UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

NICANOR P. PALOMARES	
v.	CFTC Docket No. 99-R017
JAMES W. BRADSHAW d/b/a NEURAL-TECH CAPITAL MANAGEMENT, and LFG, LLC	OPINION AND ORDER

Complainant Nicanor P. Palomares ("Palomares") appeals from an Administrative Law Judge's ("ALJ") dismissal of his complaint against respondents James W. Bradshaw ("Bradshaw"), doing business as Neural-Tech Capital Management ("Neural-Tech"), a commodity trading advisor, and LFG, LLC ("LFG"), a futures commission merchant, for failure of proof. Neither respondent filed a brief opposing complainant's appeal.

We conclude that the ALJ committed prejudicial procedural errors in resolving Palomares's claims against Bradshaw. In light of our independent assessment of the evidentiary record, including inferences drawn as a consequence of Bradshaw's failure to comply with his procedural obligations, we conclude that he violated Section 4o of the Commodity Exchange Act ("Act") and order him to pay Palomares $32,699.79, plus prejudgment interest and costs. While this appeal was pending, LFG filed a petition for voluntary bankruptcy, whereupon this action was stayed automatically pursuant to federal bankruptcy laws as to LFG. Palomares filed a claim in bankruptcy against LFG, which was dismissed as untimely. Accordingly, this complaint is dismissed with prejudice against LFG.

BACKGROUND

I.

Many of the facts material to Palomares's claims against Bradshaw are undisputed. During the period at issue, Palomares lived in Cedar Grove, New Jersey, was in his early sixties, and served as the president of a commercial reproduction firm. He had some experience trading both commodity futures and options.

Palomares's initial contact with Bradshaw was arranged by Avco Financial Corp. ("Avco"), of Greenwich, Connecticut. After reading one of Avco's print advertisements, Palomares developed an interest in an Avco trading system called Recurrence IV. According to the advertisement, the developer of Recurrence IV had isolated a number of currency patterns that, on average, identified 75% winning trades with no overnight exposure and minimal drawdowns. The advertisement indicated that the benefits of the patterns were available in an easy-to-use software program. It stated that the use of the Recurrence IV system to trade Swiss franc futures between January 1989 and September 1995 resulted in a profit of $565,750 on a starting equity of $10,000 – a return of more than 800%.

Palomares contacted Avco to discuss its Recurrence IV software. When Palomares decided that he could not use the software on his own, Avco referred him to Bradshaw. Bradshaw agreed to use Avco's software to trade an account that Palomares later opened with LFG. Bradshaw, prior to trading the account, provided Palomares with an August 22, 1995 disclosure document ("Disclosure Document") he had prepared.[1] The Disclosure Document included a general description of the risks of commodity trading and a specific warning relating

[1] The Disclosure Document indicated that Bradshaw did business under the name Neural-Tech Capital Management ("Neural-Tech"), and that he was a private trader, technical analyst and researcher who had spent four years focusing on research, testing and utilization of computer trading system programs using "advanced technical analysis and neural net design application." Disclosure Document at 5.

to Bradshaw's approach to trading. The latter indicated that Bradshaw's approach involved day trading, and stated that day trading tends to generate both "large commission expenses" and a "high level of transactions."[2] The warning also noted that these factors would lead to a "high break-even point" and reduced the "probability that total profits [would] exceed total losses." Disclosure Document at 3.[3]

The Disclosure Document indicated that Bradshaw required customers to deposit a minimum of $20,000 to open an account, and that customers were required to open accounts at LFG. *Id.* at 10, 12. It also indicated that there had been no material administrative, civil, or criminal actions pending, concluded, or appealed against Bradshaw or LFG within the last five years. *Id.* at 4, 12.

Palomares signed the forms to open his LFG account on January 3, 1996. He closed the account in September 1997. During the interim, through Bradshaw's trading of the account, Palomares lost $32,699.79.

II.

In October 1998, Palomares filed a reparations complaint seeking over $74,000 from respondents Bradshaw and LFG, an amount that included a claim for punitive damages. The

[2] The Disclosure Document included several specific provisions relating to the level and frequency of trading and the expected trading expenses and fees. It stated that, under normal market conditions, assets committed as margin would be generally $4,000 per contract, or a rate approximately 80% to 100% more than the exchange set minimum margin, and that the number of contracts traded would be determined by the resulting net asset value of the account. Disclosure Document at 7. It stated further that Bradshaw's trading program traded "almost every trading day, trading an average of 6 times a week," and, on average, resulted in "$88.44 a week per contract in commissions." *Id.* at 8. In addition, it stated that for every contract traded, $10 went to the customer's FCM and $4.74 went to the National Futures Association ("NFA"). *Id.* It also stated that customers would be charged a $25 per contract professional fee for Bradshaw's services, which, based on the average number of trades executed per week (six), would result in, on average, fees of $150.00 a week per contract" for Bradshaw. *Id.* at 9.

