright was a CTA.[256] There is good reason for such a choice and, with respect to the Division's case against Wright, very good reason.

The claim against Wright that he was a CTA can be fully resolved on the basis of his deemed admissions and stipulations. For example, Wright admitted by operation of law that, "[a]t all times since at least November 13, 1991, Wright has been a CTA."[257] In addition, he admitted to facts that place him

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> (v) the fiduciary of any defined benefit plan that is subject to the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.);
>
> (vi) any contract market; and
>
> (vii) such other persons not within the intent of this paragraph as the Commission may specify by rule, regulation, or order.
>
> (C) . . . Subparagraph (B) shall apply only if the furnishing of such services by persons referred to in subparagraph (B) is solely incidental to the conduct of their business or profession.

7 U.S.C. §1a(5). The Commission enacted a similar definition in 17 C.F.R. §1.3(bb).

[256] Edwards, on the other hand, argues that Wright was not a CTA as defined in the Act. <u>See</u> <u>infra</u> note 270.

[257] <u>See</u> Division Requests to Wright, ¶22. The Division avoided ambiguity, in part, by instructing, "The term 'CTA' is synonymous in meaning and equal in scope to the usage of the term 'commodity trading advisor' in Section 1a(5) of the Act, 7 (continued..)

squarely within the relevant definitions of CTA.[258] In short, Wright's failure to make timely responses to the Division's

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U.S.C. §1a(5) (1994), and Regulation 1.3(bb), 17 C.F.R. §1.3(bb)." Id. at 3. Similarly, it defined "Wright" by stating, "The term 'Wright' refers to respondent Roger J. Wright d/b/a Agricultural Marketing Service." Id. at 5.

[258] By failing to respond to the Division's requests for admissions, Wright has conclusively established the following.

> At all times since at least November, 13, 1991, Wright has for compensation or profit, engaged in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in contracts of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market. . . .
>
> At all times since at least November, 13, 1991, Wright has for compensation or profit, engaged in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in commodity options authorized under Section 4c of the Act. . . .
>
> At all times since at least November, 13, 1991, Wright has for compensation or profit, and as part of a regular business, issued or promulgated analyses or reports concerning the value of or advisability of trading in contracts of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market. . . .
>
> At all times since at least November, 13, 1991, Wright has for compensation or

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> profit, and as part of a regular business, issued or promulgated analyses or reports concerning the value of or advisability of trading in commodity options authorized under Section 4c of the Act. . . .
>
> At no time since November 13, 1991, has Wright been a bank or trust company or acted as an employee thereof.
>
> . . . .
>
> At no time since November 13, 1991, has Wright been a news reporter, news columnist, or news editor of the print or electronic media, or any lawyer, accountant, or teacher.
>
> . . . .
>
> At no time since 1991, has Wright been a floor broker or FCM.
>
> . . . .
>
> At no time since November 13, 1991, has Wright been a publisher or producer of any print or electronic data of general and regular dissemination, or an employee thereof. . . .
>
> At no time since November 13, 1991, has Wright been the fiduciary of any defined benefit plan that is subject to the Employee Retirement Income Security Act of 1974. . . .
>
> At no time since November 13, 1991, has Wright been a contract market.
>
> Since at least 1991, Wright has held himself out to the public as a "market advisor" and an agricultural marketing consultant, providing . . . advice and

(continued..)

requests for admissions conclusively established his status as a CTA. This result, of course, has no effect on the Division's case against the other respondents. Thus, before proceeding further, we will consider whether the Division has established the same as to Edwards and Luxenburger. In doing so, we have the opportunity to address some misconceptions.

The Division seems to take the position that Wright qualified as a CTA if he had "engaged in the business of

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> analyses about exchange-traded . . . commodity futures and option contracts, without being registered as a CTA.
>
> . . . .
>
> Since at least 1991, Wright, for compensation or profit, provided clients with a market letter that communicated detailed information concerning trends in the commodity markets, including specific futures and options trade recommendations . . . .
>
> . . . .
>
> Since at least 1991, Wright, for compensation, provided clients with individual advice concerning commodity futures and options contracts.

See Division Requests to Wright, ¶¶23-27, 29, 31, 33, 35-37, 50, 52. Thus, Wright not only admitted the ultimate fact that he was a CTA since 1991, he admitted more (but not very much more) particular facts showing that he fell within the general definition of a CTA and not one of the exceptions contained therein.

advising clients about the advisability of [trading] futures and options . . . for compensation" regardless of whether the advice rendered concerned trading futures on or subject to the rules of a contract market or Commission-authorized options.[259] This is

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[259] Division Proposed Findings at 47. For example, the Division argues that Wright's advice concerning entry into HTAs (which the Division considers to be off-exchange futures) is part of the activity that renders him a CTA. Division Posthearing Memorandum at 46 & Exhibit A. Similarly, it argues that Buckeye was dealing in unauthorized options with Wright's clients yet takes the position that advice concerning such options brings him within the definition of a CTA. Id. at 16-20, 53-56. In support of these notions, it cites the holding of CFTC v. British American Commodity Options Corp., 560 F.2d 135, 141 (2d Cir. 1977), that advice concerning the "value of commodities" brought one within the definition of CTA. Id. at 46 n.237. Reading British American in light of the legislative history concerning the Act's CTA definition reveals that the case is unhelpful in two respects.

First, British American did not address the issue of whether the express "on or subject to" and "authorized under [Section 4c]" language should be ignored. See 560 F.2d at 141-42. In addition and more importantly, it construes a definition that was materially changed about 20 years ago. In January 1983, Congress amended the definition of CTA by replacing, "The term 'commodity trading advisor' shall mean any person who, for compensation or profit, engages in the business of advising others . . . as to the value of commodities or as to the advisability of trading in any commodity for future delivery" with "The term 'commodity trading advisor' shall mean any person who, for compensation or profit, engages in the business of advising others . . . as to the value of or advisability of trading in any contract of sale of a commodity for future delivery . . . ." Senate Committee on Agriculture, Nutrition, and Forestry, Futures Trading Act of 1982 61 (Comm. Print 1983) (italics omitted); Registration Guidelines for Feedlot Operators, Registration Guidelines for Feedlot Operators, 55 Fed. Reg. 3205, 3207 n.5 (1990). Compare 7 U.S.C. §2(a)(1)(A) (1982) with 7 U.S.C. §1a(5) (1994). Thus, the portion of British American upon which the Division relies is outdated.

not quite right. As the above-quoted portions Section 1a(5) indicate, the provision of advice concerning futures that are not "made or to be made on or subject to the rules of a contract market," commodity option contracts that are not authorized under Section 4c and/or leverage transactions that are not authorized under 7 U.S.C. §23 do not bring a person within the definition of CTA.[260] While the Division's overbroad reading of the CTA definitions makes our job more difficult,[261] it poses a partial impediment only.

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[260] In re Global Link Miami Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,391 at 46,780 (ALJ June 26, 1998), involved an unregistered broker that was dealing in off-exchange futures contracts. The Division claimed that, by soliciting and accepting orders for futures contract purchases and sales without registering as an FCM, the broker violated Section 4d, 7 U.S.C. §6d. Global Link, [1996-1998 Transfer Binder] ¶27,391 at 46,793. We observed that Section 4d made it unlawful for a person to engage as an FCM "in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery, or involving any contracts for the sale of any commodity for future delivery, on or subject to the rules of a contract market . . . ." Id. at 46,794 (quoting 7 U.S.C. §6d, italics omitted). We further observed that Congress' definition of FCM also included limiting "on or subject to the rules of a contract market" language. Id. On the basis of those observations, we held that a futures broker the activities of which were limited to futures transactions not conducted on or subject to the rules of a contract market would not qualify as an FCM and could not violate Section 4d by failing to register. Id. at 46,795. On review, the Commission chose not to address the propriety of this decision. In re Global Link Miami Corp., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,669 at 48,169 n.15 (CFTC June 21, 1999). In the interim, we have found no reason to abandon it.

[261] See supra note 259.

Although the evidence concerning Wright's advice is often ambiguous on the matter of whether it relates to the types of contracts listed in Section 1a(5),[262] especially in light of the Division's assertions that Buckeye dealt in off-exchange futures and options, we find that Wright frequently provided advice concerning exchange-traded contracts. To reach this conclusion, we have no reason to look beyond Wright's AMS newsletters.

In March 1996, Wright published a marketing plan for the year.[263] In that plan, he advised that, if farmers could not find an elevator that provided flexible HTAs and facilitated

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[262] For example, the Division claims that page 1 of DX-123 contains a message in which Wright instructed a client to "contact . . . Luxenburger at . . . Edwards, and place [certain option] orders in [the client's] futures trading account." Division Proposed Findings at 3 & n.14. The exhibit shows Wright to have instructed the client to enter into an HTA contract and to place an options order. DX-123 at 1. However, it makes no reference to Luxenburger, Edwards or any other person that is proven to execute orders for the purchase or sale of commodity options on or subject to the rules of a contract market. DX-123 at 1. Thus, the exhibit does nothing to dispel the possibility that the orders concerned off-exchange transactions with an elevator that offered HTAs and entered into options sales and purchases with its HTA counterparties.

The Division posits that Wright gave commodity trading advice in the memorandum, a copy of which constitutes page 64 of DX-53. Division Proposed Findings at 4 & n.16. Like page 1 of DX-123, this document does not indicate that the options in question are those authorized by the Commission under Section 4c. DX-53 at 64. The same is true for other parts to DX-53 to which the Division refers, namely pages 77 and 117. Division Proposed Findings at 4 & n.16.

[263] DX-53 at 24.

options purchases, they should "[f]ind the money to buy puts with Phil" and "[b]uy deep in the money puts to substitute for HTA contracts . . . spend 35 cents for December corn puts . . . spend 60 cents for November bean puts . . . spend 25 cents for September wheat puts."[264] "Phil" appears to be Luxenburger and, since this recommendation rests on the unavailability of finding an elevator with (or through) whom to engage in options transactions, the options trades discussed appear to be those conducted through Edwards and executed on a Commission-designated contract market.[265] In addition, at certain times during the 1991-1996 period, Wright published advice concerning the purchase and sale of cattle and hog futures as well as the purchase of corn futures to hedge feeding costs.[266] Moreover,

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[264] DX-53 at 24.

[265] This was not Wright's only published advice concerning exchange-traded contracts. DX-53 at 115-16.

[266] DX-53 at 10 (including February 2, 1996 advice stating, in part, "Do not sell cattle futures . . . ."); DX-53 at 48, 50 (advising, in April 1996, "Do not be short on hog or cattle futures after the corn crop is made (or lost)."); DX-53 at 65, 67 (advising, apparently in 1993 or 1994, that "June futures will trade down to $74 by the first of June where any shorts should be liquidated."); DX-53 at 75-76 (including January 1993 advice that "Feeder pig buyers should hedge summer purchases in July futures at the $46.20 area."); DX-53 at 79-80 (advising, in March 1993, "Get corn covered by buying July calls or May futures."); DX-53 at 85-86 (providing April 1993 advice that "[f]eeder pig buyers should immediately hedge summer feeder pig purchases by buying August hog futures or August calls," and "Buy August futures anything below $49."); DX-53 at 91-92 (continued..)

Wright published additional advice concerning the purchase of exchange-traded soybean and anhydrous ammonia futures.[267] Wright's advice concerning exchange-traded[268] futures and options

(..continued)

(advising, in June 1993, "Do not hedge cattle in the futures for at least two weeks or at $74.90 on the August contract, whichever comes first, but not in any case below $73.50."); DX-53 at 95, 98 (stating, in June 1993, "Do not be short hog futures until the end of July at least."); DX-53 at 100, 103 (providing July 1993 advice to "Liquidate long August futures as a feeder pig hedge above $48 . . . and replace with a December long hedge below $45 . . . ."); DX-53 at 115 (explaining, in June 1994, why feed corn purchasers should not "buy corn in the futures market" and look to "sell the position out at a profit"); DX-53 at 122 ("The trend is clearly higher. Do not be short any hog futures."); DX-53 at 152-53 (advising, in May 1995, "Do not short hog futures . . . ."); DX-53 at 169 (providing June 1995 advice to "not buy corn futures or contract corn feed until fall"); DX-123 at 138-40 (stating "If you ever get the chance to buy October feeder cattle futures at $74.02 again, do it."); DX-123 at 149-50 (advising, in July 1991, "Sell hog futures regardless."); DX-123 at 159 (stating, in May 1991, "With June futures at $74.30, this is no time to be hedging. If you have any short futures, cover them immediately."); DX-123 at 172 (advising, on January 1991, "Take profit in long February cattle futures at something over $79.").

267 DX-53 at 124 ("It is very rare that we ever blatantly recommend that you take a net futures position, however, this is one of those times . . . we recommend you but March beans . . . or May beans . . . If you do not have a broker, we recommend Phil Luxenburger at A.G. Edwards . . . ."); DX-123 at 165 ("If you want to purchase futures . . . get it done now."); DX-123 at 169 ("For those of you wanting to buy futures, buy July at $2.53 to $2.54 anytime this week."); DX-123 at 410.

268 It is true that Wright's futures advice did not explicitly refer to futures traded on or subject to the rules of a contract market. However, the evidence indicates that, when Wright and his clients referred to futures, they meant exchange-traded futures.

was not limited to that he published.[269] Finally, there is no evidence that Wright falls under one of the enumerated exceptions in Section 1a(5) or Rule 1.3(bb).

For the reasons discussed above, we conclude that the Division has established that Wright engaged in the business of advising others as to the desirability of purchasing and selling futures contracts traded on or subject to the rules of Commission-designated contract markets, and options that have been authorized by the Commission pursuant to Section 4c. In addition, we find that Wright did this for compensation and profit.[270] Thus, as to its case against Edwards and Luxenburger,

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[269] On more than one occasion, Wright provided personalized advice concerning exchange-traded futures, and exercised trading control over regulated futures and options accounts of clients. DX-148 at 61; Tr. vol. 1 at 86-88; Amended Stipulations, ¶96; AGEX-1; AGEX-2; AGEX-3; AGEX-4; AGEX-5.

[270] However, Edwards argues that Wright was not a CTA under Section 1a(5) of the Act because he did not, for compensation or profit, engage in the business of providing commodity trading advice but, rather, he was "in the business of providing producers of cash grain with cash grain marketing and consulting services." Edwards Posthearing Memorandum at 6-7. Thus, it takes the position that Wright provided his cash market advisory service for compensation or profit and provided the exchange-traded futures and options advice for free. Id. at 7 ("However, he ***only*** received compensation for his services as a cash grain marketing consultant." (emphasis in original)). There is nothing in the record that would permit us to separate Wright's exchange-traded futures and options advice from the bundle of goods and services he provided for compensation or profit and reach a principled conclusion that, while Wright published his newsletter for compensation (or profit) and while every client received exchange-traded futures advice through the newsletter,
(continued..)

the Division has shown by a preponderance of the evidence that Wright was a CTA.

WRIGHT VIOLATED SECTION 4M(1)

As touched on above, the complaint included allegations that Wright violated Section 4m(1) by operating as a CTA without appropriate registration, that Luxenburger aided and abetted these violations, and that Edwards bore vicarious responsibility for Luxenburger's aiding and abetting.[271] Respondents take the position that, even if Wright was an unregistered CTA, he did not violate the statute.[272] Thus, the dispute centers on whether the Act or Commission regulations exempted Wright from the need to register.

Section 4m(1) prohibits CTAs from using the instrumentalities of interstate commerce in connection with their business as CTAs unless they are registered with the Commission.[273] As discussed above, Wright was a CTA. The record

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(..continued)

certain advice in the newsletter was distributed for compensation and other advice was not.

[271] Amended Complaint, ¶¶54-56.

[272] See infra note 276.

[273] It states, "It shall be unlawful for any commodity trading advisor . . . , unless registered under this chapter, to make use of the mails or any means or instrumentality of interstate commerce in connection with his business as such commodity

(continued..)

shows that he regularly availed himself to the instrumentalities of interstate commerce in the course of distributing the type of advice that rendered him a CTA.[274] Moreover, Wright was not registered with the Commission during the 1991-1996 period.[275] Accordingly, if Wright was not exempt from the need to register, the Division has established that he violated Section 4m(1).

The respondents argue that because Wright dealt in cash grain and advised those who produced and sold cash agricultural commodities, Section 4m(1) and Rule 4.14(a)(1) exempted him from the need to register as a CTA.[276] While these provisions exempt

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trading advisor . . . ." 7 U.S.C. §6m(1). But see In re Slusser, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,701 at 48,310 (CFTC July 19, 1999) (holding that Section 4m(1) "requires that all persons performing the functions of a [commodity pool operator] register with the Commission unless they are subject to an exemption from registration" and making no mention of whether a respondent's use of the instrumentalities of interstate commerce in connection with its business as a commodity pool operator had any bearing on the requirement to register).

[274] Tr. vol. 1 at 90; DX-53 at 48-50; DX-144 at 53. See supra note 266; see infra note 370.

[275] Wright stipulated that he was not registered during this period, and Luxenburger and Edwards stipulated that Luxenburger knew Wright was not registered as a CTA during the same span. Amended Stipulations, ¶¶8, 64. The evidence confirms the stipulations. Tr. vol. 1 at 150; DX-143 at 66-71, 74-75; DX-145 at 18.

[276] Edwards Posthearing Memorandum at 7-8 & n.1; Luxenburger Proposed Findings, ¶48 ("Because Wright was engaged in the

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certain cash market participants from registration and Wright engaged in cash grain businesses, the exemptions are not as expansive as respondents posit.

Rule 4.14(a)(1) states,

> A person is not required to register under the Act as a commodity trading advisor if . . . [i]t is a dealer, processor, broker, or seller in cash market transactions of any commodity (or product thereof) and the person's commodity trading advice is solely incidental to the conduct of its cash market business . . . .[277]

The regulation lists a number of activities that might permit the exemption from registration but makes no reference to "agricultural marketing advisors" or the like. Employing the canon of statutory construction described by the maxim _expressio unius est exclusio alterius_, we generally hold that, when a regulation lists persons or requirements and does not include a catch-all provision, the persons or requirements listed are the

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business of advising clients about the marketing of their farm products in cash market transaction[s], he did not hold himself out generally to the public as a . . . [CTA], and his commodity advi[c]e was only incidental to that activity, he was exempt from registration."); Wright Posthearing Memorandum at 20.

[277] 17 C.F.R. §4.14(a)(1). We hereinafter refer to this exemption and the Section 4m exemption discussed below as "dealer" exemptions.

only ones intended.[278] Accordingly, Wright's cash market advice did not relieve him of the need to register. However, Wright's evidenced grain dealing could have.

To determine whether Wright's grain dealing provided grounds for the exemption, we must construe Rule 4.14(a)(1)'s requirement that a cash dealer's "commodity trading advice [be] solely incidental to the conduct of its cash market business." To be more precise, we must consider whether this passage requires an exclusive relationship between the commodity trading advice and the person's cash market dealing, processing, brokering and/or selling. The Commission first enacted the dealer exemption in 1978 and initially codified it as 17 C.F.R. §1.71(a)(2).[279] Rule 1.71(a) stated, in part,

> The following persons are not required to register with the Commission as commodity trading advisors . . .
>
> (1) Any cash market dealer, producer, processor or broker, or other person similarly engaged in the business of buying or selling a cash commodity or a product or byproduct thereof . . . <u>whose commodity trading advice is solely directed to cash commodity transactions and is solely incidental to cash</u>

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[278] <u>See</u> <u>Murray v. Cargill, Inc.</u>, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,561 at 47,558 & n.29 (CFTC Mar. 4, 1999).

[279] <u>Exemption of Certain Commodity Trading Advisors From the Provisions of the Act</u>, 43 Fed. Reg. 32291, 32291-93 (1978).

<u>commodity transactions and is solely incidental to the conduct of the person's business as such</u> . . . ."[280]

The Commission interpreted Rule 1.71(a) to mean what it said and, thus, commodity trading advice was required to occur as an exclusive incident of cash commodity dealing, producing, processing, etc. before the exemption applied.[281]

In 1979, the Commission amended the dealer exemption to include its current language and recodified it as 17 C.F.R. §4.13(b)(1).[282] Although it altered the regulation's language, the Commission instructed, "While paragraphs (b)(1) and (2) [of Rule 4.13] are worded somewhat differently from §1.71, this change is not intended to expand or narrow the exemption but merely to prevent confusion between these paragraph and the registration exemption in sec. 4m of the Act for CTAs."[283] Since

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280 <u>Id.</u> at 32293 (emphasis added). The Commission corrected the release in which it enacted Rule 1.71. <u>Exemption of Certain Commodity Trading Advisors From Provisions of the Commodity Exchange Act</u>, 43 Fed. Reg. 36897, 36897 (1978). However, the relevant language of the regulation went unchanged. <u>Id.</u>

281 <u>Exemption of Certain Commodity Trading Advisors From the Provisions of the Act</u>, 43 Fed. Reg. at 32291 ("the Commission has decided to exempt from registration . . . any cash market dealer . . . whose commodity advice is (a) directed solely to cash commodity transactions (as distinguished from commodity futures, commodity option or leverage transactions) and (b) incidental to the person's business").

282 <u>Commodity Pool Operators and Commodity Trading Advisors; Final Rules</u>, 44 Fed. Reg. 1918, 1925 (1979).

283 <u>Id.</u> at 1919.

providing this guidance, the Commission has changed the designation of the dealer exemption but not its substance.[284] Indeed, it has reiterated the view that the exemption is "for persons providing commodity trading advice that is solely incidental to dealer, processor and other specified cash market activities."[285] Rule 4.14(a)(1)'s history leads us to conclude that it exempts only those dealers whose commodity trading advice is solely incidental to their business as a cash grain dealer.[286] This brings us to the issue of when advice qualifies as "solely incidental" to some other endeavor.

Udiskey v. Commodity Resource Corp.[287] provided an occasion to consider the type of relationship that the phrase "solely incidental to" is meant to designate. We explained,

> "Solely incidental to" clearly implies a relationship, but one that is "subordinate [or] nonessential . . . in position or significance." *Webster's Third New International Dictionary* 1142 (1971) (defining incidental). Accordingly, when the Commission has considered whether the provision of trading advice was "solely incidental to" some other activity, it has considered the pervasiveness of

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284 Registration Guidelines for Feedlot Operators, 55 Fed. Reg. at 3206 n.5. See 17 C.F.R. §4.14(a)(1).

285 Registration Guidelines for Feedlot Operators, 55 Fed. Reg. at 3206 n.5.

286 See supra notes 279-85 and accompanying text.

287 [1998-1999 Transfer Binder] Comm. Fut. L. Rep. ¶27,599 (ALJ Apr. 2, 1999), aff'd, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,255 (CFTC Dec. 16, 2002).

> advisory activity. *In re Armstrong*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,657 at 40,149 (CFTC Feb. 8, 1993) (drawing a distinction between advice that was "'solely incidental' to [a respondent's] business" and advice that "was the very point of that business").[288]

Because Udiskey did not require us to chart the bounds of "solely incidental" relationships, we did not discuss how the term "solely" affected the scope of "incidental." However, we discussed the term in relation to Rule 4.14(a)(6)'s reference to "solely in connection with."[289]

We determined that the inclusion of "solely" was intended to exclude commodity trading advice that is "connected with 'alternative or competing things.'"[290] Thus, we held that an introducing broker provided trading advice "solely in connection" with its business as an introducing broker when it provided advice only to its brokerage customers and that advice related closely and directly to contracts as to which the introducing broker actually accepts orders.[291] Adopting this view of "solely" in our reading of the dealer exemption, we hold that, if a cash commodity dealer has two lines of businesses,

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288 Id. at 47,858 n.167 (brackets, ellipsis and italics in original).

289 Id. at 47,858-59; see 17 C.F.R. §4.14(a)(6).

290 Udiskey, [1998-1999 Transfer Binder] ¶27,599 at 47,858 n.167.

291 Id. at 47,859.

cash commodity dealing which triggers the Rule 4.14(a)(1) exemption and one of which does not, then the dealer's advice does not occur "solely incidental to" its cash grain dealing if the dealer provides advice to persons with whom he does not deal in grain or the dealer provides advice as to transactions not part of his cash grain dealing.[292]

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[292] This conclusion finds support in Registration Guidelines for Feedlot Operators. There, the Commission reviewed various scenarios in which a hypothetical feedlot operator provided futures and options hedging advice and opined on whether, under those facts, Rule 4.14(a)(1) exempted the feedlot operator from the CTA registration requirement. 55 Fed. Reg. at 3206-08. In doing so, it instructed,

> The Commission believes that extending the Rule 4.14(a)(1) exemption to custom feedlot operators who provide commodity trading advice that is solely incidental to, and is provided without charge in conjunction with, the primary processing services they provide to their feedlot customers would not be contrary to the public interest. The Commission believes that the trading advice provided may be characterized as incidental to the customer feedlot operator's cash market business if such advice is: (1) Provided solely to hedge the customer's cattle being fed at such feedlot operator or to hedge grain purchases for the purpose of feeding such cattle; (2) not provided to customers other than customers employing the feedlot operator's processing services; (3) provided at *de minimis* cost to the feedlot operator; (4) provided at no extra charge to any of its customers, *e.g.*, there should be no difference in the amount paid to the feedlot operator by different customers having the same volume of cattle processed through the feedlot if one customer uses advisory

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In this case, the record conclusively establishes (as to Wright) and proves by a preponderance of the evidence (as to Edwards and Luxenburger) that Wright provided commodity trading advice on a regular basis from 1991 until at least 1996. He provided such advice to dozens of clients over the years.[293] On the other hand, Wright's grain dealing and brokering activity appears to have been limited to: (1) the marketing of Preble County farmers' corn in 1995; (2) grain dealing on behalf of Larry Duvall during a period running from 1993 to 1996,[294] (3) large scale grain dealing with business associates in 1987 and 1988;[295] (4) dealing grain in 1994 that was to be sold to

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> services of the feedlot operator and another customer does not; (5) provided without the feedlot operator soliciting customers for its advisory services or holding itself out generally to the public as a CTA; and (6) provided without restriction as to the customer's choice of FCM.

