UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

PAUL S. MCKNIGHT	:	
	:	CFTC Docket No. CRAA 01-01
v.	:	
	:	OPINION and ORDER
NATIONAL FUTURES ASSOCIATION	:	

Paul S. McKnight ("McKnight") appeals from a decision of the National Futures Association ("NFA") imposing a $5,000 fine for violating NFA rules prohibiting: (1) conduct contrary to just and equitable principles of trade;[1] and (2) the exercise of trading discretion in the absence of a written power of attorney signed by the affected customer.[2] He argues that NFA denied him a fundamentally fair proceeding and challenges its factual findings and legal conclusions as unsupported by the record. He also contends that the sanctions NFA imposed are disproportionate in the circumstances established on the record. NFA opposes the appeal and urges us to affirm its decision in all respects.

For the reasons explained below, we affirm NFA's conclusion that McKnight violated both NFA Compliance Rule 2-4 and 2-8, as well as its imposition of a $5,000 fine.

BACKGROUND

I.

The underlying facts material to the resolution of this appeal are undisputed. During the period at issue, McKnight was registered as an associated person ("AP") sponsored by Castle

[1] NFA Compliance Rule 2-4 provides that members and associates shall "observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business."

[2] NFA Compliance Rule 2-8 prohibits members and associates from exercising "discretion" over a customer's commodity futures account unless the customer or account controller "has authorized" the member or associate "in writing (by power of attorney or other instrument) to exercise such discretion."

Commodities Corporation ("Castle"). He later became registered as an AP sponsored by Buffalo Trading Group, Inc. ("Buffalo Trading").[3]

McKnight began working at Castle in 1993. He later made an investment and became a principal of the firm. Castle's president, Muraji Nakazawa ("Nakazawa"), named McKnight as a compliance officer.

Castle was registered as an IB guaranteed by Vision Limited Partnership ("Vision"), a registered FCM. Both Castle and Vision maintained a relationship with Minogue Investment Company ("Minogue Investment"), a registered commodity trading adviser ("CTA"). Minogue Investment offered a systematic trading program and solicited customers to grant it discretion over the trading in their commodity accounts. Castle and Vision used their APs to solicit customers to open accounts that would be managed by Minogue Investment. Castle employed Minogue Investment's president, Dennis Minogue ("Minogue"), as an AP.

On August 29, 1995, a member of the Commission Staff wrote a letter to Minogue advising him that the Division of Trading and Markets believed that the performance table and "other matters" in Minogue Investment's disclosure documents, required by Commission Rule 4.31 to be distributed to potential customers, were in apparent violation of Commission requirements.[4] The letter stated that:

> The Division has agreed in principle to a temporary continued use of your present disclosure document, provided that you prepare an addendum and sticker the performance table in the existing document and, provided further, that you work expeditiously to address all of the Division's comments provided under separate

[3] Buffalo Trading was registered as an introducing broker ("IB") guaranteed by Alaron Trading Corporation, a registered futures commission merchant ("FCM"). As discussed below, NFA named Buffalo Trading as a respondent in its complaint against McKnight, but eventually dismissed all allegations against the firm.

[4] The letter noted three problems with the performance table: (1) it combined proprietary and customer performance; (2) it presented the value added monthly index ("VAMI") on a continuous basis from the inception of proprietary trading rather than the inception of customer trading; and (3) it was not supported by current books and records. This two-page letter was a follow-up to a six-page May 23, 1995 letter, which noted a number of other shortcomings in the documents, which Minogue Investment had submitted to the Commission for review.

> cover, by no later than September 8. The addendum and stickered performance table that the Division has agreed to in principle, must be submitted to the Division for review and approval prior to its use – and may not be used beyond September 8 in any event.

August 29, 1995 Letter at 1. The letter required Minogue Investment to inform "anyone soliciting on its behalf" of the Division's position and noted that those persons could not recommence solicitation on behalf of Minogue Investment until the firm furnished them with a Division-approved addendum. *Id*. Finally, the letter emphasized that it was not intended to include "an exhaustive rendition and referencing of the apparent violations of Commission regulations," and noted that Minogue would be receiving additional comments "[u]nder separate cover." *Id*. at 2.