[3] The Disclosure Document provided a general description of Bradshaw's trading method that highlighted several factors: (1) the method was "exclusively" technical trade related; (2) it was based on computerized trading signals for both intra-day and inter-day positions; and (3) it used signals generated based on "several highly advanced technically based analytical systems programs" that were combined to form "one trading method." Disclosure Document at 6.

complaint specified five theories of recovery – breach of contract, misrepresentation, churning, breach of fiduciary duty, and failure to supervise.[4] In support of these theories, Palomares alleged that Avco referred him to Bradshaw, who "boasted about his trading track record," and promised that he would use the Recurrence IV system to manage Palomares's account. Complaint at 2. Palomares specifically alleged that, in opening the account, he relied on Bradshaw's representations about his level of expertise and his trading system. *Id.*

According to Palomares, Bradshaw rarely contacted him to discuss the trading in his account. When Palomares contacted Bradshaw to discuss losses, Bradshaw repeatedly advised, "he would make it up" to Palomares or "build it up." *Id.* Palomares claimed that the volume of trading increased each month the account was open.[5] He acknowledged receiving written notices of the trades, but characterized them as "incomprehensible." *Id.* at 3. Palomares alleged derivative liability against LFG, on the ground that Bradshaw acted as LFG's agent; and direct liability against LFG based on LFG's failure to supervise Bradshaw. Palomares later filed an amended complaint lowering his claim for damages to the amount of his out-of-pocket losses.[6]

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[4] Palomares provided a brief summary relating to each of his theories of recovery, as follows:

- Breach of Contract – Bradshaw failed to act in a manner consistent with statements in his Disclosure Document relating to his track record, the expected frequency of his trading, the expected level of transaction costs, and the appropriate loss limit.
- Misrepresentation – Bradshaw made oral and written misrepresentations that Palomares relied upon.
- Churning – The size, frequency, and cost of Bradshaw's trades far exceeded the limits described in his Disclosure Document.
- Breach of Fiduciary Duty – Bradshaw's failure to act in a manner consistent with the statements in his Disclosure Document amounted to a breach of his fiduciary duties.
- Failure to Supervise – LFG had a duty to supervise Bradshaw and failed to fulfill that duty.

Complaint at 3-5.

[5] In this regard, he claimed that overall, Bradshaw traded 2,000 contracts and generated $50,000 in commissions. He noted that in April 1996, there were more than 350 round turns generating commissions in excess of $11,000.

[6] In the amended complaint, Palomares also clarified that the trading in his account had resulted in approximately $26,000 in commissions.

LFG answered, stating that it lacked sufficient knowledge to respond to Palomares's allegations, and arguing that because Bradshaw was not its agent, LFG had no duty to supervise him. LFG also raised affirmative defenses of waiver, estoppel, and ratification. Bradshaw answered by generally denying any wrongdoing, and by asserting that he "never guaranteed profits nor . . . minimize[d] the risks." Bradshaw Answer at 2.

The case was assigned to an ALJ for resolution under procedures applicable to formal adjudications. After the ALJ issued an order establishing discovery deadlines, Palomares served discovery requests on LFG and Bradshaw, seeking, among other things, information and documents concerning: (1) the trades entered in his LFG account; (2) the relationship between Bradshaw and LFG; and (3) the relationship between both respondents and Avco. LFG provided a minimal response to Palomares's discovery requests,[7] and Bradshaw did not respond at all.

In March 1999, the ALJ issued an order scheduling a hearing for July 9, 1999 and requiring all parties to submit a prehearing memorandum and their documentary evidence by June 1, 1999. LFG's memorandum, filed in April 1999, indicated that LFG would call Bradshaw as a witness and that Bradshaw would testify that he was "a commodity trading advisor and his firm, Neural-Tech Capital Management, was an independent introducing broker."[8] LFG Prehearing Memorandum at 2. In discussing the issues raised in the case, LFG focused on a futures commission merchant's lack of any duty to supervise either a commodity trading advisor or an independent introducing broker. *Id.* at 3-4. Bradshaw did not file a prehearing memorandum, but following the service of LFG's prehearing memorandum, he filed a notice

[7] For example, LFG refused to provide trade tickets related to the transactions in Palomares's account, and produced no documents pertinent to its relationship with Bradshaw or Avco.

[8] Neural-Tech in fact is not an introducing broker; LFG abandoned this erroneous assertion at the hearing.

stating that he "concur[red]" with LFG's pleading, and that he intended to attend the hearing. Bradshaw's May 17, 1999 Notice of Participation.

On May 5, 1999,[9] Palomares filed a motion to compel Bradshaw and LFG to respond to his outstanding discovery requests. Again, Bradshaw did not respond. LFG responded by identifying two individuals with knowledge of the transactions in Palomares's account: its general counsel, James Green, and its vice president for compliance, Tom Conroy. LFG claimed that it had no documents evidencing employment or compensation agreements with Bradshaw, nor any checks or wire transfers evidencing LFG's payments to Bradshaw.

Palomares replied, challenging LFG's response as "false and misleading," and noting that LFG continued to refuse to produce trade tickets for his account. LFG responded on May 20, 1999, confirming that it would participate in a telephone conference that the ALJ had scheduled for later that day,[10] and citing several alleged deficiencies in Palomares's discovery responses. On May 25, 1999, the Commission received LFG's amended response to Palomares's motion to compel. For the most part, the amended response reiterated LFG's earlier position but included a statement that LFG had conducted an extensive investigation. As to documents evidencing payments to Bradshaw, LFG stated that once a month it sent a check to Bradshaw reflecting the $25 per trade fee that Palomares had agreed to pay Bradshaw. LFG claimed that it was unable to locate the checks, but stated that "Bradshaw ha[d] agreed to produce those documents." Amended Response at 2.

On May 26, 1999, Palomares filed a motion to postpone the June 1 deadline for submitting a prehearing memorandum and documentary evidence, citing respondents' failure to

[9] The date set by the ALJ for the close of discovery was April 26, 1999.