Id. at 3207 (emphasis added and italics in original).

[293] DX-143 at 101.

[294] Starting in 1993, Duvall and Wright established a history of cash market speculation that included entry into HTAs and culminated in the delivery of grain to satisfy them. Tr. vol. 4 at 173-76, 214-18. Duvall would enter into HTAs and then Wright would go out and find farmers to deliver the corn on Duvall's behalf for a price that was (hopefully) less than the HTA price. Tr. vol. 4 at 175-76, 191, 194, 196, 214-16.

[295] Tr. vol. 5 at 173-77.

Countrymark Co-op,[296] and (5) dealing grain on behalf of David Cottrill from 1994 through 1996.[297] Despite Wright's frequent forays into grain dealing and brokering, they did not cover the entire 1991-1996 period, did not involve every commodity concerning which Wright provided futures advice and did not involve every person who received his futures and options trading advice. Stated another way, the vast majority of clients to whom Wright provided exchange-traded futures and options advice had no part of his grain dealing and brokering. For this reason, Wright did not provide his commodity trading advice in a manner that was "solely incidental" to his business as a cash grain broker or dealer. As a result, Rule 4.14(a)(1) did not exempt him from the need to register as a CTA before using the means of interstate commerce in furtherance of his business as a CTA. This brings us to the exemption set forth in Section 4m(1), one that appears to be more broad.

Section 8 of the Futures Trading Act of 1978[298] amended

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[296] DX-143 at 155-56.

[297] DX-141 at 47-52, 61-68.

[298] Pub. L. No. 95-405, §8, 92 Stat. 870 (1978).

Section 4m(1) by adding,

> The provisions of this section shall not apply to any commodity trading advisor who is a (1) dealer, processor, broker, or seller in cash market transactions of any commodity specifically set forth in section 2(a) of this Act[299] prior to the enactment of the Commodity Futures Trading Commission Act of 1974[300] (or products thereof) or (2) nonprofit, voluntary membership, general farm organization, who provides advice on the sale or purchase of any commodity specifically set forth in section 2(a) of this Act prior to the enactment of the Commodity Futures Trading Commission Act of 1974;[301] if the advice by the person described in clause (1) or (2) of this sentence as a commodity trading advisor is solely incidental to the conduct of that person's business . . . .

The exemption differs from Rule 4.14(a)(1) in that it is limited to enumerated participants in the cash agricultural commodities markets (as opposed to the cash commodities markets as a whole), it employs slightly different language and the language was, in part, an afterthought with an almost non-existent legislative

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[299] By "commodity specifically set forth in section 2(a) of this title prior to October 23, 1974," Congress meant to designate agricultural commodities. Senate Comm. on Agric., Nutrition and Forestry, Futures Trading Act of 1978, at 99 (Comm. Print 1979); Commodity Pool Operators and Commodity Trading Advisors; Final Rules, 44 Fed. Reg. at 1919-20.

[300] The phrase "prior to the enactment of the Commodity Futures Trading Commission Act of 1974" was codified as "prior to October 23, 1974. 7 U.S.C. §6m(1).

[301] See supra note 300.

history.[302] The differences in language raise the possibility that Section 4m(1) exempts persons from the need to register who

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[302] The dealer exemption is, in part, a relic of the old CTA definition. As discussed above, advising others as to the value of cash commodities was once sufficient to bring a person within the definition of CTA. See supra note 259. During hearings related to Commission reauthorization, the Senate and House received statements and testimony urging that cash market participants, and farmer owned or controlled organizations that provided commodity advice be exempted from need to register as CTAs. Extend Commodity Exchange Act, Hearings Before the Subcommittee on Conservation and Credit of the House Comm. on Agric., 95th Cong. XIV, 168-70, 535-38 (1978).

In drafting the legislation that would reauthorize the Commission and amend the Act, the House of Representatives approved adding exclusions from the definition of CTA for "dealers, processors, brokers, and sellers of cash commodities and products thereof" as well as for certain farm organizations that provide advice on the sale and purchase of cash commodities. H.R. Rep No. 95-1181 at 1 (1978). The Senate bill reauthorizing the Commission had no such exclusion. S. Rep. No. 95-1239 at 16 (1978) (conference report). The conference committee participants decided to adopt the House approach with a number of modifications.

First, the conference committee changed the exclusion from one relating to the definition of CTA to an exclusion from the need to register with the Commission. Id. In addition, it narrowed the scope of exemption to include only those who dealt in agricultural cash commodities. Id. Finally, the conferees added the "solely incidental" limitation. Id. at 7, 16. Because the "solely incidental" language was added in committee, it received little explanation. The conference committee stated that the exclusion exempted "only such [enumerated] persons who give advice relating to agricultural commodities in cash market transactions." Id. at 16. This, of course, begged the questions of whether one could gain the exemption only if all of the person's advice related to cash market transactions and how closely the advice had to relate to cash market transactions. Stated another way, it did not expressly address whether a cash grain dealer would be exempt if it provided advice that had no proximate relationship to the dealer's transactions in the cash commodity. In addition, it is not clear that Congress intended

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are not entitled to an exemption pursuant to Rule 4.14(a)(1).[303]

As quoted above, a cash commodity dealer is exempt from registration as a CTA "if the advice by the person . . . as a commodity trading advisor is solely incidental to the conduct of that person's business." Because the "advice . . . as a commodity trading advisor" is the activity that must be judged as incidental, rather than commodity-related advice or commodity trading advice generally, if a person's whose advice concerning exchange-traded futures (and/or Commission-authorized options or authorized leverage transactions) constituted a minor part of the person's advisory activities, the person's advice as a CTA might be deemed an incidental result of the person's advisory business and, therefore, its business as a whole.[304] Accordingly, if we give the words "business," "incidental" and "solely" their ordinary meaning and read "advice . . . as a

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(or declined) to exempt persons who dealt in cash agricultural commodities but whose primary business was the provision of advice and did not qualify as nonprofit, voluntary membership, general farm organizations.

[303] However, Section 4m(1) makes no mention of exempting agricultural marketing consultants, cash commodity marketing advisors or the like. Accordingly, for reasons already discussed, Wright's cash market advice to his clients does not trigger an exemption from registration.

[304] We read "advice . . . as a commodity trading advisor" as referring to those types of advice that qualify a person as a CTA and not advice that is not listed in Section 1(a)(5).

commodity trading advisor" to refer to the types of advice listed in Section 1(a)(5), then we might be compelled to hold that a cash grain dealer who provides most of its advice concerning transactions in cash agricultural commodities (and contracts that are not listed in the definition of CTA) provides "advice . . . as a commodity trading advisor" in a manner that is solely incidental to the advisor's "business" if the recipients of its "advice . . . as a commodity trading advisor" are also recipients of some other good or service the dealer provides as part of its business as a whole. While there is reason to believe that Congress did not wish to go so far,[305] the reference to "business" is so ambiguous that reliance on the text of the statute and its legislative history leads to no

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[305] If we interpret "business" in the phrase "solely incidental to the conduct of that person's business" as referring to all activity that occurs for compensation or profit, then we would seem to read the term "solely" out of the phrase. After all, the advice that qualifies one as a CTA is, by definition, performed for compensation or profit. Thus, it would always be a part of the advisor's "business" and would not be unconnected. Accordingly, if advice was incidental to the advisor's business as a whole, it could not be other than "solely incidental" unless we were to engage in such ethereal inquiries as whether the advisor draws consumptive utility from providing advice or, more prosaically, whether it was a labor of love. Thus, while giving "business" a broad interpretation would ease our inquiry, it would also run afoul of orthodox statutory construction. <u>See</u> <u>Montclair v. Ramsdell</u>, 107 U.S. 147, 152 (1882) ("It is the duty of the court to give effect, if possible, to every clause and word of a statute . . . ."); <u>In re Kelly</u>, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,289 at 46,296 n.56 (ALJ Feb. 24, 1998).

definitive answer. As it turns out however, there is a Commission interpretation of the Section 4m(1) exemption hidden away in the Federal Register.

As noted above, shortly after enacting Rule 1.71, the Commission changed its wording and designation, in part, to harmonize the regulation with Section 4m(1). As part of this formal rulemaking, the Commission opined,

> In order to qualify for the new sec. 4m exemption, the CTA's commodity trading advice must be "solely incidental to the conduct of that person's business," *i.e.*, the person's business as a dealer, processor, broker or seller in cash market transactions or as a non-profit, voluntary membership, general farm organization . . . . The Section 4m registration -- like §1.71(c) was not intended to allow CTAs whose commodity trading advice is directed to commodity futures, commodity options or leverage transactions to evade registration by presenting their advice as directed only to the underlying cash commodity.[306]

Under this interpretation, grain dealer/CTAs that did not qualify for Rule 4.14(a)(1)'s exemption would not be exempt from registration as a result Section 4m(1). Although it does not have the force of law,[307] the Commission's brief interpretation occurred in a formal rulemaking and does not strike us as

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[306] Commodity Pool Operators and Commodity Trading Advisors; Final Rules, 44 Fed. Reg. at 1920 n.10 (emphasis added, italics in original).

[307] This is so because the interpretation was not subject to notice and comment, nor did it occur in the context of a Commission adjudication. See Richard J. Pierce, Jr., Administrative Law Treatise 152-56 (4th ed. 2002). However, it is entitled to deference. Id.

unreasonable or as having been rendered obsolete by the subsequent narrowing of the CTA definition. Thus, we are hard-pressed to vary from it and, in this case, we will not. For this reason, we hold that for a cash commodity broker-dealer/CTA to gain the Section 4m(1) exemption from the need to register, its trading advice must be solely incidental to the broker-dealer/CTA's business as a cash commodity broker-dealer. We also hold that, in Section 4m(1), the phrase "solely incidental to" has essentially the same meaning as it does in 4.14(a)(1) as we have construed the regulation above.

For the reasons set forth above, Wright provided "advice . . . as a commodity trading advisor" at times unrelated to his cash grain dealing and brokering and to persons who had no part of those activities. Thus, he did not impart "advice . . . as a commodity trading advisor" in a manner that was "solely incidental to" his grain dealing and brokering. For this reason, Wright was not exempt from registration and we conclude that Wright violated Section 4m(1) during the 1991-1996 period when he used the mails and phone lines in connection with his service of providing exchange-traded commodity futures and options trading advice. These instances would include but not be limited to every time, during the 1991-1996 period, that Wright mailed or faxed a copy of his newsletter that contained advice concerning the advisability of buying or selling (1) futures traded on or subject to the rules of a Commission-designated contract market and (2) commodity options authorized by the Commission pursuant to Section 4c.[308]

The Division Did Not Establish That Luxenburger And Edwards Aided And Abetted Wright

The Division alleged and maintains that Luxenburger aided and abetted Wright's violations and that Edwards is vicariously responsible[309] for Luxenburger's aiding and abetting as a result of him employment relationship with the FCM.[310] Edwards argued that aiding and abetting cannot be imputed to a firm by virtue

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[308] We decline to enumerate the total number of instances in which Wright violated Section 4m(1) since any additional precision would have no substantial effect on the sanctions we may impose or the constraints that the law places upon the sanctioning process. See infra note 537.

[309] The complaint alleges that Section 2(a)(1)(A)(iii), 7 U.S.C. §4, operates to impute to Edwards liability for Luxenburger's aiding and abetting. Amended Complaint, ¶56. In reality, it imputes acts, omissions and accompanying culpable states of mind from employees, officials and agents to their principals provided the acts or omissions occurred within the scope of the employment or agency. 7 U.S.C. §4 ("the act, omission or failure of any official . . . or other person acting for any . . . association . . . corporation, or trust within the scope of his employment or office shall be deemed the act, omission or failure of"). Thus, if the Division proves that Luxenburger aided and abetted Wright within the scope of his employment with the firm, we would not impute Luxenburger's liability to Edwards in the manner of Section 13(a). Rather, we would conclude that Edwards aided and abetting by deeming Edwards to have acted just as Luxenburger acted and then applying the law to those acts.

[310] Division Posthearing Memorandum at 48-51; Amended Complaint, ¶¶55-56.

of Section 2(a)(1)(iii) and that it could not be held liable on a respondeat superior basis for acts of Luxenburger that contradicted Edwards's compliance policy.[311] Luxenburger makes the argument upon which this part of the case turns. He denies having aided and abetted on grounds that he did not then appreciate the significance of Wright's advisory activities in light of his cash market business.[312]

Even if a person knows every unlawful act that another committed, that person did not aid and abet if he lacked awareness that unlawful acts were wrongful. The wrongful-not wrongful line is not bright in this area. Not every person who provides futures and options or commodity-related advice qualifies as a CTA.[313] Theoretically, people who fit the definition of CTA sometimes need not register even if no exemption applies.[314] Moreover, Commission has provided exemptions that permit a number of CTAs to lawfully forego registration.[315] Finally, Wright's Section 4m(1) violations do

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311 Edwards Posthearing Memorandum at 15-21.

312 Luxenburger Posthearing Memorandum at 9-10.

313 See supra note 259.

314 These would the rare (or, more likely, extinct) birds that operate as a CTA yet, with respect to this business, manage to avoid using the means of interstate commerce entirely.

315 See 17 C.F.R. §4.14(a).

not appear to have been inherently wrongful. Rather, they appear to have been technical. Under these circumstances, it is plausible that one could know every act that Wright committed and know of his failure to register as a CTA yet still not have a clue that he was acting wrongfully. In cases such as this, ignorance of the law could result in ignorance of the fact that Wright acted wrongfully.

At the oral hearing, Luxenburger was asked whether he believed Wright was required to be registered in any capacity.[316] He responded, "No, I did not believe he needed any registrations."[317] Later, he denied having believed that Wright was a CTA.[318] Rather, he testified to viewing Wright as a cash grain marketing consultant.[319] On the whole, Luxenburger indirectly portrayed himself as a person who had a less than rudimentary grasp of issues such as one's status as a CTA, when registration was required and when an trading club constituted a commodity pool.[320] In 1996, Luxenburger offered essentially the

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[316] Tr. vol. 2 at 47.

[317] Tr. vol. 2 at 47.

[318] Tr. vol. 2 at 51.

[319] Tr. vol. 2 at 50.

[320] Tr. vol. 2 at 47-51, 90.

same testimony.[321] In short, Luxenburger appears to have been too clueless to put one and one together and reach the conclusion that Wright's CTA activities crossed the line to become wrongful. We have located no other evidence that would permit a sufficiently-grounded inference that he was so aware.[322] We have also found no basis upon which to conclude that Luxenburger believed Wright's CTA activities to be otherwise wrongful.

Because the Division did not prove that Luxenburger was aware that Wright operated his CTA business wrongfully, it failed to established, by a preponderance of the evidence, that Luxenburger knowingly aided Wright's Section 4m(1) violations. The agency-based claim against Edwards fails for the same

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[321] DX-145 at 19-20 ("Q. Based on your understanding of what a CTA is, is Mr. Wright a CTA? A. Based on my understanding, I would say no.").

[322] Luxenburger was registered with the Commission during the relevant period. However, the Commission has held that registration does not presumptively mean knowledge. See supra note 180. There is reason not to presume. First, one need not know all of the law to pass the test that is generally required for Commission registration, the Series 3 examination. In addition, knowledge tends to decay with time unless applied or otherwise refreshed (those who disagree with this proposition are invited to recite from memory the names of their elementary school classmates). Luxenburger passed his Series 3 examination in 1983. DX-145 at 29. Assuming, arguendo, he had a good working knowledge the CTA registration requirements when he sat for the Series 3 exam, we would be climbing out on limb to assume that he still knew it in 1991 without some more probative evidence to that effect.

reason. Accordingly, we **DISMISS** Count III as to Luxenburger and Edwards.

THE CLAIMS OF FRAUD AGAINST WRIGHT

Three of the counts before us present allegations that Wright committed fraud in his dealings with clients. The evidence leads us to conclude that Wright did, in fact, seek to defraud others. However, the Act prohibits only certain types of fraud and the facts do not fit within all of the Division's theories.

The Division Proved That Wright Made Fraudulent Solicitations That Violated Section 4o

Count IV charges Wright with having violated Sections 4o(1)(A) and 4o(1)(B).[323] Section 4o(1) states,

> It shall be unlawful for a commodity trading advisor, associated person of a commodity trading advisor, commodity pool operator, or associated person of a commodity pool operator, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly--
>
> (A) to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or
>
> (B) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.[324]

[323] Amended Complaint, ¶¶57-59.

[324] 7 U.S.C. §6o(1).

Subsections (A) and (B) employ different terminology and have been construed differently. The Commission and federal courts read subsection (A) as prohibiting fraud and subsection (B) as prohibiting fraud-like acts.[325] The need to prove scienter distinguishes the two.[326] It is an element of a subsection (A) violation but need not be proven with respect to (B).[327] Thus, to establish a violation of Section 4o(1)(B), the Division must prove that: (1) the respondent was a commodity trading advisor or commodity pool operator during the time at issue; (2) the respondent made a misrepresentation or an omission;[328] (3) the

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[325] Messer v. E.F. Hutton & Co., 847 F.2d 673, 677-78 (11th Cir. 1988) (per curiam); SEC v. Princeton Econ. Int'l Ltd., 73 F. Supp. 2d 420, 424 (S.D.N.Y. 1999); In re Kolter, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,262 at 42,198-99 (CFTC Nov. 8, 1994). By "fraud-like" we means acts that have the same effect of fraud but that may not be fraud because they do not necessarily involve the scienter necessary for a finding of fraud.

[326] Messer, 847 F.2d at 677-78; Princeton Econ., 73 F. Supp. 2d at 424; Kolter, [1994-1996 Transfer Binder] ¶26,262 at 42,198-99.

[327] Messer, 847 F.2d at 677-78; Princeton Econ., 73 F. Supp. 2d at 424; Kolter, [1994-1996 Transfer Binder] ¶26,262 at 42,198-99.

[328] In the context of fraud, there are two types of omissions, pure omissions and omissions that are actionable only because they render affirmative representations misleading (i.e., omissions accompanying half truths). See Johnston v. HBO Film Mgmt., Inc., 265 F.3d 178, 192 (3rd Cir. 2001). For reasons discussed in earlier cases, we find pure omissions to violate the Act's antifraud provisions only when the Act or a Commission regulation requires disclosure. In re CMB Capital Mgmt. Corp.,

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misrepresentation or omission was material; (4) the object of the misrepresentation or an omission was the respondent's clients or the respondents' prospective clients, and (5) the respondent made use of the mails or any means or instrumentality of interstate commerce in connection with the fraud-like misrepresentation or omission. In order to establish that the same respondent violated Section 4o(1)(A), the Division must satisfy all of these elements as well as prove that the respondent made the misrepresentations or omissions with scienter.[329]

The Division argues that Wright violated Section 4o(1) when he solicited farmers for entry into the substitute HTAs.[330] It

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[1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,592 at 47,780 n.4 (CFTC Apr. 6, 1999); In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,926 n.72 (CFTC June 5, 1996) (citing Lehockzy v. Gerald, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,441 at 42,923-24 (CFTC June 12, 1995)).

329 Messer, 847 F.2d at 677-78; Princeton Econ., 73 F. Supp. 2d at 424; Kolter, [1994-1996 Transfer Binder] ¶26,262 at 42,198-99.

330 Division Posthearing Memorandum at 76-83, 85-86. Although, it indicated an intent to prove that Wright's Section 4o violations occurred "since 1991," the Division's case really focuses on the substitute HTA solicitations. Division Posthearing Memorandum at 76-83, 85-86 ("Wright defrauded his clients into signing the Substitute HTAs. . . . The same facts that establish Wright's violations of Section 4b constitute his Section 4o(1)(A) violations. At the same time, Wright's
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claims that Wright affirmatively misrepresented and failed to disclose: (1) the likelihood that entry into the substitute HTAs would garner suppliers good prices for their crops, (2) Wright's ability to ensure to establish a price floor for the farmers' grain through the substitute HTAs, (3) the risks associated with the necessary price rolling, (4) the compensation he received from Buckeye related to the HTA (his fee and a written waiver of claims against Wright), and (5) the risk that Buckeye would not be able to financially keep up its end of the bargain.[331] For the reasons discussed below, the Division established violations of both Section 4o(1) provisions.

The Real Subject Of Wright's Solicitation To The Preble County Farmers, His Plan And The Constraints Under Which He Labored

Before evaluating Wright's descriptions of the substitute HTAs, it seems fitting to determine the subject of Wright's alleged fraud, its proven characteristics and relevant circumstances. This inquiry is appropriate because Wright's solicitations encompassed more than the substitute HTAs. Often, when he tried to sell the farmers on the substitute HTAs, Wright

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activities combined to operate as an overall fraudulent scheme on the participants, in violation of Section 4o(1)(B).").

[331] Division Posthearing Memorandum at 76.

was also selling himself or, more accurately, his ability to wield the substitute HTAs and their associated "marketing tools" to achieve desirable outcomes.[332]

Wright's plan for the substitute HTAs did not require or recommend trades in on-exchange futures trades, writing options or purchasing calls.[333] Rather, it called for farmers to purchase puts through Buckeye. As a result, Wright's recommendations were constrained by the terms of the substitute HTAs. The primary constrains were threefold. First, farmers could only purchase options, they could not write them.[334] In addition, Buckeye charged transaction fees that included: a one-cent per bushel fee for purchasing options, a one-cent per bushel fee for rolls within the same crop year and a five-cent fee for rolls from one crop year to another.[335] Finally, Buckeye placed two limits on the amount of options that could be

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[332] See infra text accompanying note 346.

[333] DX-144 at 112-13.

[334] DX-144 at 110, 112-13. The farmers could offset, by sale, long positions. Tr. vol. 1 at 83.

[335] DX-144 at 110. Because the substitute HTAs required rolling even if delivery was not deferred beyond the point originally contracted for, these fees meant that, unless the rolls increased the reference price or the supplier made profitable options trades, the adjusted reference price would be at least five cents lower than the initial reference price at the time of the first delivery date.

purchased.[336] Farmers could only purchase options that corresponded to the number of bushels that they had under contract with Buckeye.[337] In addition, the substitute HTAs limited the total amount of options that could be purchased during specific time periods.[338]

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[336] In the past, Wright's clients had succeeded in increasing the reference prices on HTAs through options transactions. Tr. vol. 5 at 119-21. At least one time, this involved six to twelve options transactions in a single crop year. Tr. vol. 5 at 119. The substitute HTA suppliers did not have the luxury of such trading. DX-144 at 110.

[337] DX-144 at 1. As noted above, the risk associated with prospective rolls can be described as the risk that the price of the current-month futures will rise and/or that the out-month futures price will fall. From such a point of view, the inability to purchase puts and calls that corresponded to more than the number of bushels under contract meant that options could not be used to hedge against both aspects of spread risk. In addition, this limitation prevented suppliers from "delta hedging" (i.e., purchasing options that would cover more bushels than the farmer had under contract when the option's delta was less than one in the case of calls or more than negative one with respect to puts). See John C. Hull, Options, Futures, & Other Derivatives 302-03 (5th ed. 2002).

[338] The contract stated, "Eight cents will be available for the purchase of corn puts in the fall/winter 1995/96. . . . Eight cents will be available for the purchase of corn puts in the spring/summer 1996 on open contract bushels (undelivered bushels) and each year thereafter." DX-144 at 110. The "Eight cents" referred to the total amount of premiums that could be expended during the designated period for the purchase of options. Thus, if a substitute farmer purchased puts at a price of seven cents per bushel during the "fall/winter 1995/96," he would only be able to spend an aggregate of one cent per bushel on subsequent option purchases during the remainder of that span.

Within the constraints set forth above, Wright had the choice of trying to achieve price targets by: (1) using long put positions as a partial hedge against the rolling-related price risk and trying to time rolls so as to increase the adjusted reference price; (2) rolling the futures prices to the months in which delivery was expected, incur the reduction in adjusted reference price from the inverse and use the options to obtain speculative, upward adjustments to the reference price; or (3) using options to generate speculative profits to offset any downward price adjustments that result from rolling and seeking rolls that might minimize losses (and generate upward adjustments). It appears that Wright chose the third approach.