On October 12, 1995, Vision prepared a written memorandum for distribution to its IBs, including Castle. The memorandum referred to a prior notice informing IBs that Minogue Investment's disclosure document could not be used for solicitation after September 8, 1995, and noted that it appeared an amended disclosure document would not be available in the near future. In these circumstances, the memorandum instructed that:

> Effective immediately, there is to be no distribution of any promotional material pertaining to [Minogue Investment] (including "Professionally Managed Futures, Building a Portfolio for You"). Until further notice, Vision cannot accept any new customer accounts to be traded by Minogue.

October 12, 1995 Memorandum at 1.

A November 16, 1995 letter from Vision senior vice president Lloyd King, addressed to Vision customers who maintained accounts managed by Minogue Investment, advised them that Vision would no longer accept orders to initiate new positions from Minogue Investment because:

> The National Futures Association ("NFA") has recently informed [Vision] that in its opinion [Minogue Investment's] disclosure document previously provided to

> you containing [its] past trading performance was not prepared in accordance with NFA and Commodity Futures Trading Commission ("CFTC") rules. Accordingly, [Minogue Investment's] past performance record may have been misleading. Please note, [Vision] and your introducing broker did not prepare [Minogue Investment's] disclosure document and had no knowledge of any defects until it was recently advised by the NFA. Minogue has submitted a new disclosure document to the CFTC for approval. However, it is not yet available for your review.

November 16, 1995 Letter at 1. The letter went on to note that some customers had requested that Vision continue to accept orders from Minogue Investment for their accounts. The letter indicated that Vision would continue to accept orders from Minogue Investment if the customer signed and returned the waiver at the bottom of the letter.[5] It also specifically noted that customers might want to consult with an attorney.

A November 17, 1995 letter from McKnight, addressed to Castle customers who maintained accounts managed by Minogue Investment, implied that, absent written instruction from the customer, Castle would no longer accept orders from Minogue Investment. In explanation, it noted that:

> Questions have arisen between [Minogue Investment] and the National Futures Association (NFA) regarding the [Minogue Investment] Disclosure Document dated May 1, 1995. The Commodity Futures Trading Commission (CFTC) has informed [Minogue Investment] that it will not accept the filing of a new Disclosure Document until the issues between [Minogue Investment] and NFA are resolved. At this point it appears that resolution is several weeks away and won't occur in time for Minogue's traditional High Probability/High Return Portfolio holiday trade.

November 17, 1995 Letter at 1. The letter then addressed two groups of current Castle customers: (1) those who had a "High Probability/High Return Portfolio" account; and (2) those who had a "Long View Portfolio" account. Both were urged to read, sign and return an enclosed

[5] The specific terms included: (1) an acknowledgement that Minogue Investment's disclosure document may not have accurately reported past performance; (2) an acknowledgement that there was a substantial risk of loss and that Minogue Investment's past trading did not necessarily predict future performance; (3) a waiver of any legal right to recover the customer's initial investment; and (4) a release of Vision and its agents from legal responsibility for trading losses.

document if they wished to continue their relationship with Minogue Investment. The enclosed document was Vision's November 16, 1995 letter quoted above. *Id*.

A November 21, 1995 letter from McKnight, addressed to a group of individuals who were not current Castle customers, but who had applied to open individual retirement accounts ("IRA") managed by Minogue Investment through Castle, advised that Vision had ceased opening new accounts managed by Minogue Investment because "[q]uestions [had] arisen between [Minogue Investment] and the National Futures Association regarding the [Minogue Investment] Disclosure Document dated May 1, 1995." November 21, 1995 Letter at 1. The letter indicated that a new disclosure document would have to be reviewed prior to opening an account, but noted that the new document was not currently available. It went on to indicate that a new document would probably not be available in time for [Minogue Investment's] traditional "holiday trade." *Id*. The letter then described an avenue that might be used to participate in the holiday trade. It involved moving funds to a trust company that did not require IRA futures accounts to be traded by a CTA;[6] subscribing to Minogue Investment's "hotline"; and opening a "self-directed" broker-assisted account.[7] The letter urged the recipients to call their "Castle broker as soon as possible for details." *Id.*

Several Castle customers (the "Castle hotline customers") eventually used what Castle characterized as self-directed broker-assisted accounts to trade in accordance with recommendations offered on Minogue Investment's hotline. On December 13, 1995, McKnight filled out two order tickets, which included positions for Castle hotline customers. Minogue communicated the two orders to the trading floor.