[10] The record does not include a written notice evidencing the scheduling of this teleconference, or anything documenting the content of the conference.

promptly respond to his discovery requests. The following day, the ALJ denied both Palomares's motion to compel discovery and his motion to delay the pending deadline. The ALJ noted that he had conducted two informal telephone conferences to resolve the parties' discovery disputes[11] and that LFG had twice supplemented its responses. He indicated that he had reviewed LFG's responses and found them to be sufficient. May 27, 1999 order at 2-3. The ALJ denied Palomares's motion to compel discovery responses from Bradshaw because it was filed after discovery closed. *Id.* at 3.

The Commission received Palomares's prehearing memorandum on June 1, 1999. Palomares indicated that he intended to call Bradshaw, Green and Conroy as witnesses. He also asked the ALJ to reconsider the order denying Palomares's motion to compel discovery. The following day, the ALJ denied the motion and warned Palomares that the Commission's rules prohibit repetitive motions dealing with the same subject.

III.

The ALJ conducted an oral hearing in New York on July 9, 1999. Bradshaw did not appear. Palomares appeared and testified in his own behalf, and presented Green's testimony. LFG was represented by counsel, but did not present any witnesses. At the beginning of the hearing, the ALJ reviewed several procedural issues. First, he found Bradshaw in default for failing to appear, and stated that as a consequence, Bradshaw would be precluded from presenting evidence and cross-examining witnesses. Tr. at 4. He also discussed Palomares's continuing requests that LFG produce the order tickets for the trades in his LFG account. The ALJ stated that he thought this issue had been resolved to Palomares's satisfaction during the May 20 telephone conference during which the ALJ determined that the order tickets were not

[11] We presume that this is a reference to the May 20, 1999 conference and to one held on some other date. As noted above, there is nothing in the record documenting the content of the May 20th conference. Nor does the record reflect what occurred during the other conference.

relevant to Palomares's case. Tr. at 8-11. The ALJ stated that he would not entertain further argument with respect to the issue. Tr. at 13, 15.

After Palomares was sworn, the ALJ asked him to begin by describing his experience with trading futures contracts, how he became interested in trading with Bradshaw and LFG, and how they injured him. Tr. at 21. Palomares explained that he had a written statement that he wished to read into the record. As he began to read it, the ALJ asked whether he had received help in preparing it. When Palomares stated that he had, the ALJ ruled that the document could be submitted as an affidavit and would be received as evidence, but that no need existed to read it into the record.[12] Tr. at 22-23, 27-28. The ALJ explained that he would consider the statement to be Palomares's testimony, and that he would give Palomares an opportunity to provide orally any additional detail not included in the statement. Tr. at 28.

Palomares informed the ALJ that he had no further direct testimony, but would give a closing statement, and said that he wanted to present documentary evidence he had obtained from the NFA. Tr. at 30-37. The ALJ excluded this evidence, stating that Palomares failed to submit it by the June 1 prehearing deadline. *Id.* Palomares objected, claiming that he needed the evidence to present his case, and argued that he was being denied due process. Tr. at 35. The ALJ responded that he issued the order setting the June 1 deadline on March 29, 1999, and that it provided clear notice that documentary evidence would not be received at the hearing. Tr. at 36.

LFG's counsel then cross-examined Palomares, asking him about his experience trading futures and securities. Tr. at 38-44. Palomares acknowledged that he had maintained two futures accounts prior to opening his LFG account, but was reluctant to provide details, insisting that the questions were not relevant to his case. Tr. at 43. Counsel then referred Palomares to

[12] In response, Palomares asked the ALJ to recuse himself. Tr. at 23. In support of this request, Palomares pointed to, among other things, the ALJ's discovery rulings. Tr. at 25. The ALJ responded that Palomares was "impermissibly objecting" to discovery rulings and denied his motion to recuse. Tr. at 26.

the Power of Attorney he signed in connection with his LFG account, which included language holding LFG harmless for the actions of the account advisor. Tr. at 45-46. Palomares explained that he signed the Power of Attorney based on the Disclosure Document provided by Bradshaw. Tr. at 46.

The ALJ then asked Palomares which part of the Disclosure Document Palomares relied upon. Tr. at 47. In response, Palomares pointed to the provisions explaining that the number of contracts traded would be limited by the account funds available for margin and that the trading program would trade an average of six times per week, and claimed that Bradshaw traded far in excess of these limits. Tr. at 47-54. When the ALJ asked whether there were any other violations of the Disclosure Document, Palomares pointed to the document's claim that no material administrative or civil actions against LFG had been concluded or appealed in the last five years. Tr. at 54-55.

The ALJ next asked Palomares what Bradshaw had represented, either orally or through the Disclosure Document, regarding how he was going to trade the account. Tr. at 60. Palomares explained that after he called Bradshaw to find out how the Recurrence trading system worked, Bradshaw sent him documents and papers including the disclosure statement. *Id.* Palomares reiterated his claim that Bradshaw traded the account in excess of the limits described in the Disclosure Document, which he interpreted as six trades per week. Tr. at 61-63. The ALJ then asked when Bradshaw started trading more than six times a week. Palomares replied, "[f]rom the day he started." Tr. at 63. Palomares stated that he did not know what was in the Disclosure Document at the time, but insisted nevertheless that he relied on it and expected Bradshaw to follow it "in a more religious way." *Id.*