Wright believed that the price of old-crop corn would fall and the inverted spreads would disappear.[339] Thus, he did not

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[339] Wright did not believe that inverse between the 1995 and 1996 crop years would last. DX-128 at 5; DX-144 at 113; Tr. vol. 1 at 60; Wright Answer at 20. Thus, his plan was to wait out the old crop-new crop inverse by rolling from December 1995 to spring and summer months until the inverse declined or disappeared. Wright testified,

> I explained . . . that the reason that my clients had such good prices on their 1994 production was because of the inverse in the market. And I told him that in '80, '83, '88 and '93 the market had gone to an inverse because of the short crop. And that it would happen again and, in which case, if it did happen again, instead of rolling from December of the old crop year to December of the new crop year, we would roll from December of the old crop year to March or

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plan (and, in practice, did not try) to use options to hedge against spread risk.[340] Rather, he counseled timing price rolls and purchasing one option at a time and seems to have anticipated that this approach would generate substantial increases in the adjusted reference price.[341] Having determined

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> May or July of the new crop year and wait for the inverse to recede and then roll on out to the new crop month.

Tr. vol. 1 at 60.

[340] For example, almost immediately after entry into the substitute HTAs, the substitute farmers generally purchased May 1996 puts. DX-11 at 134; DX-37 at 1; DX-43 at 2; DX-46 at 9; DX-49 at 2; DX-69 at 3; DX-70 at 3; DX-84 at 2; DX-98 at 2; DX-109 at 2. At about the same time, they rolled the reference price to March 1996. DX-11 at 143; DX-37 at 1; DX-43 at 2; DX-46 at 9; DX-69 at 3; DX-70 at 3; DX-84 at 2; DX-98 at 2; DX-109 at 2. Later, Wright's plan called for a roll from March to May 1996. DX-37 at 5; DX-43 at 5; DX-46 at 26; DX-49 at 6; DX-69 at 5; DX-70 at 11; DX-84 at 6. Between the roll to March and the next roll to May, Wight recommended no transaction that would guard against increases in the price of March futures. Similarly, after the roll from March to May, Wright did not call for the farmers effect a transaction that would guard against price increases in May 1996 corn futures or against price declines in futures for later months. DX-37 at 5, 7; DX-43 at 5-6; DX-46 at 26, 42; DX-70 at 11, 14; DX-69 at 5, DX-70 at 11, 147. Thus, it appears that the position in May 1996 options was intended to generate a speculative profit rather than hedge any portion of the price risk that the substitute farmers faced. This inference receives additional support from Wright's correspondence with his general clients in October 1995 wherein he counseled the purchase of puts for the purpose of achieving speculative increases in HTA prices. DX-144 at 120.

[341] For example, when he explained what "the price on the December 1996 [substitute] HTA [could] be" in the fall of 1996, Wright opined that, if future prices mimicked historical prices,

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what Wright was often selling, we can now turn to how he touted it.

Wright's Written Solicitation Of The Preble County Farmers

As noted above, Wright sent a letter to the Preble County farmers in late October 1995 (the "October 30th letter").[342] The communication served to promote the substitute HTAs and Wright's plan for them. Early on, Wright touched on the issue of counterparty risk by stating that the substitute HTA offer was "one that Buckeye Countrymark has a commitment from their lender to back with the money through the life of the contract."[343] Later and after implicitly recognizing that the initial

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two put purchases would increase the adjusted reference price by 64 cents and that two rolls would occur, one which would result in a six-cent increase in the adjusted reference price and one that would result in a six-cent reduction. DX-144 at 112-13. As for the 1997 crop year, Wright speculated that the price roll from 1996 to 1997 would increase the adjusted reference price by an additional 30 cents. DX-144 at 113.

342 DX-144 at 112-3. Wright addressed the October 30, 1995 letter to "Folks." DX-144 at 112. However, Wright made several references to Buckeye's claim on the recipients' "1995 corn." DX-144 at 112. Although the Preble County farmers did not commit their 1995 corn to Buckeye, the AMS HTAs called for delivery of 1995 grain and it was contemplated that the Preble County farmers' would deliver their 1995 grain to fulfill Wright's 1995 crop year delivery obligation. <u>See</u> <u>supra</u> text accompanying notes 34-35. In the absence of evidence that all or most of Wright's clients had any connection to an obligation to deliver 1995 corn, we infer that Wright directed this letter to the Preble County farmers.

343 DX-144 at 112.

reference price for the substitute HTAs was below market,[344] Wright explained that he viewed substitute HTAs to present a good deal because of: (1) his undivided loyalty to farmers,[345] (2) Buckeye's absolute abandonment of a claim on the Preble County Farmers' corn, (3) the ability to use up to eight cents per crop year to purchase puts and (4) Wright's availability to "recommend actions . . . for the purchase of puts, the rolls, etc., throughout the life of the contracts."[346] He also explained how the prices for corn would turn out under his plan if prices for 1995 and 1996 mimicked 1993 and 1994.[347] The Division lumps this letter in with its other charges of fraud but denied the Court the benefit of any analysis that focused specifically on its contents.[348] However, it did well enough to establish that the letter included a fraudulent misrepresentation.

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344 DX-144 at 112 ("Your question is, 'Why should I sign this contract for 1996 and 1997 corn at $2.53 or $2.56 on a December, 1995 HTA price?'").

345 DX-144 at 112 ("Before I explain how I see this program working for you, keep in mind I work for farmers in all cases . . . .").

346 DX-144 at 112.

347 DX-144 at 113.

348 Division Posthearing Memorandum at 76-83.

Wright's Statement Of Lender Backing For The Substitute HTAs Was False

Before determining the falsity of a representation, we must determine the representation's meaning. "In determining the meaning of a representation, the touchstone is not so much the words of the solicitations themselves, but the message that those words actually convey" (i.e., how a reasonable recipient of the representation could have understood the statement in light of its actual content and the surrounding circumstances).[349] That process is eased when the statement was made in writing.

Wright's representation concerning creditor backing can be taken literally to mean that a creditor had agreed to finance Buckeye's obligations under the substitute HTAs for the life of the contracts. There is no credible evidence[350] that, when Wright sent the October 30th letter, Buckeye had secured a line of credit to finance its obligations under the substitute HTAS. Indeed, the weight of evidence is to the contrary. Buckeye's internal records reveal that, during October and November of 1995, its lender was CoBank, CoBank had frozen Buckeye's line of credit, Buckeye was concerned with its ability to post margin

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349 In re First Fin. Trading, Inc., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,089 at 53,682 n.39. (CFTC July 8, 2002).

350 See infra note 362.

with respect to HTAs, CoBank was withholding judgment on the possibility of extending additional credit to cover margin requirements and Buckeye had not yet secured another source of credit.[351] Thus, by his October 30th Letter, Wright affirmatively misrepresented the counterparty risk[352] that entrants into the substitute HTAs would face.[353]

Wright's Misrepresentation Of Counterparty Risk Was Material

A finding of materiality depends on an objective determination of whether there is a substantial likelihood that a reasonable prospective contract entrant "would consider the [represented or omitted] matter important in making . . . [the] decision" of whether to effect the relevant transaction.[354] Representations concerning a contract counterparty's ability to

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[351] DX-9 at 1-2, 5, 9-10, 13-14; DX-142 at 67-68.

[352] Really, he misrepresented one portion of counterparty risk, credit risk. Roberta Romano, A Thumbnail Sketch of Derivative Securities and Their Regulation, 55 Md. L. Rev. 1, 51 (1996).

[353] In light of this affirmative misrepresentation, his failure to disclose Buckeye's true financial status was incidental and not a pure omission.

[354] Sudol v. Shearson Loeb Rhoades Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,748, at 31,119 (CFTC Sept. 30, 1985) (citing TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

perform are generally held to be material.[355] The representation that Buckeye's offer of the substitute HTAs was backed by a creditor concerns a fact that a reasonable person, in the situation of the Preble County farmers, would consider important in determining whether to enter into the substitute HTAs.[356] This is so because, as the evidence shows, farmers enter into contracts such as HTAs with certain objectives in mind and, when they enter into one type of contract, they forego another. Thus, the farmers incur opportunity cost.[357] This cost is starkly manifested when an elevator defaults on an HTA due to credit insufficiency or insolvency and, regardless of whether the farmer made any payments to the elevator or delivered any

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355 Bell & Howell Fin. Servs. Co. v. St. Louis Pre-Sort, Inc., No. 97 C 6063, 1999 U.S. Dist. LEXIS 16233, at *11-12 (N.D. Ill. Sept. 28, 1999); Maciak v. Olejniczak, 79 F. Supp. 817, 819 (E.D. Mich. 1948). Cf. Combined Servs., Inc. v. Lynn Elecs. Corp., 888 F.2d 106, 107-08 (11th Cir. 1989).

356 Tr. vol. 5 at 135, 157-58. Wright touched on the reasons in his investigative deposition when he testified, "If a farmer thinks . . . there's any chance that he will not get paid for grain, he probably isn't going to deliver. And that would set off a chain of events that would be pretty ugly." DX-143 at 131. It would logically follow that, if the farmer was aware that he would not be paid for his grain before entry into an agreement with an elevator, he would take his business elsewhere.

357 Afram Export Corp. v. Metallurgiki Halyps, S.A., 772 F.2d 1358, 1369-70 (7th Cir. 1985); Robert Cooter & Melvin Aron Eisenberg, Damages for Breach of Contract, 73 Calif. L. Rev. 1432, 1440 (1985).

grain for which it has not received payment, the farmer loses the benefit of the contract into which he entered as well as the benefit of the one he would have entered had he not contracted with the defaulting elevator.[358] For this reason, Wright's written portrayal of Buckeye's finances was material.[359]

Wright Made His Written Misrepresentation With Scienter

"[M]isleading statements are made with scienter when, at the time they are made, the 'speaker' knows them to be false or harbors a reckless disregard for their truth or falsity."[360] The record of this case lends sufficient support to the inference that Wright made each one of the misrepresentation found above with scienter.

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358 As Buckeye demonstrated, when an elevator runs short of money, it may try to give its suppliers the worst of both worlds by not complying with the terms of the agreement while seeking to hold the suppliers to the contract.

359 The importance would seem greater in this case since Buckeye had already once refused to accept option orders in connection with the AMS HTAs due to a money crunch and Wright had disclosed this to the Preble County farmers before sending them the letter in question.

360 First Fin., [Current Transfer Binder] ¶29,089 at 53,684. As discussed in First Financial, the Commission's take on what constitutes recklessness is difficult to pin down. Id. at 53,684 n.66. However, we need not delve into the issue of whether recklessness amounts to a state of mind or a standard of conduct because Wright acted so culpably that either version would be satisfied.

The evidence shows that Wright was aware of Buckeye's financial situation when he solicited the Preble County Farmers.[361] Thus, Wright knew that Buckeye's credit had been frozen, that the freeze would not necessarily be lifted and Buckeye did not yet have a new lender. There is no credible evidence that anyone informed Wright that Buckeye's lender had agreed to finance Buckeye's obligations under the substitute HTAs.[362] From these circumstances, we infer that, when Wright informed the Preble County Farmers that Buckeye's lender had committed to backing the substitute HTAs through the life of the contracts, he knew that the representation was baseless and, indeed, knew it to be false. Thus, the Division established scienter as to the misrepresentation.

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[361] Tr. vol. 1 at 40; Tr. vol. 3 at 98-99.

[362] Wright testified at the hearing that he told Leach he would not solicit farmers to enter into the substitute HTAs unless Buckeye obtained its lender's approval of the contract (i.e. agreed to back it) and that he was told it had been obtained. Tr. vol. 1 at 46-47. This testimony is incredible.

When the Commission deposed him, Wright provided a detailed and fairly lurid description of the conversation by which he agreed to solicit farmers to enter into the Buckeye contract and he made no mention of the requiring such approval. DX-143 at 175-83, 219-20. In the deposition, Wright testified that he agreed to solicit farmers to enter into the contracts because Buckeye agreed to his terms and Leach had been forthright with him in their previous dealings. Id. Given these inconsistencies and the evidence that CoBank had not prospectively agreed to lift the credit freeze even if farmers covered AMS's delivery obligations, we cannot credit Wright's version of events. See infra note 388.

For the reasons set forth above, we find that Wright committed fraud and fraud like acts. Thus, if the Division proved that Wright committed the right type of fraud and constructive fraud, it will have established violations of Sections 4o(1)(A) and 4o(1)(B). As set forth in the statute, the right type of fraud or constructive fraud is one accomplished by use of some means or instrumentality of interstate commerce and directed at clients or prospective clients. For the reasons discussed below, the Division has presented sufficient evidence to satisfy these last two elements.

The Recipients Of The October 30th Letter Were Wright's Clients Or Prospective Clients, And Wright Used The Instrumentalities Of Interstate Commerce To Distribute It To The Preble County Farmers

Section 4o(1) prohibits acts perpetrated upon a "client" or a "prospective client." However, definitions for either of those terms appear nowhere in the Act. Ordinarily, the term "client" means one for whom professional services are rendered.[363] As a statutory term of art, it has been taken as being no less expansive.[364] The Seventh Circuit recently

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363 American Heritage Dictionary 281 (1976).

364 For example, the Commission has enforced Section 4o(1) against a seller of trading software, one of the most impersonal types of trading "advice." In re R & W Tech. Servs., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,582 at 47,728-29, 47,745 (CFTC Mar. 16, 1999).

interpreted Section 4o(1)'s reference to "client" in Commodity Trend Service, Inc. v. CFTC.[365] The appellant in that case argued that the term "client" designated only those who received personalized advice within a fiduciary relationship (or those on whose behalf a broker executed trades) and implicitly excluded those who received impersonal guidance.[366] Finding the term ambiguous and deferring to the Commission's view, the panel held that recipients of a CTA's impersonal advice, such as published advice that was tailored to no specific recipient, were clients for purposes of applying Section 4o(1).[367]

When Wright solicited the Preble County farmers to enter into the substitute HTAs, he was marketing more than a grain sales contract. In addition to contract rights, these farmers were made to expect that they would receive Wright's advice on matters that included the purchase of options. Accordingly, if they were not already his clients by virtue of pre-existing relationship, they were Wright's prospective clients.[368] Given

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365 233 F.3d 981, 987-89 (7th Cir. 2000).

366 Id. at 998.

367 Id. at 998-91.

368 Applying Commodity Trend in this case results in the conclusion that any recipient of Wright's AMS newsletters would also qualify as Section 4o(1) "clients." Certainly, newsletter recipients are no less clients than the purchasers of software in R & W.

these facts as well as Wright's status as a CTA, Section 4o(1) governed his solicitation of the substitute HTAs provided he made them "by use of" the instrumentalities of interstate commerce.

A fraud or fraud-like act occurs "by use of" the instrumentalities of interstate commerce when a respondent uses such instrumentalities in furtherance of and as an important part of fraudulent or constructively fraudulent acts.[369] In this

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[369] As implied above, this portion of Section 4o(1) has not received any substantial attention. However, the application of analogous statutes helps us to determine what must be proven to satisfy this element. The federal wire fraud statute, 18 U.S.C. §1343, authorizes the criminal punishment of a person who "transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing" a fraudulent scheme. The mail fraud statute criminalizes the use of the United States Postal Service or private interstate carriers "for the purpose of executing" fraudulent schemes. 18 U.S.C. §1341. Courts applying these statutes do not require that the mails or instrumentalities of interstate commerce be used to transmit the fraudulent messages at issue in order to qualify as wire or mail fraud. Rather, they require only that the wires or instrumentalities of interstate commerce be used to further the fraudulent scheme in some substantial respect. See, e.g., United States v. Rico Indus., Inc., 854 F.2d 710, 712-13 (5th Cir. 1988) (holding that use of the mails need only be incidental to an essential part of a scheme to defraud to satisfy the use of the mails prong of the federal mail fraud statute and that use of the mails to distribute the proceeds of a fraud was incidental to an essential part of the fraud); United States v. Kwiat, 817 F.2d 440, 443 (7th Cir. 1987) ("This is not to say that the mailing itself must be fraudulent."); United States v. Benny, 786 F.2d 1410, 1420 (9th Cir. 1986) (holding that "[a] mailing need not itself be false to be in furtherance of a scheme to defraud" but, instead, it need only be closely entwined or closely related to the scheme to defraud); United States v. Puckett, 692
(continued..)

case, Wright's written fraud occurred in a letter. The Division has presented evidence that Wright did not deliver letters to his clients and prospective clients by hand. Instead, it appears that he either mailed them or transmitted them by facsimile depending on the recipient.[370] Thus, it appears that Wright used the instrumentalities of interstate commerce to deliver the October 30th letter. This is a more than sufficient use of the interstate commerce mechanisms.

For the reasons set forth above, we find that Wright violated Sections 4o(1)(A) and 4o(1)(B) when he mailed the October 30th letter to the Preble County farmers. This finding does not end our inquiry since, the Commission initiated and the Division maintains claims that Wright's fraud extended beyond the letter. Thus, we must consider whether Wright orally committed fraud and/or fraud-like acts in his solicitations of Buckeye suppliers.

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F.2d 663, 669 (10th Cir. 1982) (holding that use of the wires must be "incident to the accomplishment of an essential part of the [fraudulent] scheme" and noting that "the communication proscribed by the wire fraud statute need not be directed to the victim of the fraudulent scheme"). Drawing on this authority, we hold that use of the means of interstate commerce need only be in furtherance of an important part of the fraud (or fraud-like) acts in question to satisfy Section 4o(1).

[370] DX-144 at 53; Tr. vol. 1 at 90.

Wright Committed Fraud By Omission

As noted above, after his solicitations of the Preble County farmers failed almost completely, Wright solicited some of his then-current clients. He did this in one-to-one communications and group meetings.[371] Determining the existence of fraud by affirmative misrepresentation in such communications is often difficult when the best evidence is after-the-fact testimony in which the objects of solicitations provide brief descriptions of more lengthy presentations.[372] In this case, the

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[371] Tr. vol. 1 at 45. For example, Wright presided over a meeting at an establishment called Frisch's in Urbana, Ohio. Tr. vol. 1 at 45.

[372] See First Fin., [Current Transfer Binder] ¶29,089 at 53,682 n.39; Donald C. Langevoort, Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms), 146 U. Pa. L. Rev. 101, 120 (1997) ("As the children's game of telephone inevitably illustrates, the mere act of retransmission makes it increasingly probable that the final message will not be the same as the one first sent."). As we explained in Gorski,

> The testimony of events may become distorted at each of the processes that lead from observation to testimony: perception (or acquisition), storage of information and recitation of stored information. During the retention phase, distortions may result from "the natural decay of memory over time" as well as "the transmutation of memory due to suggestion from external sources."

[1998-1999 Transfer Binder] ¶27,742 at 48,511-12 (footnotes omitted).

Thomas Prince gave us an example of how the process of using one person's subjective impressions to determine the

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record is sketchy on precisely what Wright said in his oral representations but more clear on what he failed to say.[373]

(..continued)

actual words communicated can lead to a distorted view of what really occurred. He testified that Wright had portrayed the substitute HTAs as involving "no risk." Tr. vol. 4 at 126, 128, 154. In doing so, he initially created the impression that Wright caused him to understand that the substitute HTAs involved no risk regardless of how prices moved and regardless of how well Wright advised him. On cross-examination, Thomas Prince revealed that what he meant to indicate by his reference to no risk was confidence that Wright's plan would eventually work, confidence that was based, at least in part, by having "seen it work before." Tr. vol. 4 at 154-55. While such an expression of confidence could be actionable -- if it was Wright's, rather than Prince's, and depending on the exact words used and the surrounding circumstances -- it is less likely to be deemed fraudulent than a flat representation that the substitute HTAs were risk-free.

[373] For example, the Division posits that Wright misrepresented the substitute HTA cancellation clause as having no financial consequence or condition other than the requirement of paying a 10-cent per bushel cancellation fee. Division Posthearing Memorandum at 80-81. In support of this assertion, it refers to the testimony of Thomas Prince and Howell. Id. at 80. At one point in his testimony, Thomas Prince claimed to understand that the contract permitted him to cancel his obligations provided he met only one condition, payment of a 10-cent fee. However, he also testified, "But I understood the contract is that I, for 10 cents, could be out of these contracts when I got back to black ink." Tr. vol. 4 at 117 (emphasis added). He later confirmed this understanding. Tr. vol. 4 at 128. Thus, he testified to having understood that the right to cancel the contract for 10-cents per bushel was conditioned on the adjusted reference price exceeding the current market price. Such testimony leads us to discredit Thomas Prince's understanding, as described by the Division, on one of two grounds. Either because of the apparent inconsistency or Thomas Prince's tendency to gloss over material details when first describing things. See supra note 372. In addition, such testimony is inconsistent with the assertion that Thomas Prince entered into the HTAs to earn speculative profits. See Division Posthearing Memorandum at 41. We have already

(continued..)

Thus, we first consider whether Wright committed fraud by pure omission.[374] In addition, we must also consider whether he committed this type of fraud upon the Preble County farmers.

The Division alleges that Wright fraudulently failed to disclose facts including, but not limited to, the compensation he received from Buckeye and the counterparty risk inherent in the substitute HTAs.[375] Given Wright's status as a CTA, the most

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discussed the inconsistency of Howell's testimony on this issue. See supra note 160. Because Thomas Prince and Howell were insufficiently credible on this point, the Division did not establish, by a preponderance of the evidence, that Wright told his clients that the substitute HTAs permitted them to cancel the contract with the payment of 10-cent fee and without other financial consequences.

[374] See supra note 328.

[375] Division Posthearing Memorandum at 81-83. The Division also argued that he failed to disclose the price risks inherent in the substitute HTAs. Id. at 81-83. Moreover, it asserts that that Wright failed to disclose to the signers of the substitute HTAs that "writing call options could result in the creation of additional HTAs." Id. at 83. This last assertion strikes us as farfetched. As discussed above, the substitute HTAs did not give signatories the authority to write calls (i.e., establish short call positions). Thus, the HTAs did not seem to pose this risk. As a result, if pressed to resolve this portion of the Division's case, we would find either that there was no duty to make this disclosure because the "fact" did not exist or that failure to disclose was not fraudulent because the "fact" was immaterial to suppliers who had no right to establish short option positions.

likely source of a legal duty to make such disclosures was Rule 4.31(a).[376] It states,

> No commodity trading advisor registered or required to be registered under the Act may solicit a prospective client, or enter into an agreement with a prospective client to direct the client's commodity interest account or to guide the client's commodity interest trading by means of a systematic program that recommends specific transactions, unless the commodity trading advisor, at or before the time it engages in the solicitation or enters into the agreement (whichever is earlier), delivers or causes to be delivered to the prospective client a Disclosure Document for the trading program pursuant to which the trading advisor seeks to direct the client's account or to guide the client's trading, containing the information set forth in §§4.34 and 4.35.[377]

The importance of whether Wright had a legal duty to provide disclosure documents to the substitute farmers stems from the Rule 4.34 and Rule 4.35 requirements that, among other things, a CTA provide: (1) "[a] full description of any actual or potential conflicts of interest regarding any aspect of the trading program on the part of . . . [t]he commodity trading advisor;" (2) "[a] discussion of the principal risk factors of th[e] trading program" that "must include, without limitation,

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376 17 C.F.R. §4.31(a).

377 17 C.F.R. §4.31(a). We read "direct the client's commodity interest account or to guide the client's commodity interest trading by means of a systematic program that recommends specific transactions" to exclude impersonal, published advice as well as _ad hoc_, personalized advice such as may occur when a client approaches a CTA and seeks advice concerning an isolated event or trade and the CTA renders such limited advice.

risks due to volatility . . . and counterparty creditworthiness, as applicable to the trading program and the types of transactions and investment activity expected to be engaged in pursuant to such program;" (3) a disclosure of the business background of the CTA; and (4) performance disclosures concerning the CTA.[378] These include precisely the kind of facts that the Division argues Wright withheld to the substitute farmers detriment. Thus we must determine whether Wright had a legal obligation to make these disclosures, whether he did and, if not, whether the omissions concerned material facts, and whether Wright knowingly or recklessly withheld the information.

As the first phrase of Rule 4.31(a) unambiguously indicates, it applies to persons who meet the definition of CTA and who are either registered or should be. We have already found Wright to be a CTA who was required to be registered during the relevant period of time. Moreover, we have concluded that the substitute farmers were "clients" and all other persons that Wright solicited for entry into the substitute HTAs by offering his associated services were prospective clients.[379]

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[378] 17 C.F.R. §4.34 (f)-(g), (j), (m); 17 C.F.R. §4.35.

[379] Neither Rule 1.3, Rule 4.10 nor Rule 4.31 defines "client" or "prospective client." <u>See</u> 17 C.F.R. §§1.3, 4.10, 4.31. Given the other qualifying language in Rule 4.31 we do not hesitate to apply the earlier working definition of CTA client, one who receives advice from a CTA.

Given these findings, we have only one more issue to consider, whether Wright offered to or agreed to "direct the client's commodity interest account or to guide the client's commodity interest trading by means of a systematic program that recommends specific transactions" when he solicited the substitute farmers and advised them as to either the substitute HTAs or the options traded through Buckeye related to the substitute HTAs.