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[6] These potential customers apparently maintained a relationship with a trust company named "Sterling," which imposed such a limitation.

[7] The letter indicated that this arrangement would eliminate "management and incentive fees" paid when Minogue Investment actually managed a customer's account.

II.

NFA's Business Conduct Committee ("BCC") commenced its disciplinary proceeding against McKnight in December 1997, charging him with failure to observe high standards of commercial honor and just and equitable principles of trade, in violation of NFA Rule 2-4; and with exercising discretion over the trading of customer accounts without the required written authorization, in violation of NFA Rule 2-8.[8]

The Rule 2-4 charge was based upon McKnight's activity in November 1995, when he contacted current and prospective Castle customers[9] and proposed that they subscribe to the Minogue Investment hotline and open accounts that would be traded according to hotline recommendations. The BCC alleged that 18 customers signed agreements authorizing Castle to trade according to the hotline recommendations, and that McKnight never advised these customers that the high rates of return featured in the May 1, 1995 disclosure document reflected trades in proprietary rather than customer accounts. It emphasized that McKnight advised them only that "questions" had arisen about Minogue Investment's May 1, 1995 disclosure document, and that this was insufficient. Complaint at 4. Specifically, the BCC stated that:

> High standards of commercial honor and just and equitable principles of trade obligate[] an AP who is soliciting for a CTA's hotline service to correct misinformation concerning the CTA's performance history which was previously communicated to customers and which the AP knows to be false and misleading.

Complaint at 3. As to the Rule 2-8 charge, the BCC claimed that on December 13, 1995, McKnight placed orders for 14 of the 18 customers who signed agreements authorizing Castle to

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[8] The complaint also charged McKnight with including deceptive and misleading material on his website, in violation of NFA Rule 2-29 (b). The Hearing Panel dismissed this allegation. Hearing Panel Decision at 25.

[9] The Complaint described the two groups as "Castle customers whose discretionary accounts had been traded by [Minogue Investment]" and "individuals who had applied to open discretionary accounts to be traded by [Minogue Investment]."

trade according to the hotline recommendations. The BCC alleged that, although Castle designated these customers' accounts as "self-directed," the customers did not actually specifically authorize their trades. Finally, the BCC claimed that "at least five" of the 14 customers who participated in the December 13, 1995 orders did not sign a written authorization granting Castle or McKnight discretion to trade their accounts. Complaint at 5.

McKnight filed his answer in January 1998. He acknowledged that he worked at Castle during the period at issue and that his title was compliance officer. He emphasized, however, that he had no "policy making authority," and spent most of his time working on computer or quote machine operations, or servicing clients as an account executive. Answer at 2.[10] He claimed that all substantive decisions were made by Nakazawa, that they did not get along, and that he remained employed at Castle only because he needed to build up his business and recover the $25,000 Nakazawa had deceived him into investing in Castle.

As to the alleged failure to observe high standards of commercial honor and just and equitable principles of trade, McKnight emphasized that he did not have any detailed knowledge of the alleged problem with Minogue Investment's May 1, 1995 disclosure document and, as a consequence, could not have violated the specific standard of commercial honor and just and equitable principle of trade mentioned in the BCC's Complaint. In addition, he alleged that, if he had contacted NFA to learn more about the problem, he would have been fired. Answer at 4-5.[11]

Regarding his November 21, 1995 letter, McKnight claimed that the language he chose to describe the problem with Minogue Investment's May 1, 1995 disclosure document was not

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[10] McKnight described his compliance duties as "riding herd on Castle promotional materials as they went through the Vision compliance process." Answer at 5.