The ALJ then turned to the claim contained in Palomares's written statement that Bradshaw misrepresented the likely risks and rewards associated with trading futures using his trading program. Tr. at 68. When the ALJ asked him to specify the misrepresentations, Palomares referred to churning and Bradshaw's failure to trade in a manner consistent with the Disclosure Document. Tr. at 69. When asked by the ALJ what misrepresentations Bradshaw made "directly concerning the probability and magnitude of profits and the risk of loss," Palomares replied, "I didn't know that market risk is explained, I know that. But it doesn't describe to me the proud [*sic*] and misleading way this account has been traded." *Id.* Under further questioning, Palomares again focused on Bradshaw's excessive trading. Tr. at 70. When the ALJ asked whether the only misrepresentation Bradshaw made concerned the number of contracts that would be traded, Palomares sought to rely on his written statement. Tr. at 71. The ALJ stopped him and the following colloquy took place:

> *ALJ*: No, I want you to testify. We need to clarify what your grievances are. He misrepresented the number of . . . contracts which you would trade.
>
> *Palomares*: Number of trades.
>
> *ALJ*: That's your testimony. Did he misrepresent anything else to you? He did that by misrepresenting the margin that he would require, that's your testimony.
>
> *Palomares*: I believe I provided the other violations.

Tr. at 71.

The ALJ then asked Palomares whether he had read the account statements provided by LFG. Palomares acknowledged that he read some of them, but claimed that he relied on Bradshaw. Tr. at 72. In this regard, he said Bradshaw assured him that, "if there were losses, he said we're going to make it up, he's going to build it up." *Id.* He stated that he "was looking at the amount from the initial investment time and the amount that is coming out. I was trying to

determine what he's going to do about it. He said he promis[ed] that he's going to build it up, and he's going to make it up. That's what he told me. . . . I was relying on that." Tr. at 72-73. When the ALJ sought to pin down when Palomares learned that Bradshaw was trading the account in greater volume and frequency than the Disclosure Document provided, Palomares acknowledged that he discovered the volume of trading early on, but claimed he didn't realize that it was inconsistent with the levels described in the Disclosure Document until later, even though he read the Disclosure Document when he opened the account. Tr. at 73-76.

Palomares then called Green as a witness. Green testified that Bradshaw was permitted to call his orders directly to the trading floor, Tr. at 83, and that Bradshaw managed 15 or 20 accounts at LFG. Tr. at 102. Green explained that LFG monitored the activity in Palomares's account as it did for all accounts, to determine such things as proper trade allocation and whether the account contained sufficient margin, and stated that all the trading in Palomares's account was day trading, with the exception of trades resulting from keypunch errors. Tr. at 89-90, 104. Green explained that no margin is required for day trades, and that to the extent a position was carried overnight, there was excess margin in the account. Tr. at 89-91.

Green was asked several questions about the commissions LFG charged. He testified that LFG charged $22.50 per round turn and paid $10 of that to Bradshaw. Tr. at 98. When the ALJ asked Green why LFG had no records showing payments to Bradshaw, LFG's counsel volunteered that payments were made monthly by wire, but LFG could not locate the wires. Tr. at 100.

At the conclusion of the hearing, the ALJ informed Palomares that he found many of Palomares's allegations of fraud, misrepresentation and reliance to be very general and conclusory, and advised Palomares that these allegations were not helpful to his case. He

advised Palomares further that, in his post-hearing brief and findings of fact, Palomares should specifically document what misrepresentations were made and how they were proven in the record, including those related to fraudulent solicitation and Palomares's vague allegations that Bradshaw misrepresented the risks associated with trading, or the likely profitability of trading. Tr. at 122-26.

Palomares filed a posthearing brief in August 1999. His proposed findings of fact largely reiterated points raised in previous written submissions. He argued that the record showed that Bradshaw had both: (1) claimed to be successfully using the Recurrence IV trading system; and (2) suggested that Palomares would realize very impressive returns. Palomares also asserted that the record showed that he did not understand what was going on in his account and did not fully understand the statements that he received from LFG.

Palomares emphasized that Bradshaw neither attended the hearing nor responded to discovery requests. He also argued that LFG failed to comply with discovery requests and offered misleading information in its prehearing memorandum. Finally, in addition to discussing the legal theories raised in his complaint, Palomares complained of Bradshaw's failure to register as an introducing broker, and argued that LFG was liable as a controlling person.[13]

IV.

The ALJ issued his decision dismissing the complaint in October 2000. *Palomares v. Bradshaw*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,268 (CFTC Oct. 2, 2000) (I.D.). The ALJ noted that Bradshaw chose not to attend the hearing and was therefore deemed in default, but that Bradshaw's default did not make Palomares "an automatic winner." *Id.* at 50,620 n.12. Rather, the ALJ stated, it precluded Bradshaw from introducing evidence or

[13] LFG's filed a posthearing brief, no longer relevant to this appeal, arguing that no reliable evidence established that Bradshaw was its agent.

cross-examining witnesses, and would deem him to have admitted all well-pled allegations of fact, but not ultimate conclusions of law. *Id.*

As alleged in the complaint, the ALJ found that Palomares became interested in Avco's Recurrence IV trading system after reviewing Avco's written advertisement. *Id.* at 50,620-21. When Palomares contacted the firm, Avco referred him to Bradshaw. According to the ALJ, Palomares's conversation with Bradshaw "addressed the logistics of setting up the account." *Id.* at 50,622. The account opened with a starting balance of $33,031 and began trading in March 1996. *Id.*

The ALJ reviewed the account's trading results, noting that early profits were followed by significant losses in March, that trading of up to 48 contracts a day led to profits in April, but that there were significant losses in May. *Id.* The ALJ found that when Palomares called Bradshaw to discuss the losses, Bradshaw was curt and dismissive, explained that he had "encountered a spell of bad luck," and made promises that he would build up the account balance. *Id.* at 50,622-23.