The Commission defines "commodity interest" to mean, "[a]ny contract for the purchase or sale of a commodity for futures delivery; and . . . [a]ny contract, agreement or transaction subject to Commission regulation under section 4c or 19 of the Act."[380] As discussed above, Wright touted the substitute HTAs, in part, by telling farmers that he would advise them concerning the purchase and sale of corn options.[381] The evidence indicates that what he was offering was advice concerning the purchase and sale of options on corn futures. Congress granted the Commission regulatory jurisdiction over these contracts.[382]

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[380] 17 C.F.R. §4.10(a).

[381] As discussed below, Wright did not always do this. Sometimes, here merely informed a client of the contract's existence and referred them to Buckeye. Tr. vol. 5 at 68-70. <u>See</u> <u>infra</u> notes 411-12.

[382] Corn options -- be they off-exchange options for cash corn offered by a board of trade that is not qualified as a contract (continued..)

Accordingly, when the substitute farmers purchased options with the intent of offsetting them at a profit, they engaged in commodity interest trading. Similarly, when Wright offered to tell the farmers when to purchase options and what options to purchase pursuant to a "plan" that would result in systematic trade recommendations, he was soliciting clients to guide their commodity interest trading.[383] By the time he began giving advice with respect to the substitute HTA-related options, Wright had agreed to guide the substitute farmers' commodity interest trading pursuant to such a program.[384] Thus, when he solicited farmers to enter into substitute HTAs and follow his advice,[385] Wright had a legal duty to disclose facts that

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market or options on corn futures traded on a contract market -- are options over which the Commission has regulatory authority and options over which this authority was been exercised. 7 U.S.C. §§1a(1), 1a(3), 2, 6c; 17 C.F.R. §§32.2, 32.3.

383 In addition, we find that Wright offered and agreed to guide the trading by a systematic program that recommends specific trades.

384 In addition, Wright received authority to place option trades for some of the substitute farmers in April 1996. DX-3 at 2, 4-5, 8-9.

385 As discussed below, not every farmer solicited for entry into the substitute HTA was also solicited to adopt Wright's program.

included any conflicts of interest and the associated counterparty risk.[386]

It is clear that Wright did not disclose the conflict of interest arising from the compensation he received from Buckeye.[387] As for disclosing counterparty risk, it appears that Wright sometimes did so (or, at least, stood by as Leach relieved him of the obligation),[388] sometimes did not[389] and, as

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[386] However, we cannot conclude that he had a duty to disclose this his compensation every time he solicited a farmer concerning the substitute HTAs. The evidence suggests that, when the solicitations began, Buckeye had yet to promise compensation. <u>See</u> <u>supra</u> note 67.

[387] Tr. vol. 1 at 50, 111-12 ("Q[:] And isn't it a fact, sir, that at the time you secured substitute farmers for those contracts, that you did not disclose to them that you were receiving approximately $250 per contract from Buckeye Countrymark and a total amount of over $5,000 from Buckeye Countrymark? A[:] That is true."); Tr. vol. 4 at 161.

[388] As discussed below, Howell and Thomas Price attended a meeting in Urbana, Ohio at which Wright solicited them to enter into substitute HTAs. In describing what transpired there, Howell stated, "I think there was pressure by the bank . . . it would be my recollection that Bill Leach would have volunteered this information, that they needed to have names put on these replacement contracts." Tr. vol. 2 at 223. Prince testified that the meeting included a disclosure that Buckeye was "hunting sources of financing." Tr. vol. 4 at 74. If Wright was aware that Leach disclosed that Buckeye had lost its financing at the meeting, we do not believe that it would have been fraudulent to not repeat the fact to the same audience, especially when the person who made the disclosure could speak of the matter with greater authority given his office at Buckeye.

[389] Tr. vol. 2 at 149-50; Tr. vol. 5 at 76. Indeed, there is evidence that Wright repeated the misrepresentation contained in the October 30th letter. Tr. vol. 3 at 10.

discussed above, sometimes misrepresented the state of Buckeye's finances.

For the same reasons we concluded that Wright's affirmative misrepresentations concerning Buckeye's finances were false material and knowing, we find that Wright failure to disclose the counterparty risk relating to Buckeye's finances was an omission of a fact that was material and an omission that occurred knowingly. The same is true as to Wright's failure to disclose his compensation.[390] In addition, the objects of the

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[390] As discussed above, Wright was receiving compensation from the substitute HTA suppliers' counterparty. The Commission has found a conflict of interest to be material when an advisor touted its services. In re Citadel Trading Co. of Chicago, Ltd., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,082 at 32,184-88 (CFTC May 12, 1986) (holding that a CTA made a material misrepresentation when, during a series of lectures, he solicited customers to open an account with a particular broker and grant him discretionary authority over the accounts and, in the course of the solicitations asked only that those who took him up on the offer provide testimonials for his book, while failing to disclose that the broker had agreed to pay him a percentage of the commissions generated by his clients' trading). In this case, it is difficult to escape the conclusion that an objective farmer would have considered the existence of Wright's deal with Buckeye important in determining whether to follow his recommendation. To be more precise, if an objective farmer knew that Wright was receiving a commission, he would have tended to view Wright's recommendations as promotional rather than the relatively disinterested analysis that they appeared to be. On that basis, the reasonable farmer would have tended to discount them. Thus, we find that Wright failed to disclose a material fact when, after he reached an agreement with Buckeye, he solicited farmers to enter into the substitute HTAs. As for scienter, Wright was aware of his agreement with Buckeye and his failure to disclose it. Thus, the omission occurred knowingly.

oral misrepresentations were clients or prospective clients when Wright solicited them. Moreover, Wright used the means of interstate commerce in connection with his oral solicitations.[391] Thus, we find that, by omissions, Wright violated Sections 4o(1)(A) and 4o(1)(B)[392] in certain oral solicitations of the substitute farmers[393] and his written solicitation of the Preble County farmers.[394]

Wright Committed Fraud By Affirmative Misrepresentation

In addition to written misrepresentations and pure omissions, the Division alleges that Wright made affirmative spoken misrepresentations concerning the nature of the substitute HTAs and, thereby, created the impression that the

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[391] Wright used the telephone to arrange for meetings with substitute farmers at which he solicited them with respect to the substitute HTAs. Tr. vol. 2 at 117, 218. In addition, he conducted substitute HTA solicitations by telephone. Tr. vol. 3 at 9-11; Tr. vol. 4 at 75.

[392] In addition, we find that Wright violated Rule 4.31(a) by failing to deliver disclosure documents to those who he solicited with respect to both the substitute HTAs and his program for options trading related to the substitute HTAs. See Amended Complaint, ¶¶67-69.

[393] See supra text accompanying notes 342-47.

[394] Of course, as discussed above, the scope of failures to disclose varied between the Preble County farmers and the substitute farmers as well as among the substitute farmers themselves.

contracts locked in a price floor for suppliers.[395] The record demonstrates that Wright orally discussed the contracts with his clients at meetings and in personal conversations. There is also a sufficient basis upon which to find that Wright committed fraud in one solicitation on the issue of a price floor. However, the Division did not establish that Wright regularly made the fraudulent misrepresentation that the substitute HTAs (alone or in combination with Wright's plan) amounted to minimum price contracts.

The Solicitation At Frisch's

At an establishment called Frisch's in Urbana, Ohio, Wright presided over a meeting that Thomas Prince, Howell, Leach and a fourth person (Cliff Baughman) attended.[396] Division witnesses Howell and Thomas Prince[397] purported to describe what Wright said to those assembled. Both testified that Wright described the features of the substitute HTAs and that they were informed that Buckeye was having problems with financing, and Howell testified that Wright failed to disclose that he receiving

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[395] Division Posthearing Memorandum at 77-78.

[396] Tr. vol. 1 at 45; Tr. vol. 2 at 219-20; Tr. vol. 4 at 67-70.

[397] Tr. vol. 2 at 212; Tr. vol. 4 at 62.

compensation from Buckeye.[398] However, their testimony differed on whether Wright portrayed the substitute HTAs as establishing a price floor.

Prince claimed that Wright distributed a handout, described the features of the substitute HTAs and portrayed them as a "good deal" wherein a farmer "couldn't go wrong."[399] Howell, on the other hand, testified that Wright described the "tools" made available by the substitute HTAs and spoke in terms of goals -- not guarantees -- while revealing that entrants into the substitute HTAs would incur some risk.[400] The Division made no effort to show that Thomas Prince's testimony on this point was more credible that Howell's. Rather, it chose to ignore it.[401] In addition, the Division did not fall into demonstrating that

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398 Tr. vol. 2 at 223-24; Tr. vol. 4 at 72, 74, 77. Howell stated, "I think there was pressure by the bank . . . it would be my recollection that Bill Leach would have volunteered this information, that they needed to have names put on these replacement contracts." Tr. vol. 2 at 223. Prince testified that the meeting included a disclosure that Buckeye was "hunting sources of financing." Tr. vol. 4 at 74.

399 Tr. vol. 4 at 72.

400 Tr. vol. 2 at 224 ("Q[:] What, if any, discussion of risk associated with rolling was discussed? A [:] . . . I believe Roger mentioned and talked about that there were spread risk to that agreement.").

401 Without citation to the record, the Division argued, "Wright did not tell Howell about [r]olling risks." Division Posthearing Memorandum at 36.

Thomas Prince should be believed on this point instead of Howell. At best, from the Division's perspective,[402] the testimony of these witnesses appears to have been mutually negating on the issue of whether Wright portrayed the substitute HTAs as the equivalent of a minimum price contract when he spoke at Frisch's. However, Thomas Prince and, to a lesser degree, Howell lend support to Wright's claim of having told them that Buckeye's operating line of credit had been frozen.[403]

Solicitations At Regular AMS Meetings

Wright also brought up the substitute HTAs in at least one monthly group meeting with AMS clients. Grieser and Spoerl both testified that he discussed the substitute HTAs and his plan for them in this setting.[404] As to the manner in which Wright described the contract, their testimony differed. Grieser recalled Wright having described the substitute HTAs as a contract that would permit farmers to "lock in" a price for their corn.[405] Spoerl testified that Wright did not sell them on

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[402] At worst, Howell evidenced that at least one of Wright's solicitations involved an express reference to the risk inherent in the substitute HTAs.

[403] See supra note 398.

[404] Tr. vol. 1 at 178-79, 197-98; Tr. vol. 5 at 68-70.

[405] He summarized,

(continued..)

the contract but, rather, most of the representations concerning the contract came from Buckeye.[406] Even if we were to resolve this disagreement in favor of Grieser,[407] his descriptions of what purports to have been a lengthy and detailed explanation was so generalized and vague that we can draw no meaningful inferences as to the words that Wright actually used and the

(..continued)

> I don't recall if it was in the October meeting or when exactly it was, but Roger had said there was an opportunity there to -- to enter into a hedge-to-arrive contract with Buckeye. He explained the workings of the hedge-to-arrive and I had used them in prior years.
>
> . . . .
>
> At that time, it was the contract where you could lock in a price, and you could deliver to another location, which I had normally moved my grain to -- I could go to any elevator really with an alternate delivery clause. There was a buyout clause on the hedge-to-arrive where I could -- if we didn't deliver, we could just buy out the contract.

Tr. vol. 5 at 68-70.

[406] Tr. vol. 1 at 197-98. In addition, he testified that the Buckeye HTA came up in the midst of discussions concerning the "scuttlebutt . . . that Co Bank pulled [Buckeye's] loan." Tr. vol. 1 at 197.

[407] The Division provided no basis upon which to do so.

meaning they would have had to an objective and then-disinterested farmer.[408]

Personal Solicitations

If the relevant witnesses' testimony is taken at face value, Wright did not solicit farmers one-on-one by making identical presentations.[409] In an investigative deposition,[410] Jeffers provided the following testimony concerning his entry into the substitute HTAs.

> Q. Okay. Your signature is at the bottom left of the first page and the bottom right of the second page?
>
> A. Yes.
>
> Q. And the date on those is accurate?
>
> A. Yes, it is to my knowledge.
>
> Q. And was Roger Wright present?

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[408] As discussed above, in order to determine whether the representation is false, we must first determine the objective words spoken and then determine what impression those words would have on the hypothetical, objective recipient. <u>See</u> <u>supra</u> note 349. When a witness -- especially a witness who has an interest in the outcome of a proceeding -- offers a brief, subjective summary, this task often becomes too difficult to perform reliably. When it is too difficult, the party that shoulders the burden of proof tends to suffer.

[409] Of course, there is an alternative explanation that would be just as reasonable. Wright may have given substantially-identical presentations and the witnesses may have either remembered them differently or chose to describe them differently.

[410] DX-148 at 1-7.

A. No.

Q. And had Roger Wright discussed with you the particulars of this contract before you signed it?

A. To my knowledge, no. All he told me was to read it and decide what to do.

Q. And what was your understanding of how this contract marked as Exhibit 5 worked?

A. I had -- at the time the corn market was considerably higher than what these futures contracts or this HTA contract actually is. Bill told me -- Bill Leach told me that these are contracts that other farmers walked away from, and he was in a pinch with his banker and had to have these contracts signed, or he was in essence going to be put out of business.

And in agreement to doing that he was going to allow me to buy puts for a set fee over a period of time in order to enhance the price of these contracts.[411]

Earlier in the deposition, Jeffers had testified that, in a conversation with him, Wright touted a substitute HTA as an alternative to his HTAs with Countrymark and counseled that he should read it.[412]

Snell also received a personal, telephonic solicitation from Wright.[413] In describing Wright's solicitation, he did not testify that Wright portrayed the substitute HTAs as setting a price floor. Rather, he claimed to recall that Wright

[411] DX-148 at 74-75.

[412] DX-148 at 57-58.

[413] Tr. vol. 3 at 10-11.

acknowledged that the substitute HTAs' initial reference price was lower than the current market and described what he hoped to accomplish with his plan.[414]

One substitute farmer who received a personal solicitation from Wright appears to support the Division's argument. Both at the hearing and before this proceeding began, Hamman testified, that Leach visited him and asked him to enter into a substitute HTA and, after that, Hamman telephoned Wright who paid him a personal visit.[415] Hamman claims that, during that visit, Wright

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[414] To be more precise, he testified,

> And so when I asked Roger, he said, well, he had this -- he had this plan. He says, you know, "You've got -- You've got at least two years to deliver this grain," and he said Buckeye Countrymark was going to put up like 8 cents for the winter and the spring rolls or puts or options, and his plan was to roll it from like -- from -- that was the December contract, and roll that to March and <u>possibly pick up 4 cents</u>, and then he was going to roll it from March to -- to May or July, <u>maybe pick up another 6 cents</u>, and had hoped to buy some puts and <u>maybe pick up as much as 30 cents</u>, and so, you know, you get 40 cents on 255 you're not looking at too bad a price for corn. And then, they also had another 8 cents that he said that they were -- were going to buy in this the following summer and the next fall to do these rolls.

Tr. vol. 3 at 11-12 (emphasis added).

[415] <u>See</u> <u>infra</u> note 416.

told him that the substitute HTAs in combination with Wright's plan would set a price floor of \$2.50.[416]

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[416] The following colloquy took place.

> A[.] We were -- They -- Buckeye came out to our farm and asked us to sign a contract, and at that point we refused to do so.
>
> Q[.] Okay. And when you say Buckeye came out, who came out to the farm?
>
> A[.] I don't recall the man's name; one of the representatives that worked there.
>
> Q[.] Okay. And what happened when he came out to the farm?
>
> A[.] He wanted us to sign this contract, and we said we would not sign it because we didn't have any idea what it was for.
>
> Q[.] Okay. So what happened?
>
> A[.] We ended up calling Roger Wright and asking him what this was all about, and he ended up coming out and meeting with us.
>
> . . . .
>
> Q[.] After you called him, did he come out to the farm?
>
> A[.] Yes, he did.
>
> Q[.] And what did he say to you when he came out to the farm?
>
> A[.] He thought the contracts were good -- good contracts, they were for a hundred thousand bushel a year for four years in a row.

(continued..)

(..continued)

. . . .

Q[.] Why don't you just tell the Court what Mr. Wright told you was good about those contracts at that time when he came to the house?

A[.] He said that these -- the worst we could get for these contracts was $2.50 a bushel, and he thought it was going to be good for us to -- to sign them, to sign for a hundred thousand bushel a year. He had facts and figures and documentation of things that happened in the past, as far as the grain marketings were concerned.

Q[.] Did he represent anything else that was good about the contract other than that?

A[.] It had -- It had -- Buckeye was going to buy puts and calls, they were going to pay for them, there was going to be rolls, they were going to take care of that expense, there's a cancellation fee. We didn't have to actually deliver to that -- to Buckeye, there was other destinations of our choice.

Q[.] And what did he say bad about that contract at that time?

A[.] He never really said anything bad about the contract.

Q[.] And after those representations, what did you do?

A[.] Well, we -- we kind of told Roger we'd probably sign them. And then they sent somebody out another day and we did actually sign the contract.

(continued..)

Other Testimony

The Division argues that "Wright . . . represented to Fogelsong that $2.50 was the 'floor' price under the [the substitute HTAs]," and, in support thereof, referred to Fogelsong's testimony.[417] This assertion resulted from having overlooked (or implicitly mischaracterized) two important aspects of his statements. First, Fogelsong did not testify that, when Wright described the benefits of HTAs to him, he said "$2.50" was the price floor.[418] More importantly, when Fogelsong testified to Wright's representation that HTAs provided a price

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(..continued)

Tr. vol. 2 at 117-19. Accord DX-144 at 60 ("Roger thought . . . 2.50 was the worst we were going to get. Anything that happened . . . we wasn't going to get any less than 2.50.").

[417] Division Posthearing Memorandum at 78 & n.316.

[418] In support of its assertion, the Division cited Tr. vol. 4 at 33, lines 5 through 7. Id. at 78 & n.316. In this portion of his testimony, Fogelsong stated,

> With the pros of a HTA, you would establish a floor price to build on through rolls, calls or puts. But then as the -- we went along with this contract with Columbus Countrymark in January of '95 or somewhere in that time frame, early '95, Columbus Countrymark changed the marketing plan as to how many rolls we could do and calls and puts, plus they also added on higher service fees to do it.

Tr. vol. 4 at 33.

floor, he was not describing the substitute HTAs.[419] More to the point, it is not clear that the HTAs he was describing involved necessary or anticipated rolls when Wright described them. Thus, even though the substitute HTAs did not lock in a price because rolling was required, we cannot say that Wright's characterization of the "Countrymark Columbus" HTA was false if he described it as locking in a price[420] nor did the Division seek to prove that his actual representation was false.[421]

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[419] As the above-quoted testimony indicated, Fogelsong did not purport to characterize Wright's description of substitute HTAs. See supra note 418. Rather, he testified to Wright's description of an HTA offered by "Columbus Countrymark." Tr. vol. 4 at 32-33.

[420] As discussed above, if a supplier enters into an HTA and does not intend to roll price or delivery, the only portion of the ultimate price that remains undetermined is the basis. Thus, to a large extent but not completely, HTAs can lock in prices.

[421] See Division Posthearing Memorandum at 78-79.

The Division also argues that Wright told Bob Finkbine that HTAs were minimum price contracts that, when combined with options, provided "minimum upside potential." Id. at 78. On cross-examination, Finkbine admitted that he did not recall Wright having actually referred to HTAs as minimum price contracts but, rather, that he discussed the use of options in an attempt to address the risks associated with rolling. Tr. vol. 5 at 50-51. More importantly, Finkbine's stated "understanding" was so confused that it is impossible to reliably determine what Wright told him. For example, the record clearly indicated that Wright understood the relationship between price movements in underlying assets and their effect on the price of options. In other words, Wright did not appear to believe that a put would increase in value if the underlying asset increased in price. Finkbine, on the other hand, had impressions that were flat wrong such as understanding that the (continued..)

Wright (At Least) Once Misrepresented The Price Risk Of The Substitute HTAs

For the reasons set forth above, the Division failed to prove that Wright always (or regularly) characterized the substitute CTAs as setting a price floor. However, Hamman testified that Wright made such representations in a personal conversation. Wright did not deny this.[422] Hamman's credibility

(..continued)

purchase of puts would be a method to follow a rising market for the underlying asset and generate profit while having claimed to receive the understanding from Wright. Tr. vol. 5 at 18-19. Given his confusion and his admission on cross-examination, it is too difficult to credit Finkbine's testimony as a basis for determining the actual words Wright employed.

[422] After Hamman testified, Wright provided the following description of the conversation at issue.

> And when it came time for GAB Hamman Farms to sign those contracts that I recommended, once again, they wanted to talk to me. And that's when I went to their farm and spent another at least three hours there explaining how this worked.
>
> Once again, each -- they wanted the benefits of an excellent marketing program, but they didn't want to take the time nor did they want to take the mental ability that it took to try to understand how this -- how this information worked. They wanted to hear it, they wanted to be reassured, but it just -- it just didn't -- they weren't willing to make the commitment to try to understand and learn about marketing.

Tr. vol. 5 at 182. In his posthearing memorandum, Wright claimed he "encouraged Hamman's (sic) to accept the revised contract because . . . the contracts provided an element of (continued..)

on this point is buttressed by the consistency of his account at the hearing with the 1996 deposition transcript. Given this earlier testimony and the lack of evidence to the contrary, we find Hamman credible on this point[423] and conclude that, when Wright solicited him to enter the substitute HTAs, he represented that the worst price he would receive for his corn was $2.50.

The Representation Was False, Material And Made With Scienter

The Division argues that its evidence in combination with prices that it asked the Court to judicially notice[424] demonstrate the falsity of a claim that Wright's substitute HTA program would establish a price floor of $2.50.[425] It points to the fact that, almost immediately after execution of the

(..continued)

price protection for their 1996, 1997, 1998 and 1999 crops." Wright Posthearing Memorandum at 17.

423 This does not mean that we found all aspects of his account credible or useful. The evidence indicates that Wright's personal solicitation of Hamman lasted hours while Hamman's account of it spanned seconds. Tr. vol. 5 at 181. See supra note 416. Under such circumstances much would tend to be lost in the time decay of recollection as well as the condensation and expression that occurs in testimony, especially when the person telling the story is untrained and inexperienced in relating their observations objectively and accurately.

424 Division Posthearing Memorandum at 78-79

425 Id. at 79.

substitute HTAs, the substitute HTA suppliers were required to roll the initial reference price from December 1995 and, at the time of entry into the contracts, the then-current market price for December 1995 futures was 75 1/2 cents higher than the initial reference price of \$2.55 1/4.[426] Based on this observation, the Division asserts that, at the time of their signing, the substitute HTAs were worth \$1.78 3/4, a figure representing \$2.55 1/4 minus the 75 1/2 cent difference and one-cent rolling fee.[427] This argument is flawed but makes a salient point.[428] More importantly, the evidence disproved Wright's representation to Hamman.

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426 Id.

427 Id.

428 The Division is apparently stumped by the fact that Buckeye had not accounted for the "significant loss incurred" in the adjusted reference prices of the substitute HTAs that were recorded after the reference prices were rolled from December 1995 to March 1996. Division Posthearing Memorandum at 79 n.321. The apparent source of the Division's confusion is the evidence that the roll of prices from December 1996 to March 1996 increased the initial reference price for the substitute farmers by just over six cents per bushel (including the 1 cent per bushel rolling fee) and the next roll, from March 1996 to May 1996, resulted in only a three-cent reduction in the adjusted reference price. Id.; see DX-37 at 1, 5; DX 109 at 2, 5. The real source was the fact that no significant reduction in the adjusted reference price had yet accrued and the, to borrow the parties' terminology, the substitute HTAs were "worth" substantially more than \$1.78 3/4 per bushel. As discussed above, the effect of rolls can be calculated by adding (or subtracting in the case of an inverted spread) the spread to (or from) the reference price. Thus, the difference between the (continued..)

The representation that a particular price outcome can be reached with certainty can be proven false with evidence of how events unfolded. The Division presented evidence that, by May 1996, the HTAs were "worth 95 cents."[429] This evidence lends credence to the theory that the substitute HTAs employed in accordance with Wright's plan did not place a certain floor under the adjusted reference price.

Because he was effectively starting with an expected, adjusted reference price of less than $2.10, the only way for

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(..continued)

reference price and the price of the reference month futures at the time of rolling is but one factor in the price outcome of a roll.

That is what the Division got wrong. Here is why it was substantially correct. When it is known that an HTA (or the reference price thereof) will be rolled from one crop year to the next and the delivery is expected to occur in that year, the best thumbnail calculation of the expected final reference price (not accounting for "enhancements" such as the options trades that could occur in connection with the substitute HTAs) would result from calculating a hypothetical roll to the month of expected delivery. On the day that Hammond farms entered into its substitute HTA, the expected reference price in December 1996 would have been about $2.06 (excluding the transaction fee for rolling from one crop year to another). Division Posthearing Memorandum, exhibit B. Thus, given his claimed ability to achieve a price of no less than $2.50, Wright had his work cut out for him.