[11] McKnight admitted that the performance information in Minogue Investment's May 1, 1995 disclosure document failed to separately display proprietary and customer performance. He claimed, however, that he was not aware of this until after NFA filed a disciplinary action against Minogue Investment. According to McKnight, Minogue advised him that the inaccuracy in the performance information related to a sales fee that was not paid by Castle customers. Answer at 6.

substantially different than Vision's November 16, 1995 letter. He claimed that the two paragraphs in the letter relating to moving funds to a different trust company and subscribing to the Minogue Investment hotline were included "[a]t Minogue's insistence." Answer at 8. He claimed that these paragraphs did not amount to a solicitation and emphasized that his letter left the details of this alternative to the prospective customer's assigned broker.

McKnight denied that this letter was sent to customers who had already opened accounts that were managed by Minogue Investment, but acknowledged that he discussed the hotline approach with one of his own customers who had an account managed by Minogue Investment. McKnight claimed that this customer subscribed to the hotline, orally granted him time and price discretion, and orally instructed him to enter trades in accordance with the hotline recommendations. He alleged that all the other customers who participated in the December 13, 1994 orders had signed written authorizations granting discretion to enter the trade. Answer at 13. McKnight acknowledged that Castle was unable to locate some of the written authorizations when NFA requested them in July 1997, but argued that he could not be held responsible for Castle's loss of the documents. *Id.*

III.

NFA's Hearing Panel conducted a hearing on the BCC's allegations in September 1998. NFA relied primarily on documentary evidence to support its case, and on the testimony of Patricia Cushing ("Cushing"), and Jaci Stone ("Stone"), both present or former members of NFA's Compliance Department ("Compliance"). McKnight testified in his own behalf and submitted documentary evidence in support of his defense.

During Cushing's testimony, Compliance introduced four documents in support of its case: (1) the August 29, 1995 letter from the Commission's Division of Trading and Markets

addressing the problems with the performance table included in Minogue Investment's disclosure document; (2) the May 23, 1995 letter from the Commission's Division of Trading and Markets noting several other shortcomings in the disclosure document; (3) an August 21, 1995 letter from the Commission's Division of Trading and Markets reminding Minogue Investments that a CTA is prohibited from using a disclosure document known to be inaccurate or incomplete; and (4) Vision's October 12, 1995 memorandum notifying its IBs that Vision could not accept new customer accounts to be traded by Minogue Investment.

During Stone's testimony, Compliance introduced eight documents, including: (1) Vision's November 16, 1995 letter advising customers that it would no longer accept orders to initiate new positions from Minogue Investment; (2) McKnight's November 17, 1995 letter to Castle customers who maintained accounts managed by Minogue Investment; (3) McKnight's November 21, 1995 letter to customers who had applied to open an IRA account managed by Minogue Investment; (4) two block order tickets that McKnight filled out on December 13, 1995; (5) a list of Castle customers who participated in the two December 13, 1995 trades; (6) a form directing Castle to execute trades specified on the Minogue Investment hotline executed by one of the customers who participated in one of the December 13, 1995 trades;[12] (7) a May 14, 1997 letter from Compliance to Muraji Nakazawa reporting on its conclusions after auditing Castle's operations;[13] and (8) the transcript of a deposition of McKnight conducted by

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[12] The form instructed Castle to:

> [E]nter the holiday trade with the quantity of stock index futures indicated by Minogue's model portfolio when it is initiated by the Minogue Hotline and . . . use the stop loss orders recommended by the Minogue Hotline.

[13] The letter was signed by NFA's Compliance Director and directed Nakazawa to respond in writing to each deficiency noted in the letter. Among the cited deficiencies were:

> A. Castle's solicitation of 22 customers to open accounts to be traded in accordance with Minogue Investment's hotline during a period when Minogue Investment was prohibited from using its May 1, 1995 disclosure document;

Compliance on November 4, 1997.

Cushing testified that Castle's owner, Nakazawa, was a 50 percent owner of Minogue Investment when it was initially incorporated. (Tr. at 41.) She also noted that Compliance advised Minogue that it believed the May 1, 1995 disclosure document made it appear that Minogue Investment had been trading for customer accounts much longer than it actually had. (Tr. at 37.) Finally, Cushing stated that Minogue Investment did not prepare an acceptable replacement for the May 1995 disclosure document until July 1996. (Tr. at 36.)