The ALJ then turned to his interpretation and evaluation of Palomares's misrepresentation claims. The ALJ stated that this was not an easy task, noting that Palomares's complaint was "short on specifics." *Id.* at 50,624. The ALJ found that the complaint's "sweeping and general claim that Bradshaw's 'oral statements' and . . . disclosure documents, 'gross[ly] misrepresent[ed] . . . all aspects of the trading implemented' in [his] account," failed to meet the requirements of Commission Rule 12.13 that any person complaining of a violation of a Commission rule, regulation or order do so with particularity. *Id.* at 50,624 and n.46. The ALJ then stated that the only concrete testimony Palomares provided at the hearing on this score focused exclusively on the alleged written falsehoods contained in the Disclosure Document, *i.e.*,

the statements describing the limitations on trading volume; and the claim that LFG had not been the subject of any material administrative or civil actions for the past five years. *Id.* at 50,624-25. The ALJ acknowledged that in the written statement Palomares submitted at the start of the hearing, he alleged that in his initial conversations with Bradshaw, Bradshaw "boasted about his trading track record and the high returns from the 'Recurrence system,'" I.D. at 50,625 n.48 (quoting Prepared Statement at 3, ¶ 3), and that in closing remarks, Palomares made "boilerplate" claims that Bradshaw "misrepresent[ed] the probability, magnitude of profits, [and] risk of loss associated with the trading of futures using the computer trading program." *Id.* (quoting Tr. at 117). The ALJ stated, however, that "aside from offering these canned legal conclusions, Palomares would not specify the manner in which Bradshaw made such misrepresentations." *Id.*

The ALJ rejected Palomares's misrepresentation claims relating to the Disclosure Document, finding that they were based on a plain misreading of the document's language, or on a misinterpretation of the meaning of "material" under Commission Rule 4.34(k).[14] *Id.* at 50,625-26. The ALJ also held that these claims were "frivolous," *id.* at 50, 626, because Palomares testified not to know what was in the Disclosure Document at the time trading took place, and thus could not have relied on it. *Id.* at 50,626 n.65, 50,627.

The ALJ rejected Palomares's churning claim for failure of proof. *See generally id.* at 50,628-33. He found that the record indicated that Palomares's trading objectives were consistent with a strategy emphasizing day trading and the generation of a significant level of commissions. The ALJ also noted that the record showed that Palomares received account

[14] Commission Rule 4.34(k) provides that commodity trading advisors must disclose "any material administrative, civil or criminal action, whether pending or concluded, within five years preceding the date of the [Disclosure] Document" with respect to any futures commission merchant with which the customer will be required to maintain his account.

statements that clearly disclosed the level and frequency of trading, but failed to object to Bradshaw's aggressive trading. *Id.* at 50,631. The ALJ declined to credit Palomares's claim that he did not understand the LFG account statements. *Id.* Finally, the ALJ held that the record did not establish that LFG was responsible for any of Bradshaw's alleged wrongdoing, and that LFG accordingly had no duty to supervise him. *Id.* at 50,633-36.

Palomares filed a timely appeal, broadly challenging the ALJ's factual assessments, including his failure to consider the false statements in Avco's written advertisement as an element of his misrepresentation claim. He also challenges the ALJ's discovery rulings, his failure to impose a default judgment on Bradshaw, and his failure to find that Bradshaw was LFG's agent.

DISCUSSION

I.

Commission Rule 12.312 addresses the effect of a party's failure to appear at a hearing. It states in relevant part that a party who fails to appear shall "be deemed to have waived the opportunity for an oral hearing in the proceeding" and that, for "just cause," the ALJ "may take such action as is appropriate pursuant to § 12.35" against the party who fails to appear. Under Commission Rule 12.35, the ALJ may:

> (a) Infer that the documents or things not produced would have been adverse to the party;
>
> (b) Rule that for the purposes of the proceeding the information in or contents of the documents or things not produced be taken as established adversely to the party;
>
> (c) Rule that the party may not be heard to object to introduction and use of secondary evidence to show what the withheld documents or other evidence would have shown;

(d) Rule that a pleading, or part of a pleading, or a motion or other submission by the party, to which the order for production related, be stricken;

(e) Dismiss the entire proceeding with prejudice to matters alleged in the complaint, but without prejudice to counterclaims; and

(f) Issue a default order and render a decision against the party, whose rights shall thereafter be determined by §§ 12.22 and 12.23 of these rules.

In the present case, the ALJ found that Bradshaw waived his opportunity for an oral hearing through his default. We conclude that in the circumstances presented, this ruling did not go far enough and amounted to an abuse of discretion.[15] The abuse of discretion had roots in the ALJ's ruling denying Palomares's motion to compel discovery from either LFG or Bradshaw. The ALJ indicated in his May 27 order denying the motion to compel that he had conducted two informal telephone conferences to resolve discovery issues and was satisfied with LFG's responses. The ALJ did not address the impact of Bradshaw's failure to produce anything in response to Palomares's discovery requests and, because the record contains nothing evidencing the content of the telephone conferences, we have no way of knowing whether this was discussed during the conferences, or why the ALJ felt it was unnecessary for Bradshaw to do so. The record reveals only that the ALJ denied Palomares's motion to compel Bradshaw to respond as untimely. There is no suggestion on the record, however, that Bradshaw would have been prejudiced by the brief delay had he been required to respond, or that it would have resulted in any significant delay of the proceedings as a whole. At the very least, given the obvious misrepresentations in Avco's written advertisement and Avco's referral of Palomares to Bradshaw, the ALJ should have compelled Bradshaw to produce information about his relationship with Avco. Failing to do so severely prejudiced Palomares.