[429] DX-144 at 73. By "worth 95 cents," the evidence seems to indicate that, if the reference price for the substitute HTAS had been rolled from May 1996 to December, the resulting adjusted reference price would have been reduced to less than one dollar as a result of the prevailing old crop-new crop inversion.

Wright to achieve a $2.50 price floor was to pick dates for rolling that increased reference prices and/or make a small number of option purchases that would generate substantial profits. In other words, Wright's ability to truthfully guarantee a minimum price of $2.50 depended on his faculty for outguessing the market with certainty. As we have discussed in earlier cases, transparent, liquid markets such as those for exchange-traded futures and options tend to assimilate publicly-available information so quickly that off-exchange, industry professionals have no better than a random chance of determining whether the prices of futures or options on futures will rise or fall.[430] Wright was not exceptional.

As touched on above, Wright made a poor prediction concerning the old crop-new crop spread. To a certain extent, this came as no surprise to him. After all, he followed the markets very closely and, as a result, he knew that, when there was an inverted spread between the old crop and new crop years, there was a substantial possibility that the inverse would not disappear.[431] Because the 1995-1996 crop year inverse was not

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430 First Fin., [Current Transfer Binder] ¶29,089 at 53,683 & nn.59, 61.

431 One of Wright's newsletter showed that in the 18 years preceding 1996, there had been 13 years in which the spread between the July and December futures was inverted. DX-123 at 13. In seven of those years, the inverted spread prevailed through the month of June. Id.

certain to dissipate, Wright's guaranteed reference price floor could only exist if he was an options trading wizard who was able to generate substantial profits though a very small number of trades that could not include writing options or purchasing calls.[432] The Micah pool account records in evidence show that Wright was neither a futures or options trading genius, even when his trading involved the types of commodities about which he advised his clients.[433] Thus, Wright's trading results demonstrated his inability to guarantee that, within the constraints of the substitute HTA program, he could guarantee a minimum price of $2.50.

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[432] Between entry into the substitute HTAs and December 1996, a substitute HTA supplier could purchase a total of 16 cents worth of options. If the supplier made only two eight-cent purchases and those options had doubled in value by the time they were offset, the options transactions would increase the reference price by 14 cents (taking into account the two one-cent transaction fees). That 14 cent increase would not have offset half of the December 1995-December 1996 inverted spread that existed when Wright solicited farmers to enter into the substitute HTAs. Even if the options purchased in those two transactions tripled in value, they would not have fully offset the old crop-new crop spread in November 1995, March 1996 or May 1996. Wall St. J., May 2, 1996, at C14; Wall St. J., Mar. 4, 1996, at C12; Division Posthearing Memorandum, exhibit B.

[433] As discussed below, Wright advised the commodity pool and the pool account records in evidence show that Wright's trades, on average, lost money during calendar years 1989, 1990, 1991, 1994 and 1995. DX-131 at 8-11. As for the pool's options trades, it appears they generated losses about as often as profits. DX-131 at 13-31.

The issue of whether Wright's guarantee of a price floor was material is easily resolved. At a general level, the Commission has long held representations concerning the likely outcomes of profit-seeking transactions to be material as a matter of law.[434] With respect to the circumstances underlying this case, there seems to be no doubt that reasonable corn farmers would give a great deal of weight to the potential results when considering whether or not to enter into contracts that covered tens of thousands of bushels of their crop. For this reason, we see no reason to depart from the general rule and we, therefore, conclude that Wright's representation concerning the worst-case outcome with the substitute HTAs was material. This brings us to the issue of scienter.

When he spoke to Hamman, Wright was aware that, if Hamman entered into the substitute HTAs, he would have to roll the initial reference price across one at least one crop year. He was also aware that rolling could reduce the initial reference price and that, if then-current futures prices held, rolling would reduce the initial reference price of the substitute HTAs by more than 50 cents per bushel. In addition and as a result of monitoring agricultural prices on a regular basis in the

[434] First Fin., [Current Transfer Binder] ¶29,089 at 53,685.

years preceding 1995,[435] Wright knew that the inverse between the 1995 and 1996 crop years was not necessarily going to disappear.[436] Moreover, as a drafter of the substitute HTA's appendix, he knew these contracts substantially limited his ability to purchase options for the purpose of generating speculative profits that could increase the reference price. Finally, Wright knew from his past experience that he was no better than hit-or-miss when it came to forecasting the prices of futures and options.[437] Given this evidenced knowledge, the Division has proven that Wright knowingly misrepresented his ability to ensure that a substitute HTA supplier could lock in a price floor of $2.50.

For the reasons set forth above, we find that Wright committed fraud and fraud like acts in his solicitation of Hamman. Thus, we turn to the issues of whether Wright accomplished the fraud by use of some means or instrumentality

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[435] DX-123 at 1-444.

[436] See supra note 431. On this point, it is important to note that the post-December increase in 1995 corn prices and the resulting expansion in inverses did not doom Wright's plan so much as the fact that the December old crop-new crop inverse did not lessen. While the corn prices that prevailed during the Spring and Summer of 1996 may have been unprecedented, the maintenance of an inverse throughout the old crop year was not. See supra note 431.

[437] See supra note 433.

of interstate commerce and whether, at the time, Hamman was a client or prospective client.

The Remaining Elements Of Section 4o(1) Were Satisfied

At the time that he paid his visit to Hamman, Wright was advising him.[438] Thus, Hamman and/or the farming entity GAB Hamman Farms on whose behalf Hamman was working, was a client. In addition, Wright used the telephone to arrange for the personal meeting with Hamman. We therefore find that Wright used an instrumentality of interstate commerce to further his fraudulent solicitation of Hamman and the instrumentality served as an important part of that fraud. For these reasons as well as those set forth above, we find that Wright violated Sections 4o(1)(A) and 4o(1)(B) during his solicitation of Hamman.[439]

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[438] Tr. vol. 5 at 181-82.

[439] The Division also argues that Wright falsely represented that rolling and option purchases "would" increase the initial reference price of the substitute HTAs with certainty. Division Posthearing Memorandum at 79. We note at the outset that there is tension between the argument that Wright told substitute farmers that, if they enter into an HTA with an initial reference price of just over $2.55 and followed his plan, they will do no worse than $2.50 and the claim that he represented that if farmers entered into the same contracts and followed the same plan they would necessarily "enhance" the crop price. Put another way, if Wright was saying the price must increase it would be a contradiction to also represent that the price will fall no less than five and one-half cents.

The apparent inconsistency aside, the Division's argument does not follow from the evidence as neatly as it would like. First of all, a representation that a contract is a "good deal" is puffery and, without more, puffery, opinion, and other soft

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and subjective claims "do not constitute actionable fraud." Bragg v. Price, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,298 at 46,360 & n.68 (CFTC Apr. 13, 1998). In addition, sincerely formulated but erroneous prognostications are not actionable in fraud. Syndicate Sys., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,289 at 32,788 (CFTC Sept. 30, 1986). Moreover, a sincere opinion that is expressed as opinion -- rather than as epistemological fact -- is not misleading unless it is accompanied by some other representation that gives it the veneer of a guarantee. Raab v. General Physics Corp., 4 F.3d 286, 290 (4th Cir. 1993). This is so because the reasonable listener would tend to view facial opinion about the future as "anything but definite" and, therefore, immaterial.

The Division seems to think that a discussion of possibilities is much more. It begins its argument that Wright guaranteed success by observing that Wright represented what "could" be accomplished through his program and, from that observation, immediately concludes that Wright was communicating that such results would occur as a matter if simple futurity. Division Posthearing Memorandum at 79-80 (arguing that Wright representing that his plan "would" increase the adjusted reference price by stating the substitute HTAs "were 'good deals' because Wright could 'enhance' their price by purchasing puts and rolling."). The problem is that the representations upon which it relies do not seem to have that "something extra" that transforms opinion into the type of "hard" representation of fact that might qualify as fraud or constructive fraud. More importantly, they do not appear to have been representations concerning the substitute HTAs and Wright's plan for those particular contracts.

For example, the Division posits, "Even Wright's written solicitation touting the benefits of the [s]ubstitute HTAs, makes a similar claim [of guaranteed profit]: 'If corn drops $1 from now into next fall, the probability is that puts will add $1 per bushel to the current price.'" Division Posthearing Memorandum at 80 (emphasis added and brackets omitted). The quoted representation was made in a letter dated "3 October, 1995" and sent to "Folks with corn contracted to Agricultural Marketing Service." DX-128 at 5. This letter makes no mention of the substitute HTAs. DX-128 at 5. Rather, it appears to have been part of the effort to induce the Preble County farmers (continued..)

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to deliver their crops in satisfaction of the AMS HTAs. DX-128 at 5. Even the careless reader will notice that the assertion begins with an express condition precedent and does not guarantee the condition's fulfillment. Thus, read in isolation, the passage does not come close to a representation that puts would increase "the current price" by any amount, let alone the reference price of the substitute HTAs. Indeed, while the letter voiced the opinion that corn futures prices would soon fall, it also indicated the possibility that the opposite may occur. Id. at 6 ("If corn rallies further into the winter, buy a May or July put for 3 cents . . . .").

The Division draws our attention to Wright's implicit admission that "in a market letter dated January 16, 1995, [he] assured his clients . . . 'if you use our market plan and corn prices go down, you will get a higher price (HTA) and, if prices go up, you will get a higher price (HTA)." Amended Complaint, ¶22 (emphasis in original); Wright Answer, ¶22; Division Posthearing Memorandum at 80. It argues that this amounted to a concession that Wright "represented to his clients and signers of the substitute HTAs that their HTA prices would always increase under his market plan with the use of options." Division Posthearing Memorandum at 80. While we are automatically skeptical of a solicitation that contained such a representation, the representation does not appear related to the substitute HTAs. The complaint alleged that Wright published the above quoted statement more than nine months before he and Leach drafted the substitute HTAs, and before he formulated a plan that would fit within the contracts' strictures. Amended Complaint, ¶22 (emphasis in original); Wright Answer, ¶22; Division Posthearing Memorandum at 80. In addition, we have located no "January 16, 1995" newsletter that includes the quoted language or provides insight concerning the plan to which Wright allegedly referred, the HTAs he mentioned or the context in which he made the statement. See DX-53 at 144-45 (containing a copy of an AMS newsletter entitled, "Soybean and Grain Situation - 16 January, 1995"). Without such information, we cannot gauge the impact that the representation would have had on the hypothetical, reasonable reader. In addition, we cannot say it would automatically be false (or misleading) in all contexts.

For example, assume that Wright was commenting on a strategy that permitted his clients to write calls and do so

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Having determined that Wright committed actionable fraud and did so on enough occasions to justify very serious penalties, there is a temptation not to evaluate the remaining fraud claims since they really serve no purpose other than attaching additional labels to the same acts. The law would permit our fraud inquiry to end here if additional legal conclusions would have no substantial effect on the sanctions to be imposed.[440] We must press on, however, since the additional

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under conditions that, if calls are exercised, new HTAs for a subsequent crop year are created with the strike price as the initial reference price. Assume further than when calls were sold, the premiums were added to the reference price of the original HTAs. Under such conditions, if a farmer entered into the HTAs at question and wrote an option at a strike price above the HTA reference price, the reference price of the initial HTA would become "higher" as a result of the adjustment. If the price of corn (corresponding to the calls) declined and never hit the strike price, the farmer would have a higher reference price that when he started. If the price of corn increased and the option was exercised, then the farmer would have two HTAs, both of which had initial reference prices "higher" than the initial reference price of the first HTA. Thus, the statement could be true and, depending on the standard of goodness used in the discussion and the other relevant statements, not misleading. For the reasons set forth above, we cannot conclude that the Division proved by a preponderance of the evidence that, in his oral representations, Wright made a false representation of fact that his plan would result in certain increases to the substitute HTAs' reference prices.

440 In re Interstate Sec. Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,295 at 38,954-55 (CFTC June 1, 1992) ("in determining sanctions our focus is on the overall nature of the wrongful conduct rather than the number of legal theories the Division can successfully plead and prove").

fraud theories could affect the scope of any cease and desist order we may issue as to Wright.

<u>The Division Failed To Satisfy the "In Connection With" Requirement Of Section 4b</u>

Count V of the complaint charges Wright with having violated Section 4b(a) of the Act.[441] The Division maintains that Wright did this by making fraudulent representations in connection with his touting of and the substitute farmers' entry into the substitute HTAs.[442] Although Section 4b(a) prohibits fraud and the Division proved that Wright committed fraud, the Division's case falls short of satisfying the "in connection" requirement.

Section 4b(a) states, in relevant part,

> It shall be unlawful . . . for any person, in or <u>in connection with</u> any order to make, or the making of, any contract of sale of <u>any commodity for future delivery</u>, <u>made, or to be made</u>, <u>for or on behalf of any other person</u> if such contract for future delivery is or may be used for (A) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (B) determining the price basis of any transaction in interstate commerce in such commodity, or (C) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof--

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441 Amended Complaint, ¶¶60-61.

442 Division Posthearing Memorandum at 77 ("to establish a violation of Section 4b the Division must show that Wright cheated or defrauded or willfully deceived the signers of the [s]ubstitute HTA").

(i) to cheat or defraud or attempt to cheat or defraud such other person . . . .[443]

Thus, Section 4b facially prohibits a limited spectrum of fraud. Stated another way, only fraud that occurs in connection with some, but not all possible orders or transactions in futures contracts violate it. As already discussed above, the substitute HTAs have not been proven to be futures. In addition, even if the HTAs were futures, they were not the right kind for purposes of the "in connection with" element.

Section 4b(a) seems to prohibit only fraud that occurs with futures contracts that are "made, or to be made, for or on behalf of any other person." Those words "for or on behalf of any other person" are traditionally taken as referring to an agency.[444] This does not answer the question of whether the respondent must be the person acting in a representative capacity or whether a futures transaction satisfies the "in connection with" requirement by involving some agent. Case law that most explicitly addresses this precise issue leans in the direction of the former alternative. However, there is authority to go the other way.

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[443] 7 U.S.C. §6b(a) (emphasis added).

[444] Cf. Hays v. Crutcher, 54 Ind. 260, 261 (1876). See Restatement (Second) of Agency §156 cmt. a (1958).

Commodity Trend required the Seventh Circuit to consider the meaning of Section 4b(a)'s reference to "for or on behalf of any other person."[445] The appellant, a publishing CTA, argued that the term operated to limit Section 4b's coverage such that it "only applies to people who make contracts 'for or on behalf of' other people, that is brokers and other agents."[446] The Commission took the litigating position that the language was not so limiting and Section 4b covers any person who commits fraud in connection with a contract made for another person regardless of whether the person was the one who acted in a representative capacity.[447] The Seventh Circuit sided with the appellant and explained,

> CTS is correct regarding the meaning of §6b. The CFTC's reading would render the "for or on behalf of" language mere surplusage. According to the CFTC, this phrase only specifies that the contract must be made on behalf of someone other than the party committing fraud. Since a person cannot defraud him or herself through contract or otherwise, Congress could have omitted "for or on behalf of" and the statute would have the exact same meaning as the CFTC now proposes. Thus, the CFTC's construction contravenes the aforementioned canon that each word or phrase in a statute should be given effect if possible. Unlike in the above discussion of §6n(3)(A), where the CFTC pointed to §61 as indicating that a subscriber is a type of client, the CFTC does not provide any evidence

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[445] 233 F.3d at 991-92.

[446] Id. at 991.

[447] Id.

> that Congress intended "for or on behalf of" to be subsumed by some other part of §6b(a). Thus, "for or on behalf" unambiguously refers to "any person," and therefore the provision applies only to brokers or others who have an agency relationship with their clients. Because CTS does not have such a relationship with its customers, §6b cannot be applied to CTS.[448]

This interpretation mirrors the Commission's most explicit adjudicatory interpretations.

In Gordon v. Shearson Hayden Stone Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,016 at 23,975-81 (CFTC Apr. 10, 1980), the Commission considered the level of culpability necessary to establish a Section 4b violation.[449] Its inquiry focused on the codified text and included the observation, "By its terms, Section 4b applies only to any person who acts 'for or on behalf of' any other person in or in connection with any order to make or the making of any futures contract."[450] Tens years later, the Commission reiterated the view that "Section 4b(A) of the Act only applies when there is an agency-like relationship between the damaged party and the

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448 Id. at 992 (citation and footnote omitted).

449 The Commission concluded that proof of scienter was not necessary to establish a Section 4b violation but, later, reversed course. Hammond v. Smith Barney, Harris Upham & Co., Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,617 at 26,658-59 (CFTC Mar. 1, 1990); Gordon, ¶21,016 at 23,981.

450 Gordon, ¶21,016 at 23,976.

wrongdoer."[451] Thus, like the Seventh Circuit in Commodity Trend, the Commission expressly limited Section 4b(a) liability to acts or omissions that had a connection to futures transactions wherein the respondent was acting as the agent of the person who he allegedly defrauded (or tried to defraud).

Although it never expressly abandoned Gordon and Hammond, the Commission has not strictly followed it.[452] To the degree that the Commission has deviated from Gordon and Hammond, we have found no instance wherein it held that Section 4b(a) can be violated when the relevant misrepresentation occurred in connection with a contract that the target of the misrepresentation explicitly entered into on its own behalf (or, in the case of a corporation or other entity, through its partners or officers) and did not nominally or actually effect through an intermediary such as a CTA with discretionary authority, an introducing broker, an FCM, a broker or a dealer.

In this case, Wright does not appear to have acted on behalf of the substitute farmers concerning entry into the substitute HTAs. The Division's evidence tends to show that neither Wright nor an intermediary such as a broker or advisor

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[451] Hammond, ¶24,617 at 26,658 n.16.

[452] See, e.g., R & W Tech. Servs., [1998-1999 Transfer Binder] ¶27,582 at 47,740-45 (finding that a software retailer violated Section 4b(a)).

with discretionary authority entered into any substitute HTA in a representative capacity. Instead, it appears that the substitute farmers entered into the contracts on their own behalf (or, in the case of entities, through a partner or officer).[453] Because the substitute farmers entered into the substitute HTAs themselves rather than through Wright or some other intermediary acting on their behalf, there a reason beyond the Division's failure to establish that the substitute HTAs'

[453] Buckeye entered into substitute HTAs with: Agle, GAB Hamman Farms, Jeffers, the Fogelsong Brothers, Richard and Joan Prince, Thomas Prince, Howell Farms, Grieser, Snell, Spoerl, and Wagner. DX-10. It appears that: (1) Agle executed the substitute HTAs on his own behalf and, in April 1996, expressly declined to grant Wright power of attorney concerning his dealings with Buckeye; (2) Andy Hamman and Bill Hamman executed documents concerning the substitute HTAs on behalf of GAB Hamman Farms; (3) Jeffers executed his HTAs with Buckeye on his own behalf; (4) David and William Fogelsong executed contracts concerning the Fogelsong Brothers' substitute HTAs; (5) Richard and Joan Prince executed the substitute HTAs into which they entered and declined to grant Wright to authority to effect substitute HTA-related transactions on their behalf; (6) Thomas Prince executed the substitute HTAs on his own behalf and declined to grant Wright discretionary authority with respect to his Buckeye contracts; (7) Terry Howell entered into substitute HTA contracts on behalf of himself and Howell Farms; (8) Grieser executed substitute HTA contracts on his own behalf and, when asked, declined to grant Wright authority to act on his behalf as to Buckeye; (9) Snell entered into all of the Buckeye HTAs on behalf of Snell Bothers; (10) Spoerl executed his Buckeye HTAs personally; and (11) Wagner personally executed his Buckeye HTAs. DX-11 at 8-20; DX-37 at 1-7; DX-43 at 1-7; DX-46 at 6-7; DX-49 at 1-8; DX-53 at 127-34; DX-69 at 1-6; DX-70 at 1-13; DX-84 at 1-7; DX-109 at 1-4; DX-98 at 1-8. Hamman Farms, Howell Brothers, Snell and Wagner eventually authorized Wright to roll HTAs and place option orders on their behalf. However, this occurred in April 1996. DX-37 at 6; DX-46 at 37; DX-49 at 7; DX-84 at 7; DX-98 at 7.

were futures to find that it failed to satisfy the "in connection requirement" of Section 4b(a). We therefore **DISMISS** Count V of the Amended Complaint and turn to the remaining fraud claim.

<u>**Wright Violated Rule 33.10 And Section 4c(b)**</u>

Count VII charges Wright with violations of Section 4c(b), 7 U.S.C. 6c(b), and Rule 33.10, 17 C.F.R. §33.10.[454] As discussed above, Section 4c(b) effectively incorporates the Commission's options regulations by reference. Rule 33.10 states,

> It shall be unlawful for any person directly or indirectly --
>
> (a) To cheat or defraud or attempt to cheat or defraud any other person;
>
> (b) To make or cause to be made to any other person any false report or statement thereof or cause to be entered for any person any false record thereof;
>
> (c) To deceive or attempt to deceive any other person by any means whatsoever
>
> in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction.[455]

We have held that, in order to establish that a respondent violated this provision, the Division must prove the traditional

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[454] Amended Complaint, ¶62.

[455] 17 C.F.R. §33.10.

elements of fraud in an enforcement context (a misrepresentation or omission, materiality and scienter).[456] In addition, the Division must prove that the fraud occurred "in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction."

At first glance, a requirement that fraud occur in connection with options transactions does not seem to require proof of anything more than the fraud's connection with a transaction in any contract that would be considered an option. This first glance would be deceiving because "commodity option transaction" refers only to transactions and agreements "in interstate commerce."[457] Thus, transactions and agreements that do not occur in interstate commerce and that are not considered

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[456] In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,924 (ALJ June 5, 1996), aff'd in relevant part, [1996-1998 Transfer Binder] Com. Fut. L. Rep. (CCH) ¶27,206 (CFTC Dec. 18, 1997).

[457] The Commission defined "commodity option" and "commodity option transaction" as,

> any transaction or agreement in interstate commerce which is or is held out to be of the character of, or is commonly known to the trade as, an "option," "privilege," "indemnity," "bid," "offer," "call," "put," "advance guaranty," or "decline guaranty" and which is subject to regulation under the Act and these regulations.

17 C.F.R. §1.3(hh) (emphasis added).

to so occur cannot form the transactional anchor for a Rule 33.10 violation.[458]

As discussed above, the evidence lends strong support to the inference that when HTA suppliers placed options orders with Buckeye, the elevator caused the order to be executed by purchasing (or selling) options through its futures commission merchant on the CBOT. Such transactions qualify as occurring in interstate commerce as defined by Section 1a(13). Thus, we can turn to the remainder of the in connection requirement.

Nominally, fraud must occur in connection with the offer to enter into, entry into, confirmation of the execution of, or the maintenance of option transactions. Here, the Division does not claim that Wright committed fraud in connection with any of these in a strict sense. Rather, it argues that Wright committed fraud in the solicitation of a relationship that would permit farmers to trade options, the substitute HTAs. This is close enough. Like the federal courts, we have held that fraudulent solicitations occur in connection with enumerated transactions when the solicitations relate to a good or service (such as the opening of an account) that is expected to be used in connection with such enumerated transactions.[459]

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[458] See supra text accompanying notes 198-229.

[459] In a case where a trading software company fraudulently solicited people to purchase its product, we considered whether (continued..)

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the fraud occurred "in connection with" futures transactions. In re R & W Technical Servs., Ltd., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,193 at 45,724-25 (ALJ Dec. 1, 1997). The respondent argued that any misrepresentations it may have made did not occur in connection with futures transactions because it neither solicited customers for discretionary authority nor solicited them to open accounts. Id. We rejected that argument and held that, when fraudulent representations are used to market a good that related to futures trading and the good's intended use has a sufficiently close relationship to such trading, the fraudulent solicitations occur "in connection with" futures transactions. Id. at 45,725.

In reaching this conclusion, we relied, in part, on Hirk v. Agri-Research Council, Inc., 561 F.2d 96 (7th Cir. 1977), and Saxe v. E.F. Hutton & Co., Inc., 789 F.2d 105 (2d Cir. 1986). Id. at 45,725 nn.56, 61. Hirk reviewed the dismissal of a complaint in which the plaintiff alleged that the respondents violated Section 4b of the Act by fraudulently inducing him to open a discretionary futures account. 561 F.2d at 98, 103. The trial court had dismissed this claim based on the ruling that the "in connection with" language of Section 4b addressed only conduct relating to persuading a customer to engage in a futures transaction or reporting the status of the transaction to the customer and, thus, deceptive conduct that occurred when soliciting a customer to open a discretionary account and before any trading took place did not fall within the ambit of Section 4b. Id. at 103. The appellate court disagreed, opining that the district court's reading of Section 4b could not be squared with a legislative history that indicated Congress' intent to reach solicitations to open accounts. Id. at 103-04. Thus, the court held that deceptive solicitations to open a futures account amounted to fraud "in connection with" futures transactions. Id. at 104.

Saxe involved the prior dismissal of a complaint in which the plaintiff claimed that he had been induced to open a futures account and grant discretionary trading authority to a CTA based on representations concerning the CTA's qualities. 789 F.2d at 106. The trial court had dismissed the complaint based on the observation that the alleged fraud involved "descriptions of the brokers' services rather than misrepresentations concerning 'the nature of commodity futures trading and its risks,'" and ruled that such misrepresentations had an insufficient connection to

(continued..)