Stone testified that the initials on the two December 13, 1995 order tickets were McKnight's and that the tickets had been prepared so that Castle customers who subscribed to the Minogue Investment hotline could participate in "the holiday trade according to Mr. Minogue's trading program." (Tr. at 77-78.) She noted that, during his deposition, McKnight acknowledged that he had filled in the order tickets, but pointed out that Minogue transmitted the orders to the trading floor. (Tr. at 79.) According to Stone, the customers participating in the December 13, 1995 trades had received Minogue Investment's May 1, 1995 disclosure document, and had not received a revised disclosure document as of the time of the trade. (Tr. at 82, 87.)

McKnight offered his version of the events at issue both through his testimony and in statements he made during his cross-examination of Compliance's witnesses. For the most part, McKnight focused the latter statements on what he regarded as Compliance's inequitable

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B. McKnight's placing discretionary trades on December 13, 1995 for six customers for whom the firm failed to maintain a written power of attorney;

C. Minogue's placement of discretionary trades for customers who had not executed written powers of attorney;

D. Castle's failure to promptly transmit customer checks to Vision; and

E. Minogue's placing block orders for both customer and non-customer accounts.

conduct.[14] In his own testimony, McKnight largely reiterated what he had said in his answer to the BCC's complaint. For example, he claimed that no decision-making authority went along with his designation as a compliance officer. (Tr. at 251.) He claimed that Minogue kept him and other Castle account executives "completely in the dark" about the problems with Minogue Investment's May 1, 1995 disclosure document. (Tr. at 263.) He also stated that he and the other account executives erroneously "accepted Minogue's word" when they were told that the problem with the disclosure document's performance results related to fees that Vision charged to customers who did not trade through Castle. (Tr. at 265.) He reiterated his claim that he did not know about Minogue's use of proprietary trading results in preparing the disclosure document's performance table until after he wrote his November 21, 1995 letter to the Sterling customers. (Tr. at 268.) As to his alleged participation in improper discretionary trades, he emphasized that he had recommended that hotline customers provide written authorization (Tr. at 271)[15] and noted that there were several plausible innocent explanations for the fact that some of the forms were missing when NFA looked for them at Castle. (Tr. at 272-76.)[16] In addition, McKnight alleged that he did not place the orders for the hotline customers, and that he only placed later trades to move stop/loss orders. (Tr. at 282.)

During his cross-examination, McKnight acknowledged that, at the time of the two December 13, 1995 trades: (1) the participating customers had received Minogue Investment's

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[14] For example, during his cross-examination of Cushing, he noted that he had sent a letter of inquiry to Compliance and that Nakazawa became aware of the letter and almost fired him. (Tr. at 46-49.) He then asked Cushing whether this might explain his reluctance to contact Compliance to inquire about the precise problems with Minogue Investment's May 1, 1995 disclosure document. (Tr. at 50.) He also asked her whether Compliance had ever come to the aid of a compliance person at an IB who was fired for becoming too close to Compliance. (Tr. at 53.)

[15] In support of this claim, McKnight introduced into evidence a November 16, 1995 memo from himself to Castle brokers. The memo stated that no accounts would be returned to Vision to be opened as hotline accounts "unless the customer has signed a trading authorization." November 16, 1995 Memorandum at 1.

[16] McKnight acknowledged that customer Ed Mitchell ("Mitchell") did not execute a written authorization, but insisted that Mitchell had specifically authorized the trades made for his account. (Tr. at 272, 277.)

May 1, 1995 disclosure document, and had not received a revised Minogue Investment disclosure document (Tr. at 297-98); and (2) he knew that there were problems with the May 1, 1995 disclosure document, but did not contact either the Commission or NFA to find out what they were. (Tr. at 300-05.) Finally, he acknowledged that Vision's November 16, 1995 letter indicated that one of the disclosure document's problems related to the past performance table. (Tr. at 308.)

IV.

The Hearing Panel issued its decision in December 1998. In reviewing the testimony offered by the four witnesses, the Panel found that McKnight had offered unconvincing testimony about his responsibility for the November 17, 1995 and November 21, 1995 letters and his knowledge of the nature of the problems with the May 1, 1995 disclosure document. In this regard, it noted that McKnight's demeanor was forceful and intelligent, and that his presentation of his case indicated that he paid close attention to detail. It also emphasized that McKnight acknowledged being skeptical about some of Nakazawa's conduct and had a $25,000 investment in Castle, which gave him a "real interest in having customers participate in the hotline trading through Castle."