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[15] We review discovery sanctions rulings under an abuse of discretion standard. *Wichman v. Hewitt,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,613 at 36,628 (CFTC March 7, 1990).

In our view, Bradshaw's refusal to participate in the discovery process and his absence from the hearing—coupled with Palomares's prehearing declaration that he would rely on Bradshaw's testimony to prove his claims and Bradshaw's failure to offer any notice of or excuse for his failure to appear—provide just cause for drawing the adverse inferences authorized by Commission Rule 12.35 (a) and (b), in addition to finding Bradshaw in default.[16] Consequently, for purposes of evaluating the evidentiary record, we infer that the documents that Bradshaw should have produced, and testimony that he should have offered, would have been adverse to his interests and supportive of Palomares's misrepresentation claims.

II.

As noted above, in reviewing Palomares's misrepresentation claims, the ALJ acknowledged that, in the written statement submitted for the record at the start of the hearing, Palomares alleged that Bradshaw boasted about his trading track record and the high returns produced by the Recurrence IV trading system. The ALJ acknowledged also Palomares's closing remarks, during which he stated that Bradshaw misrepresented the probability of profits and risk of loss associated with the trading system. The ALJ nevertheless rejected these allegations as too general, and characterized them as "canned legal conclusions." I.D. at 50,625 n.48. Rather than "legal conclusions," however, these statements constitute unrebutted

[16] Although the ALJ did not cite the relevant Commission rules in his opinion, he, in effect, deemed Bradshaw to have waived his opportunity for an oral hearing under Rule 12.312 and issued a default order against him under Rule 12.35(f). The ALJ then held a default proceeding under Rule 12.22 with respect to Bradshaw. That rule provides, in relevant part, that the ALJ may "enter findings and conclusions concerning the questions of violations and damages and, *if warranted*, enter a reparation award against the non-responding party." Commission Rule 12.22(b) (emphasis added). Thus, the ALJ correctly found that Bradshaw's default did not mean an automatic win for Palomares. As explained more fully in this opinion, however, Palomares's allegations in the context of the entire record, including the adverse inferences to be drawn by Bradshaw's failure to participate, are sufficient to render judgment in Palomares's favor.

allegations of fact.[17] As such, it is proper to treat them as true, and although general, they state a claim for relief which, taken together with the other evidence of record and the adverse inferences to be drawn by Bradshaw's failure to participate, are sufficient to merit judgment in Palomares's favor. *See McDaniel v. Amerivest Brokerage Services*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,264 at 50,589 (CFTC Sept. 26, 2000) (holding that a presiding officer must independently evaluate the reliability of a witness's version of events, not in isolation, but "in light of the record as a whole").

The written solicitation that Palomares received from Avco was deceptive on its face and it is undisputed that an Avco salesperson referred Palomares to Bradshaw for trading "according to the Recurrence system." I.D. at 50,622. The record developed at the hearing does not clearly establish either the nature of Bradshaw's link with Avco or the detailed representations he made about the high returns that Palomares could expect from the Recurrence IV system. If Bradshaw had appeared at the hearing, he might have established that he was unaware of Avco's deceptive advertisement, or that he clearly warned Palomares that no system could guarantee profits through futures trading. In the context of Bradshaw's failure to respond to discovery requests and failure to appear at the hearing, however, we draw an adverse inference that Bradshaw was aware of Avco's deception and made oral misrepresentations to Palomares consistent with Avco's written advertisement.

As noted above, Palomares's complaint specifically alleged that in opening a futures account managed by Bradshaw, he relied on Bradshaw's representations about his level of expertise and his trading system. We credit this sworn allegation, along with Palomares's claim that, when he questioned Bradshaw about the losses in his account, Bradshaw lulled him with

[17] The legal conclusion to be drawn is whether these allegations, taken in the context of the record as a whole, establish a violation of the Act or Commission rules.

promises that "he would make it up" to Palomares or "build it up." Complaint at 2. Palomares did maintain his LFG account for a considerable period after suffering significant losses. In view of Bradshaw's lulling conduct, however, we do not view this fact as undermining evidence showing that Palomares justifiably relied on Bradshaw's misrepresentations in opening and maintaining his account.

III.

As regards LFG, while this appeal was pending, LFG filed a voluntary petition for bankruptcy in the U.S. Bankruptcy Court for the Northern District of Illinois. *In re LFG, LLC*, Case No. 01 B 12604 (Bankr. N.D. Ill.) (filed Apr. 9, 2001). We take notice of that fact, although nothing appears in the record of this case respecting the bankruptcy filing. The filing operated automatically to stay this proceeding as to LFG. The court established a bar date of July 11, 2001 for claims arising before the petition was filed. The bankruptcy record shows that Palomares filed an unsecured claim against LFG for $74,360, the original amount of his reparations claim. The claim form bears Palomares's signature and a handwritten date of July 10, 2001, and is stamped by the court as being "filed" on July 16, 2001. LFG filed an omnibus objection to late-filed claims on March 22, 2002, asking the court to dismiss as untimely claims by Palomares and others. After a hearing, the court disallowed five of the late claims, including that of Palomares. Order Disallowing Late Filed Claim Nos. 106, 107, 109, 111 and 114 (May 3, 2002). A liquidating reorganization plan was confirmed later that year. Order Confirming Amended Joint Plan of Liquidation of Debtor and Official Committee of Unsecured Creditors (Sept. 19, 2002). The foregoing events require that Palomares's complaint against LFG be dismissed.