Entry into the substitute HTAs created a relationship between the suppliers and Buckeye wherein the farmers had a limited right to trade options through the elevator. Thus, soliciting farmers to enter into the substitute HTAs was analogous to soliciting them to open an options trading account. Based on these facts, we have no difficulty concluding that Wright's solicitations of the Preble County farmers as well as the substitute farmers constituted activity in connection with commodity option transactions. Incorporating our Section 4o findings concerning the content of Wright's solicitations, their falsity, their materiality and Wright's scienter, we also find that Wright violated Rule 33.10 and Section 4c(b) when he made those solicitations that violated Section 4o(1).

CHARGES RELATED TO WRIGHT'S COMMODITY POOL

Wright not only acted as an grain dealer and a CTA, he operated an unregistered commodity pool for some of his clients, the Micah Club I.[460] The Amended Complaint charged Wright with having violated Rules 4.13(b)(1) and 4.13(b)(2) by (1) failing

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(..continued)

futures contracts to fall within Section 4b. Id. at 109-10. The Second Circuit reversed the dismissal, holding that Section 4b reaches fraudulent solicitations of potential customers to open futures accounts as well as the solicitation of present customers to place orders. Id. at 110-11.

[460] DX-119 at 1; DX-131 at 1-32; Tr. vol. 1 at 159-60.

to provide the Micah I participants with certain disclosures and (2) not forwarding copies of the pool's monthly statements to them.[461] But for a last minute twist in the Division's presentation, we would have resolved both claims in its favor. As it turns out, the Division prevailed on the latter charge but not the former.

Wright May Have Violated Rule 4.13(b)(1) But The Division Did Not Prove That His Violations Occurred During The Relevant Time

Rules 4.13(b)(1) and 4.13(b)(2) both apply to a person who operates a commodity pool, is not registered as commodity pool operator ("CPO") and who need not register due to one of the exemptions provided in Rule 4.13(a).[462] Subsection (b)(1) prohibits an unregistered, exempt pool operator from "directly or indirectly" soliciting, accepting or receiving property from "prospective participants" in a pool that it operates unless, during or prior to the solicitation, acceptance or receipt of such property, the pool operator provides certain disclosures that include the following representation.[463]

> The commodity pool operator of this pool is not required to register, and has not registered, with the Commodity Futures Trading Commission. Therefore, unlike a registered commodity pool operator, this

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[461] Amended Complaint, ¶¶64-66.

[462] 17 C.F.R. §4.13(b)(1)-(2).

[463] 17 C.F.R. §4.13(b)(1).

> commodity pool operator is not required by the Commission to furnish a Disclosure Document, periodic Account Statements, and an Annual Report to participants in the pool.[464]

The Commission drafted and interprets its disclosure requirements strictly.[465] This means that neither non-culpable nor _de minimis_ failures to comply can serve as a complete defense. However, strict liability mandates lead us to construe such regulations strictly.[466]

Wright admitted to no Rule 4.13(b) violations. Initially, he denied having had Rule 4.13(b)(1) obligations because he never actually received funds from pool participants.[467] Now, he claims to have relied on Edwards to make the necessary

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464 17 C.F.R. §4.13(b)(1).

465 Rule 4.13(b)(1) speaks in absolute terms and makes no mention of substantial compliance or standards of culpability that, by reasonable inference, would excuse good-faith, negligent or completely "innocent" failures. In the context of similarly absolute disclosure requirements that apply to commodity trading advisors, we previously explained, "The requirement to make disclosures in the manner prescribed by Commission regulation is absolute . . . liability is strict." _Udiskey v. Commodity Res. Corp._, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,599 at 47,857 (CFTC Apr. 2, 1999) (footnotes omitted).

466 _In re CMB Capital Mgmt. Corp._, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,592 at 47,778 n.2 (CFTC Apr. 6, 1999).

467 Wright Answer at 28.

disclosures.[468] These arguments fail and do so, in large part, on the basis of conclusively-established facts.

Through his failure to respond to admission requests, Wright established that: (1) he created the Micah pool to allow his clients to speculate in regulated futures markets; (2) from "at least 1991," he administered the Micah I pool; (3) in connection with his administration of the Micah I pool, he solicited, accepted or received from participants funds, securities or other property for the purpose of buying and selling exchange-traded commodity futures and options contracts; (4) he did not file with the Commission an exemption statement of the type required by Rule 4.13(b); (5) he did not furnish each participant an exemption statement of the type required by Rule 4.13(b); and (6) he failed to furnish monthly account statements to participants in the Micah Pool.[469] In addition, Wright was unregistered during the relevant period,[470] and the pool was composed and operated in a manner that rendered Wright exempt from the obligation to register as a CPO by operation of

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468 Wright Posthearing Memorandum at 22-23.

469 See Division Requests to Wright, ¶¶57-58,60-61. As our adoption of these deemed admissions indicate, we do not find the underlying requests to be impermissibly ambiguous.

470 See supra text accompanying note 275.

17 C.F.R. §4.13(a)(2).[471] Finally, the evidence and relevant judicial admissions establish Wright's status as a CPO[472] and

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[471] Rule 4.13(a)(2) states that a person is not required to register as a commodity pool operator if "(i) [t]he total gross capital contributions it receives for units of participation in all of the pools that it operates or that it intends to operate do not in the aggregate exceed $200,000; and (ii) [n]one of the pools operated by it has more than 15 participants at any time." 17 C.F.R. §4.13(a)(2). The evidence demonstrated that the Micah pool was formed with avoiding the need to register as one of the guiding principals. Tr. vol. 2 at 16-17. Wright and the Division stipulated that the Micah I pool had fewer than 15 participants and capital contributions did not reach $200,000. Amended Stipulations, ¶¶44-45. _See also_ Tr. vol. 1 at 151 ("Because the Micah fund was less than $200,000 investment, had less than 15 investors, and I didn't get any compensation for managing it."). Thus, in the absence of evidence showing that Wright ever intended to operate the Micah pool beyond the limits of Rule 4.13(a)(2) or that he operated (or intended to operate) additional pools that would have the same effect, the stipulations and evidence establish facts that bring Wright within a Rule 4.13(a) exemption.

[472] While the parties agree that Wright operated the Micah pool, they dispute whether he was a CPO. Intuitively, one would expect that a person who operates a commodity pool would _per se_ qualify as a CPO. Things are not that simple. For purposes of its regulations, the Commission defined a CPO as:

> any person engaged in a business which is of the nature of an investment trust, syndicate, or similar form of enterprise, _and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property_, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, _for the purpose of trading in any commodity for future delivery or commodity option on or subject to the rules of any contract market_, but does not include such persons not within the intent of this definition as the Commission may specify by rule or regulation or by order.

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17 C.F.R. §1.3(cc) (emphasis added). Thus, to qualify as a CPO, one must (1) engage in the business like that of a collective investment vehicle; (2) solicit, accept or receive assets in connection with such a business; and (3) do so for the specific purpose of trading in futures or options on or subject to the rules of a contract market.

Wright does not dispute that the Micah pool operated in the manner of a collective investment vehicle. See Wright Posthearing Memorandum at 23. Before and during this proceeding he testified to this fact and the documentary evidence supports those statements. DX-119 at 1-18; DX-131 at 1-32; DX-143 at 148-49; Tr. vol. 1 at 159-60. In addition, the pool's apparent purpose was to trade futures and options on a Commission designated contract market. DX-131 at 2-32. Thus, if Wright solicited, accepted or received funds for the pool, he was a CPO.

In his answer, Wright denied soliciting or receiving funds with respect to the Micah I pool. Wright Answer at 28. The Division did not address these denials in its pre- or post-hearing pleadings while, after the hearing, Wright once again denied soliciting funds. Wright Posthearing Memorandum at 23. The record refutes these denials. Wright conclusively established that, in connection with his administration of the Micah I pool, he solicited, accepted or received from participants funds, securities or other property for the purpose of buying and selling exchange-traded commodity futures and options contracts. See Division Requests to Wright, ¶57. Moreover, he expressly admitted to such solicitations.

When asked, during the investigation leading up to this proceeding, whether the administration of the Micah I pool was part of the services he provided to AMS clients, Wright testified,

> It was just, hey, by the way folks, we're going to start a trading group. Phil Luxenburger and Roger Wright will call the shots. In fact, at the time we said Phil Luxenburger, Roger Wright and Ray Tope will call the shots and we're asking for $1,000 from anybody that wants to be a part of it. Multiples of a thousand. Some ya-ho sent in

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that, at the very least, he solicited funds from prospective participants.[473]

(..continued)

> $2500. And so we made the shares $500 each and there's 29 shares of five dollars each (sic) and one couple has five shares and two or three couples have four shares. But the majority of people have two shares.

DX-143 at 149. The Division then asked if he made participation in the fund available to all clients. Id. Wright responded, "I put it in my market letter that went to all my clients, yes, sir." Id. Even if it was low-key and not his idea originally, Wright's advertisement to clients amounted to the solicitation of funds from prospective pool participants. This solicitation, the nature of the Micah pool and Wright's administration of the pool rendered him a CPO.

473 See supra note 472. Our emphasis on "prospective participants" arises from the facial requirement to provide a Rule 4.13(b)(1) disclosure before soliciting, receiving or accepting property from a "prospective" pool participant and the absence of such an explicit requirement to provide the disclosure before doing the same with respect to a "participant" who had not yet received the disclosure. 17 C.F.R. §4.13(b)(1). When the Commission has meant to designate actual participants in a commodity pool rather than prospective participants, it has demonstrated the ability to choose words that clearly convey that intent. See 17 C.F.R. §4.22(c). Indeed, the Commission has defined a participant as "any person that has any direct financial interest in a pool" and, thus, excludes from the definition those who have no such financial interest, regardless of their keenness to purchase an interest in a pool 17 C.F.R. §4.10(c). Moreover, the Commission has used the terms "participant" and "prospective participant" in the same subsection of a regulation. 17 C.F.R. §4.12(b)(ii) ("Each existing participant and prospective participant in the pool . . . ."). Given the definition of "participant," our often-employed presumption that the Commission drafts regulations with care and does not insert superfluous terms, and the Commission's use of the terms "participant" and "prospective participant" in a manner that we presume was intended to identify two different classes of people, we conclude that the Commission's inclusion

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Given these facts, we find that Wright was required to distribute Rule 4.13(b)(1) disclosures prior to (or contemporaneous with) any solicitation, receipt or acceptance of funds from prospective participants in the Micah I pool and that he failed to do so.[474] From these observations, a conclusion of wrongdoing could easily follow. Before reaching it, we must determine whether it is proper to do so.

The Amended Complaint's Rule 4.13 charges relate to acts alleged to have occurred "[s]ince at least 1991."[475] Thus, the Division alleged that Wright's malfeasance could have pre-dated

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of term "prospective participant" and exclusion of "participant" was meaningful.

[474] Wright argues that he left all of the pool-related disclosure tasks up to Edwards and, thus, admitted that he did not make the disclosures himself. Wright Posthearing Memorandum at 23. However, there is no substantial evidence that Edwards made any Rule 4.13(b)(1) disclosures on Wright's behalf. Luxenburger testified that he was the Edwards employee who serviced the Micah pool account and administered completion of the account opening documents but that, concerning the pool, he provided nothing other than his "standard services." Tr. vol. 2 at 52. The standard services appear not to have included making disclosures other than those that the law obligated Edwards to make as a result of its status as a registered futures commission merchant. See DX-119 at 1-18; DX-145 at 26-29.

[475] Amended Complaint, ¶5 ("Since at least 1991 (the 'relevant period'), Wright has . . . ."); id., ¶¶8-9 ("During the relevant period, Wright . . . administered the Micah I Investment Club ('Micah Pool') . . . . Wright failed to . . . deliver to each participant an exemption statement of the type required by the Commission's regulations, and Wright did not promptly furnish the monthly account statements to pool participants required under Commission regulations.").

1991. In his answer, Wright admitted that he formed the Micah pool in "1988 and 1989" and implied that the funding of the pool occurred during that time period.[476] Moreover, the Division's investigation uncovered evidence that the pool was formed in 1989.[477] Having reason to know that the majority (if not all) of the evidenced acts that triggered Rule 4.13(b)(1) disclosure requirements predated 1991, the Division did something that seems not to make sense in hindsight. At the oral hearing, it abandoned claims that Wright committed Rule 4.13(b) violations prior to 1991.[478] This choice complicates matters.

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[476] Wright Answer, ¶¶65-66.

[477] DX-119 at 1-18.

[478] As noted above, the Division temporally narrowed its Section 4(a) claims during the parties' presentation of their cases-in-chief. See supra note 98. In doing so, it prompted a discussion concerning the time periods as to which it intended to prove other wrongdoing. Tr. vol. 3 at 119-23. A short time later, the Division summarized the revised temporal scope of its claims by stating,

> Your Honor, I would just like to go through the complaint count by count to make sure that it's clear in the record what time period the Division is alleging.
>
> . . . .
>
> As to Count I against Wright and Buckeye, that would be since 1995; as to Count II against Wright and Buckeye, that would be since 1995; as to Count III against Wright, Luxenburger and Edwards, that would be since 1991; as to Count IV against

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Neither Wright's deemed admissions nor his stipulations indicate that he performed an act that required Rule 4.13(b)(1) disclosure after 1990.[479] The evidence supports the inference that Wright accepted funds from actual or prospective

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> Wright, that would be since 1991; as to Count V against Wright, that would be since 1995; as to Count VI against Wright, that would be since 1995; <u>as to Count VII against Wright, that would be since 1991</u>; as to Count VIII against Wright, that would be since 1991; and as to Count IX against Edwards, Wright and Luxenburger, that would be since 1991.

Tr. vol. 3 at 135 (emphasis added). Implicit in this explanation is the Division's abandonment of any claims that Wright or any other respondent engaged in wrongdoing prior to 1991. In the face of such abandonment, it would be unfair to Wright to sanction him for wrongdoing that occurred before that year or even saddle him with findings that he committed pre-1991 violations if there is no evidence that he committed violations of the regulation after 1990.

[479] Wright's stipulations concerning the Micah pool do not refer to his having directly or indirectly solicited, accepted or received property from prospective participants in the pool. Amended Stipulations, ¶¶44-47. On the other hand, he is deemed to have admitted that, "[f]rom at least 1991, [he] administered the Micah Pool, and in connection therewith, solicited, accepted or received from participants funds . . . or other property for the purpose of buying and selling exchange-traded commodity futures and option contracts." <u>See</u> Division Requests to Wright, ¶57. This request does not state that the solicitations etc. occurred in or after 1991. In addition, it refers to acts perpetrated upon "participants" and not "prospective participants." Moreover, because a pool operator could solicit funds from a current participant, the request does not necessarily imply that the solicitations of property occurred when the participants were prospective participants.

participants in 1991 and 1994.[480] However, we have located nothing in the record that sheds light on whether the funds came from participants or prospective participants, or, more to the point, whether the pool had any prospective participants after 1990. As a result, the Division failed to prove that the funds originated from prospective participants.[481] For this reason, it has not established by a preponderance of the evidence that Wright violated Rule 4.13(b)(1) in 1991 or subsequently.[482]

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[480] The evidence shows deposits in the Micah pool's trading account. DX-131 at 13, 15. Wright denied investing in the pool. DX-143 at 148. From this, we infer that the funds came from participants or prospective participants. Because Wright operated the pool, was aware of the account's activity and had the authority to withdraw deposited funds in order to return them to their source, we hold that Wright accepted these funds when he became aware of their deposit into the account and chose not to return them to their source(s).

[481] One could posit that violations of Rule 4.13(b)(1) are continuing in nature. While we might ordinarily give this theory serious consideration, it would be unfair to do so in light of the Division's abandonment of its pre-1991 claims.

[482] For this reason we **DISMISS** that part of Count VII that charges Wright with having violated Rule 4.13(b)(1). Count VII also charged Wright with having violated 17 C.F.R. §4.13(b)(1)(iv) by failing to file the required disclosures with the Commission. Amended Complaint, ¶¶64-66. The Division seems to have implicitly abandoned this claim. Compare Division Prehearing at 25-26 with Division Proposed Findings at 55. However, even if it had not done so, the record provides an insufficient basis upon which to find that Wright committed violations for which we can fairly sanction him.

Rule 4.13(b)(1)(iv) requires non-registered, exempt CPOs to file copies of the Rule 4.13(b)(1) disclosure statement with the Commission and the National Futures Association on the date upon

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However, the Division fares better with the remainder of its Count VII claims.

Wright Violated Rule 4.13(b)(2)

Rule 4.13(b)(2) requires that unregistered, exempt pool operators,

> [p]romptly furnish to each participant in each pool that it operates a copy of the monthly statement for the pool that such person received from a futures commission merchant pursuant to [17 C.F.R.] §1.33 . . . and . . . [c]learly show on such statement, or on an accompanying supplemental statement, the net profit or loss on all commodity interests closed since the date of the previous statement . . . .[483]

Wright had occasion to act in conformity to this rule because, on a number of occasions during the 1991-1996 period, the pool's FCM (Edwards) provided him with monthly statements concerning the Micah pool's account.[484] Wright never complied with the

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which the pool begins trading in commodity interests or within seven days of delivering it to the first prospective participant, whichever is earlier. 17 C.F.R. §4.13(b)(1)(iv). Given the facts evidenced in this proceeding, we would be as inclined to conclude that Wright failed to make timely filings as we would to find that Wright failed to provide the disclosure statement to the Micah pool's prospective participants. However, for reasons discussed above, we would be similarly inclined to conclude that the Division abandoned charges that Rule 4.13(b)(1)(iv) violations occurred prior to 1991 and failed to prove that any such violations occurred after 1990.

[483] 17 C.F.R. §4.13(b)(2)(i)(A)-(B). As with subsection (b)(1), we interpret (b)(2) as imposing strict liability.

[484] DX-131 at 13-15, 27-31.

regulation.[485] Thus, in each month during the 1991-1996 period that he received a monthly account statement from Edwards concerning the Micah I pool, Wright violated Rule 4.13(b)(2). Having made this determination, we have one more count to resolve.

CHARGES CONCERNING THE CLAIM THAT EDWARDS COMMITTED PRIMARY VIOLATIONS OF RULE 1.37(a)

Count IX charges Edwards with violations of Rule 1.37(a) and alleges that Wright and Luxenburger aided and abetting that wrongdoing.[486] These claims succeed in part but once against fall short on the knowledge prong of aiding and abetting as it relates to technical wrongdoing.

The Division Established Edwards's Primary Violations Of Rule 1.37(a)

The Division alleged and maintains that the Edwards violated Rule 1.37(a) when Luxenburger, acting in his capacity as an Edwards employee, accepted orders that Wright placed on behalf of his customers without having or maintaining documents

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[485] In paragraph 66 of the complaint, the Division alleged, "Additionally, in violation of Section 4.13(b)(2) of the Regulations, 17 C.F.R. §4.13(b)(2) (1996), Wright did not provide monthly account statements to participants in the Micah I Pool." Amended Complaint, ¶66. Wright responded, "True, Wright did not provide monthly statements to participants and was unaware of such a requirement as stated in 17 CFR Section 4.13(b)(2) (1996)." Wright Answer, ¶66. He later admitted his failure by operation of law. See Division Requests to Wright, ¶61.

[486] Amended Complaint, ¶¶70-73.

identifying Wright as a person authorized to control the trading of those accounts.[487] Respondents argue that Rule 1.37(a) imposes no requirement to make records and, even if it did, the regulation does not mandate when records must be created and, as a result, any belated record creation would satisfy it.[488] In the absence of precedent to the contrary, these arguments might have prevailed. However -- as sentences such as the preceding one almost always foretell -- case law seems to favor the Division.

Rule 1.37(a) Requires More Than Record Retention

Rule 1.37(a) states,

> Each futures commission merchant, introducing broker, and member of a contract market shall keep a record in permanent form which shall show for each commodity futures or option account carried or introduced by it the true name and address of the person for whom such account is carried or introduced and the principal occupation or business of such person as well as the name of any other person guaranteeing such account or exercising any trading control[489] with respect to such account. For each such

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[487] Division Posthearing Memorandum at 51-52; Division Prehearing Memorandum at 26; Amended Complaint, ¶¶10, 71-73.

[488] Edwards Posthearing Memorandum at 21-23; Luxenburger Proposed Findings, ¶53; Luxenburger Posthearing Memorandum at 10-11.

[489] We read "any trading control" to cover the entire spectrum of control. Thus, it includes broad, discretionary authority but also very limited control such as the authority to place a single, specific trade within narrow parameters such as might occur if a busy account holder directed a spouse to place a trade and provided such detailed, confining instructions so as to eliminate any room for discretion.

> commodity option account, the records kept by such futures commission merchant, introducing broker, and member of a contract market must also show the name of the person who has solicited and is responsible for each option customer's account or assign account numbers in such a manner to identify that person.[490]

There is no dispute that, during the time relevant to this proceeding, Edwards was a registered FCM and, therefore, subject to this regulation. The disagreement centers on whether Rule 1.37(a) requires only what appears in its explicit prescriptions.

Rule 1.37(a) requires FCMs to keep records containing certain information about persons who control trading in others' accounts but does not, on its face, require the creation of such records,[491] mandate the first day upon which such records need be kept or require the retention of accurate information (as opposed to the retention of whatever documents come into an

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[490] 17 C.F.R. §1.37(a) (emphasis added).

[491] As quoted above, Rule 1.37(a) commands that FCMs "keep" certain records and does not explicitly require that anyone "make them. In a number of other regulations, the Commission requires that certain persons "make and keep" records. 17 C.F.R. §§1.18(b), 4.23, 4.33, 31.9(d). The seemingly deliberate use of the term "keep" in Rule 1.37(a) and requirement to "make and keep" records in other Commission regulations strongly supports the inference that, when the Commission commands an FCM to "keep" certain records, it does not intend to require that the FCM "make and keep" them.

FCM's hands).[492] In practice, the Commission has come to view Rule 1.37(a) as more than a requirement to keep documents.

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[492] 17 C.F.R. §1.37(a). On the issue of timing, the Division argues that the regulation must be read in conjunction with Rule 166.2, 17 C.F.R. 166.2(b), a regulation that the Division describes as requiring written authorization before accepting orders for an account from a person in whose name the account is not carried. Division Posthearing Memorandum at 52. This argument fails because the Division's avowed reading of Rule 166.2 is not accurate. Indeed, it is one that the Division abandoned early in this proceeding.

Rule 166.2 states, in relevant part,

> No futures commission merchant . . . may directly or indirectly effect a transaction in a commodity interest for the account of any customer unless before the transaction the . . . person designated by the customer to control the account--
>
> (a) Specifically authorized the futures commission merchant, introducing broker or any of their associated persons to effect the transaction . . . or
>
> (b) Authorized in writing the futures commission merchant . . . to effect transactions in commodity interests for the account without the customer's specific authorization . . . .

17 C.F.R. §166.2 (emphasis added). On its face, Rule 166.2(a) permits an FCM to effect an order placed by "a person designated by the customer to control the account," when that person provides specific authorization, and includes no requirement that the designee be authorized in writing (let alone authorized in writing before the trade is effected). For this reason, the Second Circuit, adopting the amicus view of the Commission, has held, "Nothing in the regulation or in the case law interpreting subdivision (a) [of Rule 166.2] requires that, before an FCM makes trades specifically authorized by a designee, the FCM has to get written authorization from the customer appointing the designee." Peltz v. SHB Commodities, Inc., 115 F.3d 1081, 1087 (continued..)

In re Spiegel[493] required consideration of claims that an FCM violated Rule 1.37 by failing to document that a natural person "occasionally" placed trades in the account of another. At the trial level, the administrative law judge found that a Rule 1.37 violation occurred due to a failure to "list" the third-party natural person as having authority to trade through the account.[494] In addition, there was never a finding that a record listing the third party as having trading authority ever existed.[495] Thus, the administrative law judge read Rule 1.37 as requiring the creation and retention of records showing the name of any person, other than the account holder, who exercised even de minimis trading control with respect to the account. The Commission, without making any new relevant findings of fact,

(..continued)

(2d Cir. 1997). See Division of Enforcement's Motion for Partial Relief From Stay and for Leave to Amend the Complaint and Notice of Hearing, dated June 30, 1997, at 4-6. As a result of Peltz and the Commission's stated position in that proceeding, the Division chose not to press the claim that Edwards violated Rule 166.2. Id. at 4-7. Compare Amended Complaint, ¶¶70-73 with Complaint, ¶¶70-73. For the same reason that it dropped this theory, the effort to revive it through the back door fails.

493 [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,103 at 34,768 (CFTC Jan. 12, 1988)

494 In re Spiegel, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,232 at 32,632 (ALJ Aug. 21, 1986).

495 Id.

also concluded that the FCM violated Rule 1.37.[496] This was not the first instance in which the Commission portrayed the regulation as a record creation requirement.

