U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581

SUSAN M. SMITH, Complainant, v. IAN FLOYD BETTY, MINSON JI, THOMAS COURTLAND KENNEDY, MAJESTIC COMMODITY CORPORATION, MICHAEL JOSEPH VALLEE and GARY MICHAEL VOITH, Respondents.	*	CFTC Docket No. 06-R048

INITIAL DECISION

This is yet another case in which respondents lost the right to present evidence because of not filing prehearing memoranda, engaging in procedural misconduct or failing to answer the complaint. The one-sidedness of the hearing probably warped the record. However, the complainant also committed a misstep that affected the outcome. She did not answer admission requests and, thereby, conclusively established a range of facts that undermined her case. For this and other reasons discussed below, the complainant failed to establish that any of the respondents are liable to her for damages in reparations.

Background

In June of 2005, respondent Ian Floyd Betty solicited complainant Susan M. Smith to trade options.[1] About two months later, Smith opened an account with Comtrust, Inc.[2] and made an initial deposit of $3,000.[3] Over the next two months, she deposited an additional $25,260.[4] Beginning in August 2005, Smith established four options positions.[5] The first trade, a long ratio strangle comprised of options on oil futures, resulted in a substantial profit.[6] However, Smith lost money on the next three[7] and, after she liquidated the last position on February 22, 2006, her account balance was $60.76.[8]

---

[1] Affidavit of Ian F[.] Betty, dated March 8, 2007 ("Betty Affidavit"), at 1. At the time, Betty was a registered associated person who was employed by respondent Majestic Commodity Corporation. Betty Affidavit at 1; CX-4. Majestic is and, during the time in question, was a registered introducing broker. Betty Affidavit at 1; CX-3-9; CX-4.

[2] Comtrust is the futures commission merchant that carried Smith's account. CX-1-30, CX-1-31; CX-4.

[3] CX-1-22 - CX-1-32; CX-2-1; CX-3-2. Majestic "introduced" the account. CX-3-20.

[4] CX-3-7 - CX-3-10, CX-3-15.

[5] Michael Joseph Vallee solicited the trade by which Smith established her second position and Betty solicited the trades that established the other three. Affidavit of Susan Smith, dated March 8, 2007 ("Smith Affidavit"), at 1-2.

[6] CX-3-2, CX-3-6, CX-3-12.

[7] CX-3-4, CX-3-13, CX-3-14, CX-3-17, CX-3-19, CX-3-23. They were simple long positions in options on Treasury note, oil and silver futures. CX-3-4, CX-3-13, CX-3-19.

[8] CX-3-23. Smith withdrew the $60.76 on March 8, 2006. CX-3-25.

In June of 2006, Smith filed a reparations complaint.[9] She named Betty, Vallee, Minson Ji, Thomas Courtland Kennedy, Gary Michael Voith[10] and Majestic as respondents and alleged that she was the victim of fraud, unauthorized trading and failures to supervise.[11] Majestic, Kennedy and Ji filed answers in which they denied wrongdoing.[12] Betty, on the other hand, substantially agreed with Smith's allegations[13] while neither Vallee nor Voith answered the complaint. On October 25, 2006, the Office of Proceedings transmitted the case to us.[14]

---

[9] Commodity Futures Trading Commission Reparations Complaint Form, dated June 27, 2007 ("Complaint Form").

[10] Ji and Voith were Majestic principals at various times during the life of Smith's account. CX-4. See infra text accompanying notes 32-33, 42. Kennedy was a Majestic AP and applied to be a principal but the National Futures Association never approved his application and Kennedy eventually withdrew it. CX-4.

[11] Attachment 'A,' dated July 19, 2006 ("Amended Attachment A"), at 1-4; Attachment 'A,' dated June 23, 2006 ("Initial Attachment A"), at 1-3; Complaint Form. Smith also listed Comtrust as a respondent. Letter from Susan M. Smith to the U.S. Commodity Futures Trading Commission, dated July 27, 2006. However, she subsequently reached a settlement with the firm and, at the request of the two parties, we dismissed her claims against Comtrust. Order of Partial Dismissal, dated April 16, 2007; Notice of Satisfaction and Withdrawal of Complaint, received April 13, 2007.

[12] Answer of Majestic Commodity Corporation, Comtrust, Inc., and Thomas Courtland Kennedy, filed August 24, 2006, at 1-5; Answer of Minson Ji, Individually, filed August 24, 2006 ("Ji Answer"), at 1-3.

[13] Untitled document, received October 6, 2006, at 1.

[14] Notice and Order, dated October 25, 2006, at 1.