CONCLUSION

In light of our analysis, we vacate the ALJ's decision, find Bradshaw liable to Palomares on the misrepresentation claim, and order Bradshaw to pay Palomares $32,699.79, plus prejudgment interest at a rate of 5.25% from February 29, 1996 to the date of payment, and costs of $250.[18] The complaint against LFG is dismissed with prejudice.

IT IS SO ORDERED.[19]

By the Commission (Acting Chairman LUKKEN and Commissioners DUNN, SOMMERS and CHILTON).

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: December 7, 2007

[18] Because our decision makes Palomares whole, we need not, and do not, reach his other claims against Bradshaw or any appeal arguments not addressed herein.

[19] Under Sections 6(c) and 14(e) of the Commodity Exchange Act (7 U.S.C. §§ 9 and 18(e) (2000), a party may appeal a reparation order of the Commission to the United States Court of Appeals for only the circuit in which a hearing was held; if no hearing is held, the appeal may be filed in any circuit in which the appellee is located. The statute also states that such an appeal must be filed within 15 days after notice of the order, and that any appeal is not effective unless, within 30 days of the date of the Commission order, the appealing party files with the clerk of the court a bond equal to double the amount of the reparation award.

A party who receives a reparation award may sue to enforce the award if payment is not made within 15 days of the date the order is served by the Proceedings Clerk. Pursuant to Section 14(d) of the Act (7 U.S.C. § 18(d) (2000)), such an action must be filed in the United States District Court. *See also* 17 C.F.R. § 12.407.

Pursuant to Section 14(f) of the Act (7 U.S.C. § 18(f) (2000)), a party against whom a reparation award has been made must provide to the Commission, within 15 days of the expiration of the period for compliance with the award, satisfactory evidence that (1) an appeal has been taken to the United States Court of Appeals pursuant to Sections 6(c) and 14(e) of the Act or (2) payment has been made of the full amount of the award (or any agreed settlement thereof). If the Commission does not receive satisfactory evidence within the appropriate period, such party shall be suspended automatically. Such prohibition and suspension shall remain in effect until such party provides the Commission with satisfactory evidence that payment has been made of the full amount of the award plus interest thereon to the date of payment.

Commissioner Dunn, concurring in the result

I concur in the result of this case, but do so based on different grounds than those expressed by the majority. Adverse inferences are an extraordinary remedy that are appropriate to ensure that a party does not profit from his or her failure to participate in a reparations proceeding. *See, e.g., McGough v. Bradford*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,265 (CFTC Sept. 28, 2000). However, I believe the result could have been achieved more easily in this matter.

In this case, such an extraordinary remedy is unnecessary because, from the record, it is clear that Palomares alleged sufficient facts to support a violation of fraud under the Commodity Exchange Act ("CEA"). Palomares alleged that Bradshaw unlawfully misrepresented the risk of trading his system, and unlawfully represented his own success trading the system. Therefore, the ALJ erred in failing to grant a default judgment to Palomares.

The central issue in this case is whether Palomares made allegations sufficient to support a default judgment in his favor following the ALJ's determination that Bradshaw was in default for failing to attend the oral hearing. The ALJ incorrectly answered this question in the negative, finding that Palomares had failed even to make a *prima facie* showing that Bradshaw was liable to him for violating the CEA or Commission Regulations. *Palomares v. Bradshaw*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,268 at 50,620 (I.D. Oct. 2, 2000).

The record reveals that Palomares alleged that he had granted Bradshaw authority to trade his account based upon Bradshaw's representations that he had a "very impressive track record" trading the Recurrence trading system. Tr. at 116. Palomares further stated that Bradshaw had "misrepresent[ed] the probability, magnitude of profits, risk of loss associated with the trading futures using the computer trading [Recurrence] program," and "failed to disclose the actual trading results he had previously obtained." *Id.* at 117.[1]

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[1] Relevant statements made by Palomares include (emphasis added):

> "[Bradshaw] boasted about his trading track record." Complaint at 2.
>
> When Palomares asked him about his losses, Bradshaw told him that "I'm gonna make it up to you," and "Don't worry, we'll build it up." *Id.*
>
> "[Bradshaw] promised that he would use the "Recurrence" futures trading system to manage Palomares' [account]." *Id.*
>
> "[Palomares] relied on contractual representations made by Bradshaw concerning his trading method including his track record, the frequency of trading, the anticipated transaction costs and the loss limit as described in Respondents' 'Disclosure Document.'" *Id.* at 3.
>
> "I called Bradshaw and he told me that he was a commodity trading advisor ("CTA") and boasted **about his trading track record and the high returns from the 'Recurrence' system.** Exhibit CX-7 at 2 (Palomares Prepared Statement).
>
> "Bradshaw was extremely abrupt and **whenever I asked about the losses he said 'I'm gonna make it up to you . . . .'**" *Id.* at 4.