In re Buckwalter involved claims that three FCMs violated Rule 1.37(a) and proof that, while the FCMs had possessed and maintained records purporting to identify the holder of a certain accounts, the documents did not identify the person who controlled the trading of the accounts.[497] The respondents apparently retained the documents that were generated as part of the account-opening process and argued that, without knowledge that the documents were incorrect, they could not have violated Rule 1.37.[498] The administrative law judge opined that Rule 1.37 required the FCMs to keep records that accurately portrayed the required information and not merely keep whatever records the FCMs received.[499] Thus, he treated Rule 1.37 as a data recording obligation, one that was not merely satisfied by record retention. On review, the Commission affirmed the administrative law judge's conclusion that keeping but not

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496 Spiegel, [1987-1990 Transfer Binder] ¶24,103 at 34,768.

497 [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,782 at 31,268-69 (ALJ Sept. 27, 1985).

498 Id. at 31,268.

499 Id. at 31,269.

revising incorrect records was as much a violation as keeping no records at all.[500]

Given the determinations that a party can violate Rule 1.37(a) without ever having received records that could have been retained and that it can violate the rule by retaining misleading records that go uncorrected, it seems that the Commission views Rule 1.37(a) as a strict-liability, information keeping requirement.[501] This raises the issue of when the obligation to record information arises and when, if ever, recordation becomes tardy.

We have located no explicit authority on the issues of when information must be recorded and how much time can be taken to make (or amend) documents. Edwards seems to argue any belated creation of a record is sufficient.[502] Such an argument does not take into account the purposes served by the regulation or the general principles revealed by applicable case law.

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[500] In re Buckwalter, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,995 at 37,679, 37,686-88 (CFTC Jan. 25, 1991). In addition, the Commission emphasized that scienter is not an element that must be proven to establish a Rule 1.37 violation. Id. at 37,687.

[501] Actually it more than seems so. In 1983, the Commission described Rule 1.37(a) as requiring "that certain information be kept." Domestic Exchange-Traded Commodity Options; Recordkeeping Requirements, 58 Fed. Reg. 14348, 14348 (1993).

[502] Edwards Posthearing Memorandum at 22.

Compliance with Rule 1.37(a), as currently interpreted would tend to enhance the Commission's ability to monitor participants in and beneficiaries of trading activity, and perform enforcement investigations. In addition, compliance tends to reduce uncertainty within a firm -- and between a firm, its customers and those who control the trading of its customers' accounts -- on issues related to account ownership and control. Such matters can arise as soon as an account is opened, or as soon as control over or ownership of an account changes. As a result, the apparent purposes of Rule 1.37(a) would be thwarted if too great a time could lawfully pass between changes in (or the incidence of) circumstances that must be recorded and their actual documentation.[503]

This conclusion finds its faint reflection in Buckwalter. As discussed above, Buckwalter held that Rule 1.37(a) requires the maintenance of "true" records. A record is true if it reflects current circumstances. A record cannot reflect current circumstances unless it is promptly created and amended as conditions change. Accordingly, Buckwalter seems to require a certain level of promptness. We take this as a rule that, when

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[503] For example, Edwards introduced evidence that Wright exercised discretionary control over the account that Cottrill carried at Edwards and Luxenburger serviced that account. AGEX-1. However, in his 1996 deposition, Luxenburger did not recall that Wright exercised this authority. DX-145 at 30.

an FCM learns of information concerning which Rule 1.37(a) requires the keeping of records, if the FCM has no records containing that information, it must create such records within a reasonably short time after the FCM becomes aware of the information.

Edwards Failed To Timely Create Necessary Records

In this case, Wright exercised some cognizable trading control over accounts carried at Edwards by at least four individuals (David Cotrill, Cecil Robinson, Matt Jeffers and Roger Sceiderer) and one couple (Rosemary and Eugene Wagner).[504] However, Edwards, kept no record in permanent form, prior to August 9, 1996, that listed Wright as exercising trading control over the account of any Edwards customer.[505] This raises the factual issue of whether Wright exercised third-party trading control over the admitted accounts prior to August 1996.

The evidence leads us to conclude that Wright exercised control over the five accounts prior to May 1996.[506]

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[504] AGEX-1; AGEX-2; AGEX-3; AGEX-4; AGEX-5; Tr. vol. 2 at 14-15, 64.

[505] Amended Stipulations, ¶97; Tr. vol. 2 at 64.

[506] Edwards introduced evidence indicating that Wright: (1) exercised control over the Cottrill account prior to January 23, 1997, and exercised control over the accounts of Robinson, Scheiderer, Jeffers and the Wagners prior to September 18, 1996. AGEX-2; AGEX-3; AGEX-4; AGEX-5. The Division presented a May 1996 deposition transcript in which Luxenburger testified that (continued..)

Accordingly, Edwards went for at least three months and, in at least one instance, years without documenting Wright's control. Each one of these lapses fails the test of reasonable promptness. Before making an express finding that violations occurred and moving on to the issue of derivative responsibility, we must again consider whether the Division tossed away its claims.

Despite evidence that at least one of the Rule 1.37(a) failures pre-dated 1991,[507] the Division abandoned allegations that Edwards violated Rule 1.37(a) before 1991.[508] Because Rule 1.37(a) is not a precondition to accepting and executing orders, the violation may be completed (and not repeated) shortly after the FCM is aware that a person such as Wright has trading control even though that person places trades in the account

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(..continued)

Wright placed orders for the accounts of Jeffers, Robinson, the Wagners and Scheiderer. DX-145 at 29-30. Moreover, the Division's evidence tends to show that Cottrill opened his account in 1990, he traded through it up to at least May 1996 and that Wright had authority to control the account's trading from the account's inception until at least May 1996. DX-25 at 2-4, 23; DX-141 at 22-24. The respondents did not refute the evidence as to these facts.

[507] DX-143 at 94; see supra note 506.

[508] See supra note 478.

over a period of years.[509] Thus, the Rule 1.37(a) violations may have predated 1991. Except for records related to the accounts of Jeffers and Cotrill, we have located no evidence, admission or stipulation that sheds light on when Wright received and/or first exercised trading authority over the five accounts and, thus, on when Edwards's violations occurred with respect to them.[510] As a result, the Division has not demonstrated that

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[509] See supra note 492. For this reason, we do not believe that, once a Rule 1.37(a) violation occurs through a failure to create a record, failures to rectify the omission constitute independent violations. In other words, we do not view such failures to constitute continuing violations of the regulation (assuming that the continuing violation doctrine has any use outside the application of statutes of limitation). See Christiansen v. APV Crepaco, Inc., 178 F.3d 910, 915-16 (7th Cir. 1999).

[510] See Tr. vol. 1 at 88-89; Tr. vol. 2 at 14-15, 63-65; DX-143 at 90-96; DX-145 at 29-39. The Division's requests for admissions provide no help because those that related to Wright's exercise of control or Edwards failure to obtain documents concerning Wright's control designated no time. Division of Enforcement's First Request for Admissions by Respondent A.G. Edwards & Sons, Inc., dated December 17, 1997 ("Division Requests to Edwards"), ¶¶55-56, 63-64, 72-75; Division Requests to Wright, ¶¶62-63, 70-71; Division of Enforcement's First Request for Admissions by Respondent Philip L. Luxenburger, dated December 17, 1997 ("Division Requests to Luxenburger"), ¶¶55-56, 63-73. As for Edwards's failure to keep records, the Division sought admissions that the omissions occurred "prior to August 9, 1996" without specifying when the obligations to act arose and were violated. Division Requests to Edwards, ¶¶65-71; Division Requests to Wright, ¶¶72-78; Division Requests to Luxenburger, ¶¶65-71. The parties' stipulations generally applied to a period that started before 1991. Amended Stipulations, ¶3; Amended Complaint, ¶5. The stipulations concerning Wright's exertions of control and Edwards's failures to document Wright's status do not portray

(continued..)

Rule 1.37(a) violations related to these accounts postdated 1990.

Cotrill opened his account in 1990 and Wright began exercising trading authority almost immediately.[511] Accordingly, the evidence suggests that Edwards failure to document Wright's authority over this account occurred prior to 1991. On the other hand, the violation related to the Jeffers account seems to have occurred within the relevant period. Jeffers opened his Edwards account in 1993[512] and declared, in May of 1996 and later, that Wright had exercised trading authority over his account.[513] These acts place one Edwards's violation squarely within the 1991-1996 period. Thus, we conclude that Edwards violated Rule 1.37(a) during the 1991-1996 period.[514]

(..continued)

Edwards as having committed its violations after 1990. Amended Stipulations, ¶¶38, 108, 112.

511 See supra note 506.

512 DX-136 at 1-3.

513 DX-148 at 62-63; AGEX-3.

514 There is evidence that, during this same span, Wright placed orders for another Edwards client, Don Sanders. DX-143 at 95. Wright's pretrial testimony supports the inference that he first exercised control over Sanders' account in 1992 or 1993. Id. This evidence supports the inference that Edwards committed an additional Rule 1.37(a) violation during the 1991-1996 period.

<u>The Division Did Not Prove That Luxenburger And Wright Aided And Abetted Edwards's Rule 1.37(a) Violations</u>

The Division claims that Wright and Luxenburger aided and abetted Edwards's Rule 1.37(a) violations through Wright's placement and Luxenburger's acceptance of orders for the accounts of others when both knew that the account holders had not granted Wright written authorization.[515] Luxenburger denied having aided and abetted Rule 1.37(a) violations on grounds that he lacked the requisite knowledge.[516] The issue of knowledge turns out to be dispositive.

As discussed above, there can be no aiding and abetting without knowledge of the primary violation that includes awareness that the acts (and/or omissions) forming the primary violation are wrongful. Here, the record provides some support that the individual respondents had knowledge of the primary violations. However, it did not suffice.

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[515] Division Posthearing Memorandum at 23-24, 52.

[516] In his defense on this point, Luxenburger referred to an earlier argument on the issue of whether he aided and abetted Wright's Section 4m(1) violations. Luxenburger Posthearing Memorandum at 11. He argued that aiding and abetting Wright's Section 4m(1) violations could not be found because he lacked a subjective belief that Wright was acting wrongfully (since he did not personally believe that Wright was required to be registered) and he did not act with a specific intent to further Wright's misconduct. <u>Id.</u> at 9-10.

In his posthearing memorandum, Wright completely overlooked the issue.

Luxenburger Knew Of The Circumstances And Omissions Constituting Edwards's Primary Violations But Was Not Aware That They Were Wrongful

We have no doubt that Luxenburger was aware of Edwards's failure to memorialize Wright's trading control over the accounts of others. Luxenburger was the associated person servicing the accounts over which Wright exercised third-party trading control[517] and, as such, he bore the responsibility for obtaining relevant information and ensuring that that paperwork was completed.[518] In addition, he was the Edwards employee who received verbal communications indicating that Wright was the account holders' designee for placing trades and he knew of his own failure to document Wright's authority.[519] Thus, Luxenburger was aware of Edwards's primary wrongdoing in the sense of knowing of the facts and circumstances that, viewed in light of the law, led us to conclude that Rule 1.37(a) violations occurred. However, he does not seem to have known that it was wrongful.

Like the Division at the beginning of this case,[520] Luxenburger viewed the absence of documentation as a matter of

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517 Amended Stipulations, ¶108.

518 Tr. vol. 2 at 13.

519 Tr. vol. 2 at 64.

520 See supra note 492.

authorization rather record keeping. He testified that, until about two or three years before the hearing, he believed that oral authority from an account holder was sufficient for him to accept trades from Wright.[521] While there is evidence that Wright and Luxenburger discussed whether Luxenburger "should" get written authorization, that evidence does not indicate whether the discussions were those of "best practices" (as opposed to conversations in which the failure to get or make documents was characterized as wrongful or illegal) or, if the discussion concerned the unlawfulness or wrongness of not obtaining written authorization, whether they left Luxenburger convinced that the failure to document Wright's third-party authority was wrongful rather than placing him on notice that it may have been wrongful.[522]

Because the evidence sheds too little light on whether Luxenburger knew, at the time that Wright was placing third-party orders, that the failure to document Wright's authority was wrongful, we cannot say that the Division carried its burden of proving that he acted with the knowledge required for aiding

[521] Tr. vol. 2 at 95. This was consistent with his May 1996 testimony wherein Luxenburger indicated that, during the time that he accepted trades from Wright for the accounts of others, he was not aware that doing so was illegal or that he was violating Edwards policy. DX-145 at 31.

[522] DX-143 at 93-94.

and abetting. Accordingly, we **DISMISS** Count IX as to Luxenburger and turn to Wright.

The Division Failed To Prove Wright's Knowledge Of The Primary Violations

Wright was aware that he did not personally receive documents from his customers authorizing him to trade on their behalf. However, he claimed ignorance on the issue of whether such documents had been provided to Edwards[523] and no party has directed us to an instance in which Wright testified to or otherwise indicated his awareness of Edwards's failure to create documents concerning Wright's discretionary authority.[524] Because it failed to close the loop, the Division did not establish that Wright was aware that Edwards had failed to perform those acts that resulted in Rule 1.37 violations. For this reason, we cannot find that Wright knew of Edwards's primary violation. We therefore **DISMISS** Count IX as it relates

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[523] When asked, "With respect to placing those orders without the written authorization, do you know if any of those customers gave written authorization to Mr. Luxenburger for you to place those trades on their behalfs?" Wright replied, "I really don't know. But I would not be surprised if they did, but I really don't know." Tr. vol. 1 at 153. In May 1996, he said essentially the same thing. DX-143 at 93-94 ("And to be honest with you, I don't know how many clients he does have written authorization with.").

[524] For instance, no one asked Wright whether he was aware that Luxenburger did not even scribble and keeps notes that reflected Wright's trading control. This would have been a natural question since it is not unusual for associated persons to take and keep notes concerning the accounts that they service.

to Wright.[525] Having determined all issues of guilt, we now turn to the bottom line as to Wright and Edwards.

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525 This spares us an inquiry that is made more difficult by the parties' confusion. As discusses above, the Division posits that satisfying Rule 1.37(a) is a precondition to executing trades pursuant to third-party authority. From there, they reason that Wright furthered Edwards's violations by placing trades for his clients. Division Posthearing at 51-52. The converse of this argument is that, if Wright receives authority to trade the account of another, Edwards learns of this but makes no record and Wright never exercised discretionary authority, then no violation of Rule 1.37(a) occurred. We disagree.

As discussed above, once an FCM learns that a third party has trading control, the clock begins to run as to Rule 1.37(a) compliance. When too much time passes without the receipt or creation of the necessary document, the violation is complete regardless of how rarely or often it was exercised during the interim. Once the violation is complete, we question whether the acceptance of orders from a third-party with authority to place them results in additional violations of the same regulation. After all, Rule 1.37(a) is unlike Rules 1.55(a)(1) and 166.2 in that it contains no language marking its requirements as preconditions to other acts. Compare 17 C.F.R. §1.37(a) with 17 C.F.R. §1.55(a)(1) ("Except as provided in Sec. 1.65, no futures commission merchant . . . may open a commodity futures account . . . unless the futures commission merchant . . . first . . . ."); 17 C.F.R. §166.2 ("No futures commission merchant, introducing broker or any of their associated persons may directly or indirectly effect a transaction in a commodity interest for the account of any customer unless before the transaction . . . ."). If the acceptance of additional orders did not result in additional violations, we might have difficulty finding that Wright's submission of orders for his clients furthered Edwards's primary violations. Cf. United States v. McCoy, 721 F.2d 473, 475 (4th Cir. 1983) (observing that evidence one was an accessory after the fact "could not have supported a conviction for aiding and abetting since it related to a time after the base crime had been committed").

SANCTIONS AND RESTITUTION

> [W]e are mindful that our that our selection of sanctions involves judgments that cannot be accompanied by arithmetic exactitude or extended meaningful explication.[526]

The Amended Complaint charges us to consider the issuance of: (1) fines, (2) cease and desist orders, and (3) a personal trading ban upon Wright.[527] In addition, the Commission ordered that we consider the propriety of an order directing Wright to pay restitution.[528] The Division continues to press for each of these but did not show (or really try to prove) that restitution is merited.[529] As a result, there is an insufficient basis upon which to issue such relief.[530] Accordingly, we have only the issues of sanctions to determine.

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[526] In re Nikkhah, [1999-2000 Transfer Binder] Comm. Fut L. Rep. (CCH) ¶28,129 at 49,893 (CFTC May 12, 2000) (quotation marks and ellipsis omitted).

[527] Amended Complaint at 23. The Commission also directed us to consider revocation of Luxenburger's registration. Id. Because Buckeye was not proven to have committed the violations alleged in Counts I and II, and it was not proven that Luxenburger aided and abetted primary violations, there is no basis in the record upon which to sanction them.

[528] Id.

[529] Division Posthearing Memorandum at 87-94 & n.344; Division Proposed Findings at 56-63. See infra note 530.

[530] When any violation of the Act or Commission regulations has been proven, the Commission may "require restitution to customers of damages proximately caused by [such] violations." 7 U.S.C. §9. Because the Commission takes a dim view of (continued..)

Civil Monetary Penalties

Section 6(c) of the Act permits the Commission to assess a civil monetary penalty against any respondent found to have violated the Act or Commission regulations.[531] The Division urges us to fine Edwards and Wright.[532] Before discussing the merits of these requests and the appropriate fine amounts, we consider whether the law places any practical, per se limits on the penalties that we may assess given the above-stated findings.

Section 6(c) limits penalties to the larger of $100,000 per violation found or triple the respondent's monetary gain from

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restitution orders that are nothing more than gestures, we have held the remedy is not merited in the absence of proof that the respondent has the ability to pay. First Fin., [Current Transfer Binder] ¶29,089 at 53,710 (citing Staryk, [1996-1998 Transfer Binder] ¶27,206 at 45,812). Despite the aside that "the Division plans to seek restitution only as to Wright" -- no real exercise of discretion since the complaint authorized us to consider restitution as to Wright only -- it never let us in on why restitution should be awarded nor did it present any evidence that Wright had the ability to pay. Division Posthearing Memorandum at 87-91 & n. 344; Amended Complaint at 23. Given the Division's failure to satisfy its burden of proof on the issue of Wright's ability to pay restitution, we decline to award it.

531 7 U.S.C. §9.

532 Division Proposed Findings at 62-63; Division Posthearing Memorandum at 92-93.

the violation(s).[533] As we recently discussed, the statutory limit is often no limit at all if violations occurred on a relatively frequent basis.[534] Here, the Division proved that Edwards twice violated Rule 1.37(a). Thus, a $200,000 fine would fit within the confines of Section 6(c). As for Wright, there is no need to calculate the legal ceiling because a partial totaling reveals that the statutory limit will not be threatened even if we imposed a draconian penalty.

Wright sent his fraudulent, October 30th solicitation letter to the Preble County farmers. If totaled on a farm-by-farm basis, the written solicitations totaled 18.[535] Thus, even without considering any other violation found above, we could fine Wright a maximum of $1.8 million.[536] If we added the maximum fines that could be imposed for Wright's use of the mails in connection with CTA services while unregistered and his CPO violations, it becomes clear that we face no substantial danger of exceeding the statutory limit as to Wright unless we

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[533] 7 U.S.C. §9. See 17 C.F.R. §143.8(a)(1) (2002).

[534] First Fin., [Current Transfer Binder] ¶29,089 at 53,697 n.150.

[535] DX-151 at 61.

[536] This is so because each mailed letter would constitute a separate violation of at least Section 4o(1)(A). Cf. United States v. Caldwell, 302 F.3d 399, 408 (5th Cir. 2002); United States v. St. Gelais, 952 F.2d 90, 96-97 (5th Cir. 1992).

determine that Wright should be fined substantially more than $10 million.[537] As it turns out, that is precisely what the Division wants us to do.

Wright's Misconduct Merits A Large Fine But Not Nearly As Large As The One Sought By The Division

The Division asks us to fine Wright $21,318,000 -- a record, we think, in adjudications before the Commission.[538] It argues that, when Wright unlawfully convinced farmers to enter into the substitute HTAs, he avoided over $7 million in out-of-pocket expenses related to covering the AMS HTA delivery obligations.[539] This argument overlooks two salient, evidenced

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[537] For example, Wright admitted by operation of law that, in May 1996, his newsletter reached approximately 140 clients. Division Requests to Wright, ¶51. If, in the previous month, the newsletter to which we refer in footnote 266, above, reached only 100 such persons, that would amount to 100 violations of Section 4(m)(1) since each use of the mails (or phone lines for facsimiles) would constitute a separate violation. See supra note 536. Section 6(c) would permit us to impose a fine of $10 million ($100,000 multiplied by 100 violations) for mailing this one edition of the newsletter to his clients. Given the frequency with which Wright violated Section 4m(1) with his newsletters only, it is no stretch to posit that the statutory limit for a fine associated with Wright's Section 4m(1) violations would be a multiple of $10 million. See supra note 266.

[538] Division Proposed Findings at 62.

[539] Id. The Division explained,

> Here, Wright, by his serious fraud, was able to avoid delivery of $2.2 million bushels of corn to Buckeye by engaging in a fraudulent scheme to get farmers to sign on to the

(continued..)

facts. First, even if Wright had been forced to purchase cash grain to satisfy the AMS HTAS and had spent more than $7 million doing so, he would have been entitled to more than $5 million in revenue (not accounting for the basis).[540] In addition and more importantly, Wright may have had no enforceable obligation to deliver on those contracts. There seems to be no dispute that Buckeye refused to effect options transactions that Wright ordered in connection with the AMS HTAs. If the agreement to permit option transactions was a material and vital part of the AMS HTAs, then Ohio law would have permitted Wright to treat the contracts as terminated.[541] For this reason, the Division has not proven that Wright's above-found violations served to relieve him from any net losses or likely judgments resulting

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> Substitute HTAs. The lowest price per bushel of corn in November 1995 was $3.23. Therefore, had Wright not engaged in his scheme to get farmers to sign the Substitute HTAs, then Wright, who did not have 2.2 million bushels of corn to deliver, would have had to . . . pay approximately $7,106,000, which reflected the spot price of corn at the time Wright was to deliver under his AMS HTAs.

Id. at 62.

[540] DX-12 at 1-15.

[541] Wilson v. Kreusch, 675 N.E.2d 571, 576 (Ohio Ct. App. 1996).

from the AMS HTAs. Accordingly, we must consider some alternative.

Traditionally, we and the Commission have used the revenue that a respondent derived during the time it engaged in proven, sanctionable wrongdoing as the benchmark for calculating fines in fraud-related cases. As we discussed recently, the Commission's view of gains-based sanctions has changed and, as a result, so has our approach.[542] Now, in order to impose gains-based sanctions, we must calculate the profit that a respondent earned as a result in-fact of its unlawful activity.[543] In First Financial, we found the record an insufficient basis upon which to make any calculation of profit and looked for an alternative theory upon which to rest the type of sanctions that would have specific and general deterrent effects.[544]

As the only feasible alternative to a gain-based analysis that conformed to Commission precedent, we followed the old multifactor analysis that had emerged from cases where the wrongdoing imposed substantial social harm but netted modest profits for the malefactors.[545] Thus, we looked to the total

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[542] First Fin., [Current Transfer Binder] ¶29,089 at 53,699-705.

[543] Id. at 53,702-05.

[544] Id. at 53,698-705.

[545] Id. at 53,705-08.

facts and circumstances, including: (1) the relationship of violations to the regulatory purposes of the Act, (2) the consequences flowing from the violative conduct, (3) the respondent's state of mind and (4) the respondent's post-violation conduct.[546] In addition, we looked to the fines imposed in cases of comparable wrongdoing.[547] While the development in the law forced us to fall back on an analysis that has no bounds or dispositive factors, this does not mean that it lacks guiding principles.

Congress requires us to "consider" the gravity of violations when determining the level of fines to impose.[548] Consideration of the Glass factors would satisfy this charge. However, neither the Act nor Glass tell us how the factors should be weighed. Lacking clear guidance, we give primacy to harm, both the private costs imposed by the wrongdoing and the social costs, and have held that harmful conduct merits monetary sanctions that will pose a specific deterrent to the respondent

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[546] Id. at 53,708-09 (quoting In re Glass, [1996-1998 Transfer Binder] Comm. Fut L. Rep. (CCH) ¶27,337 at 46,561-67 (CFTC Apr. 27, 1998)). The types of post-violation conduct that would tend to reduce sanctions would be efforts to cooperate with authorities, cure violations or make restitution. Slusser, [1998-1999 Transfer Binder] ¶27,701 at 48,318.

[547] First Fin., [Current Transfer Binder] ¶29,089 at 53,709.

[548] 7 U.S.C. §9a(1).

and a general deterrent to those considering similar wrongdoing. With these admittedly unwieldy principles in mind we now turn to Wright.

Wright's misconduct included fraud as well as violations of other laws meant to protect individual traders and the markets. The fraud, standing alone, constituted core violations of the Act and the type of activity that undeniably imposes social as well as private costs.[549] In addition, although it is not clear that Wright committed his other violations with a high degree of culpability, he knowingly committed fraud. Ordinarily, the consequences flowing from retail-level wrongdoing include financial injury to the respondent's customers and financial benefit to the respondent.[550] On these points, the record of this case is unclear however.[551] Regardless, as we discussed on First Financial, fraud imposes social costs.[552] Viewed in light

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549 First Fin., [Current Transfer Binder] ¶29,089 at 53,705-06.