After discovery,[15] we set this matter to be heard and established a deadline for filing notices of intent to participate, prehearing memoranda and related documents.[16] In the order that scheduled the hearing, we also prohibited Betty from participating in the hearing (as a party) due to earlier procedural misconduct.[17] Ji, Kennedy and Majestic subsequently lost the right to introduce evidence or lodge objections at the hearing because they did not file any prehearing documents nor attempt to avoid sanctions by responding to our show cause orders.[18]

On March 27, 2007, we convened a one-day hearing at which Smith

---

[15] Comtrust, Majestic, Kennedy and Ji served interrogatories, admission requests and document requests upon Smith that went unanswered. Respondents' Motion to Compel Discovery Response by Complainant, filed January 5, 2007, at 1. See Respondents Majestic Commodity Corporation, Comtrust, Inc., Thomas Courtland Kennedy and Minson Ji (sic) First Request for Discovery, filed November 17, 2006 ("Discovery Requests"), at 1-12. However, they waited too long to move for an order compelling discovery and, as a result, we denied the request. Order, dated February 2, 2007, at 1. On the other hand, we noted that Smith's failure to answer or object to the respondents' admission requests had consequences. Id. at 1 n.2. Specifically, her failure to respond resulted in deemed admissions that she has not sought to withdraw. 17 C.F.R. §12.33(b) ("The matter is admitted unless within twenty (20) days after service of the request, the party upon whom the request is directed files and serves upon the party requesting the admission a verified written answer or objection to the matter.").

[16] Order and Notice of Hearing, dated February 6, 2007 ("Notice of Hearing"), at 1-2.

[17] Id. at 1 n.1.

[18] Order, dated March 21, 2007, at 1-2; Order, dated March 16, 2007, at 1-2.

presented her direct testimony,[19] her exhibits[20] and Betty's direct testimony.[21] At the hearing, we established a post-hearing memoranda schedule.[22] The deadline for submitting memoranda has passed[23] and, thus, we now turn to the substance of Smith's case.

Smith Did Not Establish That Either Ji Or Kennedy Violated Rule 166.3

Our inquiry begins with the claims against Ji and Kennedy. Smith charged them with failing to adequately supervise the Majestic employees with whom she dealt.[24] Rule 166.3, §17 C.F.R. 166.3, imposes a duty of diligence

---

[19] Transcript, dated April 10, 2007 ("Transcript"), at 7-12; Smith Affidavit; Initial Attachment A; Attachment 'B,' received June 29, 2006.

[20] Transcript at 6-7.

[21] Transcript at 13-14; Betty Affidavit; Attachment 'C,' received November 6, 2006.

[22] Transcript at 14-16.

[23] No party filed a post-hearing memorandum.

[24] Amended Attachment A at 4. Smith also maintained that they should be held liable because they were principals of Majestic and because they violated NFA compliance rules. Complainants (sic) Prehearing Memorandum, received March 13, 2007 ("Smith Prehearing Memorandum"), at 2. Both theories fail as a matter of law. We can only award damages for violations of the Commodity Exchange Act, Commission regulations and Commission orders. 7 U.S.C. §18(a)(1). Thus, complainants cannot recover on the basis of NFA compliance rule or state law violations. See Phacelli v. ContiCommodity Servs., Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,250 at 32,672-75 (CFTC Sept. 5, 1986). In addition, controlling person liability is recognized only in "action[s] brought by the Commission." 7 U.S.C. §13c(b). Consequently, it is not a theory that Smith can utilize here since she and not the Commission has brought this action. Boring v. Apache Trading Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,380 at 39,283 n.23 (CFTC Aug. 27, 1992).

upon all registrants who have supervisory responsibilities.[25] To establish that Ji and/or Kennedy violated Rule 166.3, Smith must first prove that they were occupied positions that triggered a duty to supervise.[26] She must also prove their supervision was negligent[27] and there were causal links between the

---

[25] It states,

> Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

17 C.F.R. §166.3.

[26] See Sanchez v. Crown, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,183 at 57,726 (CFTC Jan. 18, 006); Lobb v. J.T. McKerr & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,569 at 36,443-45 (CFTC Dec. 14, 1989).

[27] Because it does not modify the term "diligently," Rule 166.3 seems to require "ordinary" diligence. See supra note 25. This impression receives some support from precedent indicating that the regulation requires something less than perfection. See Sanchez, [2005-2007 Transfer Binder] ¶30,183 at 57,726; In re Murlas Commodities, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,485 at 43,158-59, 43,161 (CFTC Sept. 1, 1995). Ordinary diligence is reasonable care and a failure to exercise ordinary diligence is negligence. Sun Printing & Publ'g Ass'n v. Moore, 183 U.S. 642, 654 (1902); Smith v. United States, 207 F. Supp. 2d 209, 214 (S.D.N.Y. 2002); Black's Law Dictionary 412 (5th ed. 1979).