Pursuant to Commission Rule 12.22, under which default judgments in reparations cases are evaluated, Palomores' allegations regarding Bradshaw's misrepresentations would be admitted as statements of fact. Rule 12.22 does not directly state what the burden of proof is for establishing a sufficient basis for issuing a default judgment. However, the Commission has held that a reparations party must sufficiently state a cognizable claim that is not fatally undermined by the record in order **to affirm** a reparations award in a default proceeding. *McGough*, ¶ 28,265 at 50,607 (emphasis added).

The Commission has defined a sufficiently stated claim as one that provides "intelligible notice" of the complained-of conduct, Final Rules Relating to Reparations, 49 Fed. Reg. 6602-01, 6607 (Feb. 22, 1984), or one that "provides respondents with the requisite 'fair notice of the nature of [complainant's] claims.'" *Human v. Alaron Trading Corp.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,806 at 44,292 (CFTC October 18, 1996), *quoting Hall v. Diversified Trading Systems*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,131 at 41,751 (CFTC July 7, 1994). There is no requirement to identify specific CEA provisions or Commission rules violated, nor is it necessary to plead fraud with specificity. *Dunmire v. Hoffman,* [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH)¶ 30,201 at 57,826 (CFTC Mar. 2, 2006).

It is clear from the record that Palomares alleged that Bradshaw misrepresented the risk of trading the Recurrence system and the likelihood that he would attain profits, and that Bradshaw failed to disclose that the promised trading results were contrary to Bradshaw's actual experience trading the system. The entreaties "not to worry" that Palomares alleged Bradshaw offered when Palomares inquired about his losses is additional evidence that Bradshaw was repeatedly trying to minimize the risks of trading.

Promises of trading success and profits based on trading systems such as Recurrence are fraudulent when the actual experience of the person making such promises is negative, as Palomares has alleged of Bradshaw. Palomares' allegations establish that Bradshaw represented that he was familiar with and successfully trading the Recurrence system. AVCO referred Palomares to Bradshaw and Bradshaw held himself out to be familiar with the Recurrence system and to be trading with it successfully. However, accepting Palomares' allegations as true,

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"Bradshaw represented that he was a registered Commodity Trading Advisor ("CTA") and was **successfully using the 'Recurrence' trading system at Linnco Futures Group ('LFG') to manage futures accounts.**" Palomares Posthearing Brief at 2.

"Bradshaw offered to manage the trading for Palomares using the 'Recurrence' trading system and **suggested that Palomares would realize very impressive returns.**" *Id.*

Palomares **relied upon** Bradshaw's "representations concerning the trading system and his 'level' of expertise in making the decision to transfer his IRA from Smith Barney to [LFG]" to begin his trading. Complaint at 2.

"Bradshaw . . . **failed to disclose the actual trading results he had previous obtained from his client's** misrepresentation." *Id.*

the record shows Bradshaw was, in fact, not successfully using the system. Therefore Bradshaw had to have known his claim to be successfully using the system was false.

These facts, taken as true, are clearly enough to establish a *prima facie* case for a violation of the antifraud provisions of the CEA. Furthermore, they are sufficient to sustain a default judgment, as there is nothing in the trial record to suggest that these misrepresentations were not made or that Palomares did not rely upon them.[2] As the misrepresentations are directly related to the likelihood of achieving positive returns, they are clearly material to making an investment decision.

The ALJ questioned whether Palomares statements were specific enough to support any judgment in Palomares' favor, and my fellow Commissioners have also apparently found the trial record insufficient to support a default judgment for reasons that are not addressed in their opinion. While specificity is always valuable in reviewing a proceeding's record, the Commission has repeatedly rejected imposing formal, legalistic requirements on the reparations process. The record is specific enough to conclude that material misrepresentations were made by Bradshaw and that the Complainant relied upon them to his detriment. This is sufficient to establish a violation of the antifraud provisions of the Act by Bradshaw.

In previous reparations cases where a default judgment has been found by the Commission to be unsupportable, it has typically been because there is something in the record that irreparably undermines the claim or the claim is not cognizable under the Act.[3] Neither situation exists here.

Therefore, I concur in the Commission's award to Palomares, but would base it upon a default award in favor of Palomares. Accordingly, I do not find it necessary to find adverse inferences.

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[2] These allegations, taken as true, clearly are sufficient to allege fraudulent misrepresentations violative of the Act. Promises of high returns and other misrepresentations of the risk of commodity trading are sufficient bases for finding violations of the antifraud provisions of the Act under Commission case law. *See, e.g. McGough* at 50,604; *Hammond v. Smith Barney Harris Upham & Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617 at 36,657 CFTC Mar. 1, 1990); *In re JCC,* [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,080 at 41,568 (CFTC May 12, 1994), *aff'd sub nom., JCC, Inc., et al. v. CFTC*, 63 F.3d 1557 (11th Cir. 1995); *CFTC v. R.J. Fitzgerald & Co., Inc.*, 310 F.3d 1321, 1328 (11th Cir. 2002), *cert. denied,* 125 S. Ct. 808 (December 13, 2004).

[3] *See, e.g., McGough, supra,* at 50,607, where the Commission found that the claim that one of the respondents had misrepresented aspects of a trading system to the complainant was completely undermined by the record having no evidence that the complainant had ever had any contact at all with the respondent, and therefore it was impossible that the respondent made any representations to complainant; *Hess v. Mount*, 1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,039 (CFTC Apr. 17, 1991), where complainant provided no evidence that the respondent had actually caused or been responsible for her injury.