550 Slusser, [1998-1999 Transfer Binder] ¶27,701 at 48,318.

551 It is not clear that Wright's proven fraud generated more than $5,750 in revenue. In addition, the Division has made no effort to quantify the financial benefit that Wright derived from his other violations. As for the customer harm arising from Wright's violations, it may be substantial since they seem to have embroiled a number of Wright's clients in litigation that is bound to be costly. However, that too cannot be quantified on this record.

552 First Fin., [Current Transfer Binder] ¶29,089 at 53,705-06. In addition, there is nothing in Wright's post-violation conduct (continued..)

of the Glass factors, Wright's misconduct is sufficiently harmful to merit a heavy fine in order to deter Wright from subsequent wrongdoing and deter others who might contemplate such wrongdoing.[553]

The decision that Wright should receive a stiff penalty does not automatically lead to the conclusion that a particular dollar amount is appropriate. Having no other straws to grasp, we turn to other applications of the multifactor test in order to get a (very) rough sense of an appropriate dollar figure. Under the multifactor approach, the Commission has imposed a $110,000 penalty for a one-time record production violation, fines of $250,000 and $500,000 for unlawful trading that occurred over a period of 26 months, and fines of $300,000 and $500,000 for a handful of fictitious wash sales that occurred over a five month period.[554] In addition, we have imposed fines

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that would appear to further aggravate or mitigate his wrongdoing.

553 Although Wright's fraud may not have garnered him any substantial profits, it is the type of fraud that has the potential to generate large amounts of revenue from members of the general public. Thus, the lure can be strong and much fraud goes unpunished. As a result, the sanction must be high to pose a general deterrent.

554 Id. at 53,706, 53,709.

of $1,000,000 for fraud that occurred on a routine basis over the course of three years.[555]

Given the nature, breadth and length of Wright's proven violations, a civil monetary penalty of $500,000 seems appropriate. This is so even if we were to disregard any violations that occurred prior to the effective date of the Futures Trading Practices Act of 1992, October 29, 1992.[556] Accordingly, we hold that Wright should be ordered to pay $500,000 in civil monetary penalties. Having made this determination, we turn to Edwards.

Edwards's Proven Violations Merit A Lesser Penalty

In its posthearing memorandum, the Division asked us to fine Edwards $200,000, "an amount . . . constituting $100,000 per count against it."[557] Edwards argues that it should not be

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555 Id. at 53,709.

556 Pub. L. No. 102-546, 106 Stat. 3590 (1992); In re Nikkhah, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,892 & n.40 (CFTC May 12, 2000).

Of course, we do not have to disregard those violations in our penalty calculation. While violations penalties that predated the 1992 amendment cold be adjusted to account for a respondent's ability to pay, failure to submit evidence on net worth or request a net worth hearing results in a waiver of the issue. Slusser, [1998-1999 Transfer Binder] ¶27,701 at 48,317. Wright submitted no such evidence nor did he request such a hearing. Thus, he waived the issue, an issue that related only to the sanctions for a small fraction of his proven wrongdoing.

557 Division Post Hearing Memorandum at 93.

required to pay any civil monetary penalty on grounds that no customer lost money as a result of any Rule 1.37(a) violations, it reaped no "meaningful financial benefits" from the omissions and the costs incurred in mounting a defense are penalty enough.[558] At a general level, the Division carries the day. However, we decline to issue the fine it seeks.

Edwards cannot evade a fine in this proceeding on the basis of the arguments it presented. Even when it has concluded that a violation of its regulations could be attributed to inexperience rather than a willful disregard of regulations, the Commission has found a fine to be appropriate.[559] In addition, neither a lack of financial benefit nor the absence of direct customer harm forestalls civil monetary penalties under such circumstances.[560] Moreover, while mounting a defense to a Commission investigation and subsequent prosecution can be costly, "voluntarily" incurred legal expenses do not substitute for sanctions. On the other hand, we did not find Edwards to have aided and abetted Wright's Section 4m(1) violations. Thus,

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[558] Edwards Posthearing Memorandum at 25-26. Like Wright, Edwards also declined to introduce evidence concerning its net worth or request a net worth hearing. <u>See</u> <u>supra</u> note 556.

[559] <u>In re Kelly</u>, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,514 at 47,374 (CFTC Nov. 19, 1998).

[560] <u>Id.</u>

we must disregard half of the Division's rationale for the sanctions it seeks.[561]

While Edwards's violations did not reach to the core of the Act's regulatory scheme, they were serious.[562] This stems from the fact that, while Rule 1.37(a) violations are not the type of wrongdoing likely to garner substantial gain for an FCM, they could indirectly lead to substantial private and social injury.[563] In addition, the Division has not established that Edwards's violations resulted from anything other than Luxenburger's ignorance. Moreover, Edwards took incomplete, belated steps to cure its wrongdoing.[564]

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[561] See Division Posthearing Memorandum at 93.

[562] See Nikkhah, [1999-2000 Transfer Binder] ¶28,129 at 49,892 ("A shortcoming in recordkeeping is serious, but somewhat lower in gravity [than fraudulent misconduct], because such requirements are less central to the Act's core regulatory protections.")

[563] Failures to comply with Rule 1.37(a) tend to impede regulatory oversight and increase the risk of customer-broker discord by leaving matters to the memories of those involved rather then creating reliable documents that could nip disputes in the bud.

[564] Edwards sought to cure its Rule 1.37 violations in the sense of memorializing Wright's prior exertions of control over the accounts of others. AGEX-1; AGEX-2; AGEX-3; AGEX-4; AGEX-5. The Division argues that these efforts fell short because the curing documents did not contain the address of the persons for whom the accounts in question were carried or the principal occupations of those persons. Division Posthearing Memorandum at 52. Unlike the Division, we do not believe that all of the information mandated in Rule 1.37(a) must be kept on the same (continued..)

Without hashing through the facts further, we find that Edwards's unlawful conduct merits a deterring monetary sanction. Because Edwards's violations were far from a core violations, were not inherently wrongful, were not the type of violation that holds the promise of substantial benefit, did not appear to be intentional and were partially cured, a six-figure fine appears to be overkill. For the reasons discussed above and knowing full well that assigning a number to Edwards's fine is guesswork, we conclude that Edwards should be ordered to pay a civil monetary penalty of $20,000.[565] This brings us to non-monetary penalties.

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sheet of paper. The only alleged failure of Rule 1.37(a) that was litigated in this proceeding was the failure to memorialize Wright's control and the only information that must be kept in an account's records concerning such control is "the name of any . . . person [other than the account holder] . . . exercising any trading control with respect to . . . [the] account." 17 C.F.R. §1.37(a). Thus, with respect to these five accounts, Edwards seems to have cured its violations. However, it does not appear to have cured the violation relating to Sanders's account. <u>See</u> <u>supra</u> note 514. Moreover, none of the papers Edwards submitted indicate whether Wright was exercising then-present control over the accounts to which AGEX-1, AGEX-2, AGEX-3, AGEX-4 and AGEX-5 refer. Thus, while we find that Edwards acted to cure its violations, we cannot say that it effected a full cure.

565 This figure falls within the range of record production fines that the Commission has issued, cases that are roughly analogous except for the fact that the failure to produce is accompanied by a Division request for records, a circumstance that serves to bring the production requirement to a respondent's attention. <u>Kelly</u>, [1998-1999 Transfer Binder] ¶27,514 at 47,374 (reducing a (continued..)

Cease And Desist Orders Are Merited As To Wright And Edwards

The Division requests that we impose across-the-board cease and desist orders (i.e., that we direct each respondent to cease and desist any violations found in this proceeding).[566] Its burden concerning this sanction is easily surmounted since the standard for imposing it has been lowered to the point where violations result in cease and desist orders with virtual certainty.

A cease and desist order is a substantial sanction in that violating such an order can provide the basis for independent public and private causes of action.[567] Traditionally, the

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civil monetary penalty from $25,000 to $10,000 for an individual that the Commission found to have willfully violated record production requirements on grounds that the respondent may have committed the violation out of inexperience and eventually produced the requested documents); In re New York Currency Research Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,223 45,914-15 (CFTC Feb. 6, 1998) (imposing a $110,000 fine for a failure to produce records and describing it as a "naked attempt to circumvent the regulatory obligations under the Act"). In addition, Edwards's malfeasance was much less serious than the Section 4b and 4(a) violations found in In re Global Link, [1998-1999 Transfer Binder] ¶27,669 at 48,170, wrongdoing described as "exceedingly grave" and violations of the Act's "core provisions." In that case, the Commission fined each respondent $100,000. Global Link, [1998-1999 Transfer Binder] ¶27,669 at 48,170.

566 Division Posthearing Memorandum at 87-88.

567 First Fin., [Current Transfer Binder] ¶29,089 at 53,690.

Commission has required that the Division prove that there was a reasonable likelihood that earlier violations will be repeated before ordering that violations cease and desist.[568] In the past, the Commission ruled that a reasonable likelihood of future violations could be inferred from a pattern of past unlawful conduct but not from an isolated instance of past conduct.[569] More recently, it has held that a single instance of wrongdoing is a sufficient basis upon which to impose the sanction (and, presumably, upon which to find that there is a reasonable likelihood that future violation could occur).[570]

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[568] Id.

[569] Id. at 53,690 & n.109.

[570] In Kelly, the respondent was found to have committed a single violation of CTA record production requirements, a violation that the Commission thought could be attributed to the respondents' inexperience and one that was found to have been rectified after the Commission issued its complaint. [1998-1999 Transfer Binder] ¶27,514 at 47,374. Despite the one-time nature of the violation, the existence of a mitigating factor and the respondent's post-complaint remediation, the Commission ruled that a cease and desist order was merited. Id. at 47,373. Earlier in the same year, the Commission decided New York Currency. In that case, the Commission found that the respondent violated a lawful record production demand. Despite the one-time nature of the violation and the undisturbed finding of the administrative law judge that the respondent had resisted the document request in good faith and under color of law, the Commission issued a cease and desist order without specific reference to any justification other than the existence of the one-time violation. New York Currency, [1996-1998 Transfer Binder] ¶27,223 at 45,915; New York Currency [1996-1998 Transfer Binder] ¶27,222 at 45,905.

We have no doubt that Wright should receive a cease and desist order. Over the five-year span at issue, he violated a spectrum of laws, performed inherently wrongful acts and appeared to view the law as an impediment to be ignored when compliance would be inconvenient.[571] There is no substantial evidence that Wright mitigated the effects of his unlawful conduct or has become rehabilitated. Given his pattern of misconduct, we conclude that there is a reasonable likelihood that Wright will violate the Act and/or Commission regulations

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[571] Wright's attitude toward the law and a misunderstanding of it he shared with the Division were portrayed in the following exchange.

> Q[.] And you understood and knew that in order for you to place an order for somebody in somebody else's account, that you needed written authorization to do that, didn't you?
>
> A[.] Yes, ma'am.
> Q[.] Did you have that?
>
> A[.] No, ma'am.
>
> Q[.] And why didn't you have that?
>
> A[.] With all due respect to your Honor, my relationship with my clients was more important to me than my relationship with the CFTC.

Tr. vol. 1 at 153. There is nothing in the record to indicate he has progressed beyond this cavalier view of the law as he (mis)understood it.

in the future. Accordingly, a cease and desist order is clearly merited. The question is closer as to Edwards.

The Division argues that Edwards should be ordered to cease and desist violating Rule 1.37(a) because its unlawful conduct spanned a period of years, it remains registered and it continues to insist that Rule 1.37 does not require maintaining a record in permanent form showing authorization before allowing a person such as Wright to exercise third-party authority over an account.[572] Edwards responds that it should not be so sanctioned because it has in place a policy that requires associated persons to comply with Rule 1.37(a), it maintains that compliance program, there have been no complaints about its record keeping procedures before or since this proceeding was initiated and, "[a]t no point in its [35-year] history has Edwards been accused of violating the Act."[573] In addition,

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[572] Division Posthearing Memorandum at 88. For reasons already discussed, the Division's last point rests on a misreading of the regulations.

[573] Edwards Proposed Findings at 25; Edwards Posthearing Memorandum at 24-25. Edwards did not cite to any evidence in the support of the bold claim that no one had ever accused it of violating the Act. This is understandable since it was asserting a negative. Commission case law leads us to doubt the claim. See, e.g., Marsteller v. Doster, CFTC Docket No. 86-R57, 1987 CFTC LEXIS 103, at *1 (ALJ Nov. 10, 1987) ("This reparation case arises upon a complaint filed by James H. Marsteller, Complainant, against A.G. Edwards & Sons, Inc. . . . and Edward S. Doster . . . for alleged violations of the Commodity Exchange Act . . . ."); Irwin v. A.G. Edwards, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,557 at 33,455-56, 33,458
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Edwards argues that it did not engage in an ongoing pattern of violative behavior. While Edwards's arguments have some merit and may have carried the day prior to 1998, the law has changed in an unfavorable way from the perspective of respondents.[574] Now, one violation is enough and Edwards committed more than one.

Edwards violated Rule 1.37 no less than twice during the relevant period,[575] committed similar omissions close to and/or during the same span[576] and left at least one of the violations uncured for years.[577] In addition, we cannot attribute Edwards's violations to the inexperience of its personnel.[578] These facts

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(ALJ Mar. 30, 1987) (finding "A.G. Edwards & Sons" liable for violations of Section 4b committed by one of its associated persons).

574 See supra notes 570.

575 See supra text accompanying notes 508-14.

576 While violations outside the relevant period will not be sanctioned, they are relevant to the cease and desist order inquiry since there is a relationship between past wrongdoing and a likelihood of future violations. In re Glass, CFTC Docket No. 93-4, 1998 CFTC LEXIS 113, at *2 (CFTC May 22, 1998).

577 See supra notes 514, 564; Amended Stipulations, ¶¶96-97.

578 Neither Luxenburger nor Edwards were novices during the relevant period. Luxenburger first entered the industry in 1983 and, by 1991, appears to have amassed eight years of experience. DX-145 at 23-24. Edwards was around for decades.

present a prima facie basis for a cease and desist order. The existence of Edwards's compliance program does not tip the balance back in its favor or bring the evidence into equipoise. After all, the program does not seem to have prevented the violations at issue.[579] Thus, while Edwards may not have meant harm, Kelly and New York Currency have pushed the bar so low that we see no proper alternative to issuing a cease and desist order to the FCM. This leaves us one last sanction to consider.

Wright's Violations Merit A Permanent Trading Ban

Section 6(c) of the Act provides that, when a violation of any of the provisions of the Act or Commission regulations have been proven, the Commission may prohibit a respondent from trading on contract markets.[580] As the Division correctly summarized, a trading prohibition is an appropriate sanction when a respondent is found to have violated the Act (and/or Commission regulations) and the respondent's violative conduct undermines the integrity of the futures and/or Commodity options

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[579] In a deposition, Luxenburger testified as to the Edwards compliance policy and that he violated it. DX-145 at 30-31. However, he denied having known of the policy when he violated it. DX-145 at 31-32. If this statement is taken as credible, it supports the inference that Edwards did a less-than-stellar job in training its employees in matters of compliance. If taken as incredible, it bolsters the notion that Edwards's employees had some tendency to evade the policy. Neither alternative helps Edwards's case on this point.

[580] 7 U.S.C. §9.

markets.[581] The Commission has held that retail fraud poses a threat to market integrity that can warrant the imposition of a trading ban and Division argues that Wright poses such a threat.[582]

The Division has argued that Wright should receive a permanent trading ban because he "engaged in a pattern of fraud over a number of years which caused substantial injury to clients who placed their trust in him" and "engaged in activities without the benefit of registration for many years."[583] The fraud we found above certainly has a nexus to the integrity of the market, as it is currently defined, since those who know and learn of Wright's misconduct will likely take a dimmer view of the commodity options markets and those who serve

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[581] Division Posthearing Memorandum at 90.

[582] The Commission, following the lead of the Seventh Circuit, held that integrity of the market includes the public's perception of market integrity. In re Miller, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,913-14 (CFTC June 16, 1995).

[583] Division Posthearing Memorandum at 91. Wright's Section 4m(1) violations do not appear to pose the kind of threat such that they would serve as an independent basis for a trading ban. See R & W Technical Servs., [1998-1999 Transfer Binder] ¶27,582 at 47,747 (affirming an initial decision that a CTA violated Section 4m and committed fraud upon its customers but vacating the trading ban imposed on the CTA).

commodity option traders.[584] Thus, we find that some prohibition is warranted.

Having concluded that Wright deserves a trading prohibition, we must now consider its length. The Commission has consistently stated that the length of a trading ban should correlate with the "gravity" of the offense(s)[585] and, over time, has provided increasingly detailed explanations of what it means by "gravity."[586] This effort has culminated in the identifications of factors that include: "(1) The relationship of the violation at issue to the regulatory purposes of the Act; (2) respondent's state of mind; (3) the consequences flowing from the violative conduct; and (4) respondent's post-violation conduct. In addition, [the Commission] consider[s] any mitigating or aggravating circumstances presented by the

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584 Ironically, this order may exacerbate the damage that Wright's misconduct inflicts upon the markets by publicizing it.

585 See Miller, [1994-1996 Transfer Binder] ¶26,440 at 42,914; In re Incomco, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,198 at 38,537 (CFTC Dec. 30, 1991).

586 See First Fin., [Current Transfer Binder] ¶29,089 at 47,748; In re Premex, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,165 at 34,890-92 (CFTC Feb. 17, 1988); In re Sanchez, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,985 at 28,213 (CFTC Jan. 31, 1984); In re Haltmier, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,160 at 20,978 (CFTC May 5, 1976).

facts."[587] In short, the trading ban inquiry is similar to the civil monetary penalty analysis that we applied above.[588]

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[587] First Fin., [Current Transfer Binder] ¶29,089 at 47,748.

[588] Thus, we must once again decide without the benefit of specific formulae or principles that would allow us to weigh the circumstances with confidence. Id. See Cargill, [2000-2002 Transfer Binder] ¶28,425 at 51,225-26. Such an approach almost guarantees irreconcilable outcomes. See, e.g., Nikkhah, [1999-2000 Transfer Binder] ¶28,129 at 49,893 (finding that a respondent's fraudulent allocation scheme, which "continued over several months, and resulted in significant harm to customers," warranted a ten year trading prohibition); In re Glass, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,337 at 46,561-8-9 (CFTC Apr. 27, 1998) (imposing permanent trading prohibitions upon respondents who engaged in 12 noncompetitive trades over a five month period, and who "had been found guilty of earlier violations"); Mayer, [1996-1998 Transfer Binder] ¶27,259 at 46,140 (holding that repeated fraud, prearranged and wash trading and bucketing over the course of 26 months warranted permanent trading prohibitions for some respondents and ten-year bans for others, depending on the level of involvement.); In re Reddy, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,271 at 46,214 (Feb. 4, 1998) (concluding that respondents, who were involved in a pattern of noncompetitive trading over a period of months, should receive ten-year and five-year prohibitions, depending on the level of involvement); In re Elliott, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,243 at 46,008 (CFTC Feb. 3, 1998) (finding that 32 noncompetitive trades occurring over a two-week period which "impacted the integrity of the market by significantly inflating the volume" warranted a six-month trading prohibition); In re Fetchenhier, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,175 at (CFTC Oct. 31, 1997) (finding that a floor trader who was convicted of one Section 4b felony, one RICO felony, two felonies for wire fraud and three misdemeanors, all for acts undertaken on the trading floor, should receive a ten-year trading prohibition); In re Rousso, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,311 (CFTC Aug. 20, 1997) (stating that respondents, whose noncompetitive trading during a six-month period "represent[ed] repeated and direct assaults on the integrity of the marketplace," should receive ten-year trading prohibitions); In re Crouch, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH)

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The Commission has held that defrauding customers is "very serious even if there are mitigating facts and circumstances,"[589] and that fraud is more serious if done intentionally (rather

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¶27,114 at 45,249-50 (CFTC July 14, 1997) (finding that a floor broker, who "was indicted and tried on 39 counts of criminal violations of the Act" and subsequently agreed to plead guilty to one felony count of violating Section 4b, should receive a five-year trading prohibition); In re Ryan, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,049 at 44,984 (CFTC April 25, 1997) (finding that a floor trader who was convicted of three Section 4b felonies, one RICO felony and one misdemeanor -- all for acts undertaken on the trading floor -- should receive a six-year trading prohibition; In re GNP Commodities Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,222 (CFTC Aug. 11, 1992) (holding that a broker who, after the fact, systematically allocated winning trades over the course of a 21 months to his personal account and losing trades to customer accounts and who subsequently promoted his account's overwhelming "track record" to prospective investors should receive a permanent trading prohibition, while the broker's firm and controlling person should receive two-year bans). Compare, e.g., In re Commodities International Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,943 at 44,566-67 (CFTC Jan. 14, 1997) (finding that commodity pool fraud in which "respondents' violations of the Act involved fraud that continued over a period of many months and involved millions of dollars and hundreds of people," warranted one year trading bans), with Slusser, [1998-1999 Transfer Binder] ¶27,701 at 48,320 (holding that commodity pool fraud which took place over nine months, involving millions of dollars and hundreds of customers warranted a permanent trading prohibition). We note that the one year trading prohibition meted out in Commodities International Corp. is on the low end of the results found in Commission trading ban case law, while the permanent trading prohibition imposed in Slusser, of course, defines the high end.

[589] In re Grossfeld, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,467 n.28 (CFTC Dec. 10, 1996) (citation omitted). In the case at hand, of course, we have fraud without mitigation.

than recklessly) and repeatedly.[590] Here, Wright committed fraud, did it intentionally and did it more than once. As discussed above, his wrongdoing had substantial private and social consequences that have yet to be fully realized. Moreover, there is no evidence that his post-violation conduct or any other factor mitigated his wrongdoing. Thus, we are inclined to impose a substantial trading ban.

Without any certain method by which to weigh relevant factors, the best we can do is to search for analogous cases and impose appropriately similar sanctions.[591] Global Link provides a useful guide. The respondents in that case committed core violations that went unmitigated.[592] However, they operated for a short period of time on a small scale and caused customer losses of less than $60,000.[593] Despite the insignificant scope of the wrongdoing, the Commission imposed permanent trading bans upon all respondents.[594]

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[590] Id. at 44,467 n.29. See also Miller, [1994-1996 Transfer Binder] ¶26,440 at 42,914.

[591] See Ryan, [1996-1998 Transfer Binder] ¶27,049 44,984 (Tull, C., concurring) ("sanctions should be assessed based on the seriousness of the underlying conduct, with a view toward consistent treatment for similar violations").

[592] Global Link, [1998-1999 Transfer Binder] ¶27,669 at 48,170.

[593] Id. at 48,161-62.

[594] Id. at 48,170.

Wright's misconduct is no less grave than that of the Global Link respondents. Like the individual Global Link respondents, Wright committed fraud under the Act.[595] In addition, Wright committed a broader spectrum of violations and was more "successful" in peddling his services to others. Accordingly, if the Global Link respondents deserved a permanent trading prohibition (and the Commission found that they did), we should impose one upon Wright.

ORDER

In addition to those directives set forth above, we hereby **ORDER** that:

1. Respondent Roger J. Wright **CEASE AND DESIST** from violating Sections 4c(b), 4m(1), and 4o(1)(A)-(B) of the Act, 7 U.S.C. §§4c(b), 6m(1), 6o(1)(A)-(B), and Rules 4.13(b)(2), 4.31(a) and 33.10, 17 C.F.R. §§4.13(b)(2), 4.31(a), 33.10;

2. Respondent A.G. Edwards & Sons, Inc. **CEASE AND DESIST** from violating Rule 1.37(a), 17 C.F.R. §1.37(a);

3. Respondent Roger J. Wright be **PERMANENTLY PROHIBITED**, directly or indirectly, from **TRADING** on or subject to the rules of any contract market, either for his own account or for the account of any persons, interest or equity, and all contract markets are **PERMANENTLY REQUIRED TO REFUSE** Roger J. Wright any trading privileges;

4. Respondent Roger J. Wright **PAY** a civil monetary penalty of **$500,000** within 30 days of the effective date of this order; and

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595 He did not, however, violate or aid a violation of Section 4(a).

5. Respondent A.G. Edwards & Sons, Inc. **PAY** a civil monetary penalty of **$20,000** within 30 days of the effective date of this order.

IT IS SO ORDERED.[596]

On this 25th day of February, 2003

Bruce C. Levine

Bruce C. Levine
Administrative Law Judge

[596] Any party may appeal this initial decision to the Commission by serving upon all parties and filing with the Proceedings Clerk a notice of appeal within 15 days of the date of the initial decision. 17 C.F.R. §§10.12, 10.102 (2002). If a party does not properly perfect an appeal -- and the Commission does not place the case on its own docket for review -- the initial decision shall become the final decision of the Commission, without further order by the Commission, within 30 days after service of the initial decision. 17 C.F.R. §10.105 (2002).