Proof that an AP committed fraud "does not necessarily mean that the employee was improperly supervised." Sanchez, [2005-2007 Transfer Binder] ¶30,183 at 57,726 (quoting Protection of Commodity Customers, 42 Fed. Reg. 44,742, 44,747 (Sept. 6, 1977)).

negligence and her claimed injury.[28] To meet this burden, Smith must, among other things, adequately demonstrate the scope of Ji and Kennedy's respective supervisory roles.[29]

In his answer, Ji denied having been a Majestic owner or principal while Smith was trading.[30] At the hearing, Smith introduced only one piece of evidence concerning Ji's status, an NFA Background Affiliation Status Information Center ("BASIC") report.[31] It showed that Ji became a principal on January 5, 2006.[32] Thus, at best, we can find that Ji became a supervisor on that date. By January 5th, Smith's last position had been open for two months.[33] The BASIC report sheds no light on the scope of Ji's duties at

---

[28] In Sanchez, the Commission held,

> In assessing an alleged violation of Rule 166.3, the Commission focuses on: (1) the nature of a respondent's system of supervision; (2) the supervisor's role in that system of supervision; and (3) evidence that the supervisor did not perform his assigned role in a diligent manner. In addition, a complainant must establish that the supervisor's breach of duty played a substantial role in the wrongdoing that proximately caused the damages.

Id. Complainants must generally meet the preponderance of the evidence standard of proof. See Gilbert v. Refco, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,081 at 38,060 (CFTC June 27, 1991).

[29] See supra note 28.

[30] Ji Answer at 1.

[31] CX-4.

[32] CX-4.

[33] CX-3-21.

Majestic. Consequently, the evidence of Ji's status combined with proof of Majestic's dealing with Smith supports no reliable inference that Ji was negligent or that he substantially contributed to any harm the complainant suffered.[34] Thus, Smith has not established that Ji violated Rule 166.3 or that, if he did commit any violations, he should be held liable.

The case against Kennedy has similar defects.[35] The evidence of Kennedy's status at Majestic is an NFA BASIC report showing that he obtained principal pending status on December 29, 2005, more than one month after Smith established her final position.[36] However, the NFA never granted him principal status and he obtained an AP registration in March of 2006.[37] There is no evidence of Kennedy's specific duties and, thus, no evidence of negligence other than the handling of Smith's last open position. Having failed to prove that Kennedy was a supervisor, Smith did not even make a prima facie showing that he was negligent or that any negligence on his part contributed to her trading losses.

---

[34] The only circumstantial evidence of negligent supervision that post-dates January 5, 2006 is the failure to liquidate the Smith's last open position profitably. Smith Affidavit at 2; CX-3-21. However, both Smith and Betty place this failure at Voith's feet and there is no evidence that Ji supervised Voith at any relevant time. Smith Affidavit at 2; Betty Affidavit at 2.

[35] As with Ji, the complainant also alleged violations of NFA Compliance Rules and controlling person liability. Smith Prehearing Memorandum at 2. See supra note 24.

[36] CX-4.

[37] CX-4.

Smith Failed To Establish That Voith Violated Rule 166.3

As she did with Kennedy and Ji, Smith charged Voith with failing to diligently supervise the handling of her account.[38] However, the case against Voith has more substance[39] because Smith introduced evidence concerning his

---

[38] Smith Prehearing Memorandum at 2. She also argued that he should be held liable for having violated NFA rules and due to his status as a Majestic principal. Id. See supra note 24.

[39] Voith and Vallee are in default and, in certain cases, we could rest a judgment against them on the complainant's well-pled allegations. 17 C.F.R. §12.22; Cochran v. Amadio, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,962 at 49,076 (CFTC Jan. 4, 2000). However, Smith seeks a judgment in which Majestic is held jointly and severally liable for Voith's and Vallee's alleged torts. Attachment A at 4. When default procedures might result in inconsistent resolutions of the same claims within the single proceeding due to a respondent's default, we follow Frow v. De La Vega, 82 U.S. 552, 554 (1872), in which the Supreme Court explained,

> The true mode of proceeding where a bill makes a joint charge against several defendants, and one of them makes default, is simply to enter a default and a formal decree pro confesso against him, and proceed with the cause upon the answers of the other defendants. The defaulting defendant has merely lost his standing in court. He will not be entitled to service of notices in the cause, nor to appear in it in any way. He can adduce no evidence, he cannot be heard at the final hearing. But if the suit should be decided against the complainant on the merits, the bill will be dismissed as to all defendants alike -- the defaulter as well as the others. If it be decided in the complainant's favor, he will then be entitled to a final decree against all.

Novofastovsky v. Osadchy, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,060 at 49,557 (CFTC Mar. 27, 2000).

particular role within Majestic.[40] Evidence that we credit[41] tends to show that Voith was a Majestic principal during the time in question,[42] he formulated trading advice for at least one of the firm's APs (Betty) and he could direct Betty to make trading recommendations.[43] On the basis of this evidence, we find that Voith was a supervisor and the scope of his duties included the supervision of Betty.[44] Consequently, we must determine whether Smith established negligence on Voith's part.

Three trades made in connection with Smith's last two positions form the factual basis of her claim that Voith was negligent.[45] To infer negligence from such a small number of events, we must have evidence of the process that resulted in the unfortunate outcomes,[46] evidence tending to prove that only a few incidents were representative of how the respondent behaved or evidence

---

[40] Betty Affidavit at 2.

[41] Both Smith and Betty testified to Voith's duties. Smith Affidavit at 2; Betty Affidavit at 2. However, Smith seems to have lacked first-hand knowledge because she never dealt with him directly. Smith Affidavit at 2. Thus, we credit Betty's version of Voith's duties but not Smith's.

[42] CX-4.

[43] Betty Affidavit at 2.

[44] There is no substantial evidence that Voith supervised Vallee while he was making recommendations to Smith.

[45] Betty Affidavit at 2.

[46] Murlas, [1994-1996 Transfer Binder] ¶26,485 at 43,158-61.

that the events could not occur in the absence of negligence.[47] Although she presented the testimony of Betty, one of Voith's subordinates, there is no direct evidence of how Voith went about his duties at Majestic. In addition, there is also no evidence to support the idea that Smith's trades were representative of Voith's overall track record. Finally, Smith has not established that Voith's recommendations were so far beyond reason that only negligence could have produced them.[48] Consequently, the complainant has not established, by a preponderance of the evidence, that Voith failed to diligently supervise Betty or anyone else.

Smith Waived Her Claims Against Betty (And Failed To Establish That Betty Defrauded Her)

Smith initially charged Betty with fraud, alleging that he misled her with respect to "the integrity of Majestic . . . its service, and its brokers."[49] However, when the respondent became a cooperative witness,[50] Smith appeared to drop the allegations that Betty behaved wrongfully by excluding them from her

---

[47] When a relatively small number of apparent supervisory failures are established, the Commission does not automatically infer that they resulted from negligence. Rather, it considers the failures relative isolation or pervasiveness in light of the respondents' business. For example, the Commission declined to find negligence on the part of a firm even though the respondent's employees had churned 20 customer accounts. Id.

[48] Except in all but the most extreme cases, this type of demonstration would probably require expert testimony.

[49] Amended Attachment A at 4.

[50] See Betty Affidavit.

prehearing memorandum.[51] She did so after having been warned that "issues not set forth in a party's prehearing memorandum will be deemed to have been abandoned."[52] Thus, Smith waived her claims against Betty.[53] On the other hand, she introduced testimony at the hearing that the respondent extolled Majestic prior to her shabby treatment.[54] As it turns out, the presence or absence of waiver does not change the ultimate outcome.

---

[51] Compare Smith Prehearing Memorandum at 1-1 with Amended Attachment A at 1, 4.

[52] Notice of Hearing at 4.

[53] Fairness considerations generally compel us to prevent complainants from resting their cases on claims that were not included in prehearing memoranda. In this case, the introduction of evidence that Betty misled Smith would not, itself, provide fair notice of claims against Betty. This is so because the evidence is relevant to the issue of whether Smith relied on representations that she claims Vallee made after she first dealt with Betty. Cf. Acequia, Inc. v. Clinton (Acequia, Inc.), 34 F.3d 800, 814 (9th Cir. 1994) (explaining that, when evidence alleged to have shown implied consent was also relevant to the other issues at trial, it cannot be used to imply consent to try the new issue). Smith could argue that, had Betty received notice that she continued to seek recovery against him, there is little Betty could have done to protect himself because he had already admitted to having extolled Majestic and, thereby, misled Smith and he lost the opportunity to introduce evidence at the hearing. See supra text accompanying notes 13, 17. However, Betty cooperated with Smith in making her case against Vallee (and not explicitly defending himself) and, if there was no waiver, we could find that Betty shared in the liability for harm stemming from Vallee's alleged wrongdoing on grounds that Betty's statements about Majestic were part of the context within which Smith evaluated Vallee's alleged fraudulent solicitation and, thus, they were a substantial causal factor. Thus, Betty may have detrimentally relied on Smith's decision to not press her claim against him.

[54] Initial Attachment A at 1 ("We also discussed the background of Majestic Commodity. He assured me that Majestic Commodity was a solid firm to invest with and had an excellent track record with its clients.").

To prove that Betty committed fraud, Smith would have been required to establish that he spoke with scienter (i.e., that Betty knew his statements were false or that he recklessly disregarded their potential falsity).[55] Some misrepresentations are such complete whoppers that a registered industry professional's background provides an adequate basis upon which to infer

---

[55] In re Wright, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,412 at 54,783 (CFTC Feb. 25, 2003). Rule 33.10, 17 C.F.R. §33.10, is the anti-fraud provision that applies to exchange-traded options on futures. 17 C.F.R. §§32.1(a), 33.2(b). It 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.

17 C.F.R. §33.10. In order to establish violations of Regulation 33.10 a complainant "must prove that a representation was made that was (1) 'in or in connection with' a commodity option transaction, (2) misleading to reasonable customers, (3) made with scienter and (4) material." In re First Fin. Trading, Inc., [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,089 at 53,681-82 (CFTC July 8, 2002) (footnote omitted). To obtain an award of damages, a complainant must also establish actual and proximate causation and the existence of a resulting and a cognizable injury. Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,225 at 38,650 (CFTC Jan. 17, 1992).

scienter.[56] For others, complainants must introduce additional evidence to prove the necessary awareness. Statements concerning a firm's track record and its attributes fall into the latter category. In this proceeding, Betty did not admit to having misled Smith with scienter and the complainant presented no evidence concerning Betty's scienter other than proof of his representations and the admission that he misspoke.[57] For this reason and because Betty's admitted misstatements did not fall into a category from which scienter inferences reliably flow from proof of falsity and a respondent AP's experience, Smith did not prove that Betty committed fraud.

Smith Has Not Established That Vallee Should Be Held Liable

Smith charged Vallee with unauthorized trading, canceling a stop-loss order without authorization, refusing to follow a liquidation order and fraud by oral misrepresentation. The claims against Vallee turned out to be the strongest part of her case. However, none of these theories proved to justify an award of damages.[58]

---

[56] Filipour v. Goldberg, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,530 at 60,121 (CFTC Apr. 19, 2007).

[57] In addition, Betty did not admit the degree to which his representations were false and Smith did not prove circumstances from which to draw reliable inferences of Betty's actual or constructive awareness. See supra text accompanying note 56.

[58] See supra note 39.

Smith Conclusively Established That Vallee Had Authority To Trade On Her Behalf

Smith alleged in her complaint and later testified that, at the time she spoke to Vallee about her second trade,[59] Vallee could make recommendations only, Betty was the only AP who was authorized to effect trades on her behalf but, despite the lack of authority, Vallee caused her second trade to be executed.[60] Thus, she claims that Vallee engaged in unauthorized trading.[61] To establish that Vallee violated Rule 166.2,[62] Smith need only prove that he

---

[59] On August 9, 2005, Smith purchased 50 October 2005 puts on Treasury note futures. CX-3-4. The contracts expired on September 23, 2005. CX-3-14.

[60] Smith Affidavit at 1; Initial Attachment A at 1.

[61] Smith Prehearing Memorandum at 1; Smith Affidavit at 1; Initial Attachment A at 1.

[62] An unauthorized trading charge can be viewed as one (or more) of three interrelated but distinct claims: fraud, misuse of customer funds in violation of Section 4d(a)(2) of the Act, 7 U.S.C. §6d (a)(2), and a violation 17 C.F.R. §166.2. Slone v. Dean Witter Reynolds, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,283 at 42,433 (CFTC Dec. 16, 1994); In re Interstate Sec. Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,295 at 38,955 (CFTC June 1, 1992). However, Section 4d(a)(2) would not apply here unless Smith had engaged in futures trading and Vallee was an FCM. 7 U.S.C. §6d(a)(2). In addition, while most instances of fraudulent unauthorized trading also qualify as Rule 166.2 violations, there is no requirement to prove scienter to establish that the regulation was violated. Filipour, [Current Transfer Binder] ¶30,530 at 60,116-17. Consequently, unless a complainant alleges that a respondent met the technical requirements of Rule 166.2 but somehow engaged in unauthorized trading (something Smith did not do), we can confine our analysis to the regulation.

Rule 166.2 states, in part,

> No futures commission merchant, introducing broker or any of their associated persons may directly

(continued..)

caused a trade to be executed without prior specific authorization or a written grant of trading authority.[63] This she cannot do.

Smith cannot persuade us to find that Vallee lacked authority because she chose not to answer the respondents' admission requests.[64] This inaction resulted in automatic admissions, these admissions conclusively established the matters asserted in the requests[65] and one of the requests stated, "Admit that you authorized each and every trade that was executed for your account."[66] Thus, Smith conclusively established a proposition that, on the

---

(..continued)

> or indirectly effect a transaction in a commodity interest for the account of any customer unless before the transaction the customer, or 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
>
> 9(b) Authorized in writing the futures commission merchant, introducing broker or any of their associated persons to effect transactions in commodity interests for the account without the customer's specific authorization . . . .

17 C.F.R. §166.2.

[63] Filipour, [Current Transfer Binder] ¶30,530 at 60,116-17.

[64] See supra note 15.

[65] 17 C.F.R. §12.33(d) ("Any matter admitted under this rule is conclusively established and may be used as proof against the party who made the admission.").

[66] Discovery Requests at 10.

basis of this record, precludes a finding that Vallee made an unauthorized trade in her account.[67]

Smith Did Not Establish That Vallee Removed A Stop-Loss Order And Refused To Carry Out A Liquidation Order

In her complaint and testimony, Smith claims that, after Vallee established her second position, he cancelled a stop-loss order and rebuffed her "suggest[ions]" to liquidate the position.[68] Although she waived these theories by excluding them from her prehearing memorandum,[69] we will assume for a moment that Smith preserved the issue of whether Vallee wrongfully failed to carry out her directives. "As a general rule, a broker is required to execute its customer's instructions."[70] However, unless a strict

---

[67] The complainant might take the position that, although she granted authority, it did not take one of the forms that Rule 166.2 requires. However, Smith did not do this. Instead, she testified to having not authorized the trade in any fashion. Smith Affidavit at 2 ("Mr. Betty was the only broker who was supposed to be able to make purchases and sales for me.").

[68] Smith Affidavit at 2; Initial Attachment A at 2.

[69] See Notice of Hearing at 4; Smith Prehearing Memorandum at 1-2.

[70] Do v. Lind-Waldock & Co., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,910 at 40,965 (CFTC Dec. 15, 1993).

liability provision applies,[71] there must be scienter.[72] In addition, the complainant must prove causation and produce enough evidence for us to estimate at least some of the resulting damages with reasonable certainty.[73]

In her testimony, Smith did not state that Vallee lacked authority to cancel the stop-loss order.[74] At best, she implied it and the implication is weak.[75] In addition, Smith did not testify that, when she "suggested . . . several times" that second position be offset, she was really making an order rather than simply discussing possible trades with Vallee (and being talked out of them).[76] Moreover, the proven circumstances do not adequately support the inference that Smith's suggestions were actually orders. For these reasons, Smith has not proven, by a preponderance of the evidence, that Vallee disregarded and cancelled her orders, and did so with scienter.

---

[71] Using customer funds to keep open a position against the wishes of a customer could be a violation of Section §4d(a)(2), given the Commission's current reading of the statute. See Slone, [1994-1996 Transfer Binder] ¶26,283 at 42,433; Hinshaw v. Dean Witter Reynolds, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,606 at 30,601 (CFTC May 31, 1985). However, as discussed above, Section 4d(a)(2) only applies to FCMs and futures trading, and Smith made no effort to prove that that Vallee was an FCM. See supra note 62.

[72] Cf. Hinshaw, [1984-1986 Transfer Binder] ¶22,606 at 30,600-01.

[73] Filipour, [Current Transfer Binder] ¶30,530 at 60,120, 60,123-24.

[74] See Smith Affidavit at 2.

[75] Id. ("Though I suggested it several times, Mr. Vallee refused to sell the options he purchased, and also removed the sell-stop that was previously placed on the options.").

[76] Id.

Even if Smith had met her burden of proving these violations, we would not have been able to award damages. She introduced no evidence that allows us to reasonably estimate the day(s) upon which Vallee rejected her suggestions to liquidate the position in question or the prices that prevailed at those times. In addition, Smith introduced no evidence of the price that would have triggered the stop-loss order. Thus, had Smith established that Vallee wrongfully disregarded and countermanded orders, we still would not have had a basis upon which to estimate even a fraction of the resulting injury with reasonable certainty.

Smith Did Not Establish That She Is Entitled To An Award Of Damages For Injuries Suffered As The Result Of Fraudulent Solicitations

Like the others, Smith's fraudulent inducement claim against Vallee centers on the second trade. To be more precise, she charged Vallee with convincing her to establish her second position by misrepresenting a number of facts.[77] As noted above, the outcome of such a claim depends on the complainant's success in proving, among other things, that Vallee made false or misleading statements of fact and, in doing so, he proximately caused her losses. Smith's evidence suggests that Vallee committed fraud. However, she did not prove that she was entitled to an award of damages.

The first steps in a fraud analysis is nothing more than classifying a respondent's communications (i.e., factual or not, material or not, false or not).

---

[77] Amended Attachment A at 1-2, 4.

We cannot classify representations without first determining what about their content has been established. For this task, "the touchstone is not so much the words of the solicitation, themselves, but the message that those words actually convey" (i.e., how a reasonable recipient of the communication would have understood the statement in light of its actual content and the surrounding circumstances).[78] When the alleged misleading statements were unrecorded, the complainant's description of them is, at best, a starting point from which we try to imagine the "objective" messages conveyed.[79] However, if it is "sufficiently specific," testimony may be adequate to prove what was said even if does not include a verbatim account of the relevant conversations.[80]

In her affidavit, Smith testified, "Mr. Vallee utilized deceptive and misleading sales statements in his recommendations in regards to the 10-yr Treasury Bonds options."[81] She offered no additional detail and the complete lack of specificity prevents us from resting upon the Smith Affidavit any inferences concerning the specific facts that Vallee represented to Smith when he solicited her. On the other hand, Smith also included Initial Attachment A

---

[78] First Fin., [2002-2003 Transfer Binder] ¶29,089 at 53,682 n.39.

[79] See Kathleen Coles, "The Dilemma of the Remote Tippee," 41 Gonz. L. Rev. 181, 215-16 (2005) (footnotes omitted).

[80] Ferriola v. Kearse-McNeill, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,172 at 50,153 n.18 (CFTC June 30, 2000).

[81] Smith Affidavit at 1.

as part of her testimony and this declaration contains specifics. In particular, it states,

> On August 9, 2005, I spoke with . . . Vallee . . . . Mr. Vallee began a conversation about 10-yr Treasury Bonds. He stated that as prime interest rates were rising, the value of the 10-yr Treasury Bonds would be decreasing - that the treasury bonds would be dropping value quickly and the ["]put options["] would be generating an incredibly large return in a short amount of time. He continued with a conversation about the purchase price of options only being 10% of the cost, and [whether] various amounts [would] be available to invest, etc. Based on his conversation with me, I had believed that what I would be investing for the 10-yr Treasury Bonds would be approx. $2000.[82]

We begin with the last statements that Smith describes, those concerning the cost of options. The testimony is not perfectly clear. However, if we find Vallee to have represented that Smith would not be required to pay the entire premia for the options she purchased,[83] she cannot prove proximate causation because of facts that she conclusively established.

In retail fraud cases such as the one at hand, establishing causation usually means proving reliance, its existence, justifiability and duration.[84]

---

[82] Initial Attachment A at 1.

[83] If we found falsity, this fact combined with evidence of Vallee's background as a registered AP would be sufficient to support an inference that he acted with scienter. CX-4. In addition, because the representation conveyed facts about a customer's financial obligations, a reasonable trader would consider it to be important and, thus, the represented fact was material. Sudol v. Shearson Loeb Rhoades, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,748 at 31,229 (CFTC Sept. 30, 1985).

[84] Kaseff v. America Global Traders, Inc., [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,604 at 55,600 (CFTC Oct. 30, 2003); Wirth v. T & S Commodities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,271 at 38,876-77 (CFTC Apr. 6, 1992); Jakobsen v. Merrill Lynch, Pierce, (continued..)

When a representation is palpably false, such as when written disclosures flatly contradict an oral misrepresentation, reliance becomes unjustifiable[85] in the absence some other functional disability (e.g., illiteracy) or vitiating conduct.[86] In addition, even if there was initial, justifiable reliance, being presented with facts that reveal a misrepresentation's falsity also cut off justifiable reliance.[87]

(..continued)

Fenner & Smith, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,812 at 31,392 (CFTC Nov. 21, 1985).

In considering whether a complainant relied on misrepresentations, the Commission teaches that we consider: (1) the complainant's sophistication and expertise in matters of finance, and securities and commodity trading; (2) the existence and features of the business and personal relationships between the parties; (3) the complainant's access to relevant information; (4) the existence of a fiduciary relationship between the parties; (5) the respondents' concealment of the fraud(s); (6) the complainant's opportunities to detect the fraud; (7) the degree to which the complainant initiated or sought to expedite the transactions at issue; and (8) the generality or specificity of the misrepresentations. Schreider v. Rouse Woodstock, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,196 at 32,514 (CFTC July 31, 1986).

[85] Webster v. Refco, Inc., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,578 at 47,713-14 (ALJ Feb. 1, 1999). See Jakobsen, [1984-1986 Transfer Binder] ¶22,812 at 31,392-93.

[86] A broker can vitiate the effectiveness of written disclosures when it acts to minimize the likelihood that a customer would take the disclosures seriously. Reed v. Sage Group, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,943 at 34,299 (CFTC Oct. 14, 1987). Cf. Schreider, [1986-1987 Transfer Binder] ¶23,196 at 32,515.

[87] See Modlin v. Cane, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,059 at 49,551-52 (CFTC Mar. 15, 2000).

Prior to opening her account (and encountering Vallee), Smith received, signed and read a document entitled "Options Disclosure Statement."[88] The Options Disclosure Statement included the warnings that "Commodity Futures Trading Commission rules require the purchaser of an option to pay the full option premium when the position is opened," and "If you are purchasing an option, you will pay a premium which must be paid in full when the option position is opened."[89] In addition, prior to the execution of the orders to establish each new position in her account, Smith "was advised by someone, other than [her] broker of all of the details regarding the trade and the risks involved in the trade."[90] "[A]ll of the details" must have included the total cost of establishing the position. Thus, even if Vallee misled Smith about whether she would be charged the full premia of the puts she purchased,[91] she received written disclosures before and oral disclosures after Vallee's solicitation that would have rendered reliance unjustifiable before the second position was established. For this reason, Smith has not established, by a preponderance of the evidence, that she justifiably relied on representations that she would only have to pay a small portion of the total premia to purchase options when she purchased the 50 puts on T-bond futures that Vallee recommended. In other

---

[88] Discovery Requests at 9-10.

[89] CX-1-26, CX-1-28. It also included a definition of "[p]remium." CX-1-27.

[90] Discovery Requests at 10.

[91] See supra note 59.

words, even if Vallee made the alleged misrepresentation with scienter, Smith has not established that she is entitled to an award of damages.

This brings us to testimony that Vallee "stated that as prime interest rates were rising, the value of the 10-yr Treasury Bonds would be decreasing - that the treasury bonds would be dropping very quickly and the 'put options' would be generating an incredibly large return in a short amount of time."[92] Most naturally read, this testimony describes a guarantee that the recommended transaction would turn a quick profit. However, Smith has conclusively established that "no one guaranteed that any transaction would be profitable."[93] If we take her testimony to mean that Vallee did not guarantee the outcome of the trade, then Smith has not established that the statement constituted an actionable fraud.[94]

---

[92] See supra text accompanying note 82.

[93] Discovery Requests at 11. Had she established that Vallee made the guarantee, there would have remained the issue of justifiable reliance. The appeal of above-quoted solicitation turns on the ability to predict movements in the assets and Smith is deemed to have admitted reading that "[s]pecific market movements of the underlying future or underlying physical commodity cannot be predicted accurately." CX-1-26; Discovery Requests at 10. See supra text accompanying notes 64-65.

[94] This is so because, if the statement was softer, it could have been nothing more than an expression of opinion couched as such. In an earlier case, we explained,

> [W]ithout more, puffery, opinion, and other soft 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.

(continued..)

Smith Did Not Prove That Majestic Should Be Held Liable

The complaint named Majestic but really never specified a theory for holding it liable.[95] Because Smith alleged that each of the individual respondents dealt with her as Majestic APs, it seems that the Office of Proceedings took the complaint to imply that Majestic should be held liable on the basis of its employment relationships with the individual respondents.[96] For the reasons set forth above, Smith failed to establish violations that could be imputed to Majestic and support an award of damages. However, we must consider another claim (or at least consider its propriety).

In her prehearing memorandum, Smith charged Majestic with using deceptive written promotional material.[97] This theory suffers from a number of

---

(..continued)

> 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. Raad v. General Physics Corp., 4 F.3d 286, 289 (4th Cir. 1993).

Wright, [2003-2004 Transfer Binder] ¶29,412 at 54,792 n.439.

[95] See Revised Attachment A at 4.

[96] See 7 U.S.C. §2(a)(1)(B).

[97] Smith Prehearing Memorandum at 2 (directing attention to CX-1-1 through CX-1-22). She also charged the firm with violating NFA Compliance Rules. Id. See supra note 24.

(continued..)

defects. First, because Smith raised it for the first time in the prehearing memorandum, she deprived the respondents of fair notice. In addition, Smith did not testify that she read the promotional material before or while she traded, nor did she testify to having relied upon it.[98] Moreover, Smith made no effort to: identify the misleading portions of the promotional material, prove their falsity or establish scienter. Thus, even if Smith properly introduced the promotional material claim, she failed to prove, by a preponderance of the evidence, that it was fraudulent or that its issuance caused her harm.

Conclusion

For the reasons set forth above, we **DISMISS** the complaint.[99]

IT IS SO ORDERED.

On this 15th day of August, 2007

Bruce C. Levine
Administrative Law Judge

(..continued)

The material in question is a combination of generic information and solicitations that tout heating oil options trades and Majestic's services. CX-1-1 - CX-1-21. Most of the material is facially neutral and almost every page contains disclaimers concerning risk and the possibility that cash market, futures and options prices each behave differently. See, e.g., CX-1-8.

[98] See Smith Affidavit at 1-2.

[99] Any party may appeal this initial decision to the Commission by filing a notice of appeal with the Proceedings Clerk no more than 20 days after the initial decision is served. 17 C.F.R. §§12.10(b), 12.401(a). If no party perfects an appeal and the Commission does not place the case on its docket for review, the initial decision shall automatically become the final decision of the Commission 30 days after it is served. 17 C.F.R. §12.314(d).