In concluding that the record established that McKnight's conduct was contrary to just and equitable principles of trade, the Panel emphasized that high standards of commercial honor and just and equitable principles of trade obligate an AP to correct false and misleading information concerning a CTA's performance history. Hearing Panel Decision at 21-22.

In this regard, the Panel found that McKnight failed to advise certain customers[17] that the high rates of return shown in Minogue Investment's May 1, 1995 disclosure document "were for Minogue's proprietary accounts, not for its customers." *Id.*[18]

In concluding that the record established that McKnight exercised trading discretion in the absence of a written power of attorney, the Panel found that: (1) the customers who participated in the December 13, 1995 trades did not direct Castle to make the trades; (2) McKnight exercised discretion over the participating customers' accounts by identifying the customers to be included in the order and the trade to be placed; (3) Mitchell did not give McKnight specific authorization for the December 13, 1995 trade; and (4) as a Castle compliance officer, McKnight had an obligation to ensure "that the firm had obtained [written authority to trade on a discretionary basis] prior to placing the [December 13, 1995] discretionary orders." Hearing Panel Decision at 21-23.

In light of its liability conclusions, the Panel imposed a $5,000 fine on McKnight. In explanation, the Panel noted that McKnight's offenses involved misleading customers, but he was not the driving force behind the scheme to continue trading Minogue Investment's system, he did not intend to harm any customers, and he realized very little financial gain from his

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[17] The Panel described the customers as those who "signed agreements authorizing Castle to open accounts for them and/or trade their accounts in accordance with Minogue's hotline." *Id.*

[18] In addition to rejecting McKnight's testimony that he was unaware of this information, the Panel concluded that he had a duty to obtain the information:

> McKnight played an active role in convincing customers that they should either continue or begin following Minogue [Investment's] hotline recommendations despite the fact that Minogue [Investment] did not have a Commission approved disclosure document. McKnight admitted at the hearing, and it is obvious from his letters, that he knew that there were problems with the document. The Panel believes that McKnight had an obligation to determine what those problems were and convey that to the perspective and current customers before attempting to convince them to continue trading with Minogue [Investment]. McKnight cannot absolve himself from this responsibility by burying his head in the sand and claiming that he did not know what the problems were.

Hearing Panel Decision at 20.

association with Castle.

V.

McKnight filed a timely appeal of the Hearing Panel Decision with NFA's Appeals Committee. In October 2000, an Appeals Panel affirmed the result of the Hearing Panel's Decision. In concluding that the record established that McKnight's conduct was contrary to just and equitable principles of trade, the Appeals Panel held that:

> By its express terms, McKnight's November 21, 1995 letter solicits for hotline customers and constitutes a sufficient basis, standing alone, for affirming the Panel's finding that he solicited for Minogue hotline accounts. Our review of the evidence persuades us that McKnight made this somewhat enigmatic solicitation to facilitate the circumvention of the CFTC's prohibition against direct solicitation for [Minogue Investment's] managed account program until a corrected and approved disclosure document had been provided.

Appeals Panel Decision at 10. [19]

In concluding that the record established that McKnight exercised trading discretion in the absence of a written power of attorney, the Appeals Panel rejected McKnight's argument that he never exercised such discretion because he did not actually call the order in for execution. In doing so, the Appeals Panel agreed "with the comments made by the Hearing Panel in rejecting this overly-literal characterization of what constitutes placing a trade." Appeals Panel Decision at 15. Quoting the Hearing Panel, the Appeals Panel observed:

> "McKnight . . . claimed that he did not actually call the [December 13, 1995 block] order in for execution. Again, even accepting McKnight's testimony as true, the Panel does not find [this] to be exculpatory. McKnight exercised discretion over these accounts regardless of whether he actually called the order to the floor. He identified the customers to be included in the order and the trade to be placed. In addition, McKnight admitted that he placed other trades in these accounts based on the hotline's stop loss

[19] The Panel also commented on a compliance manager's duty to seek out information relating to compliance problems. It emphasized that a compliance manager is responsible for "adhering to the highest standard of integrity in his dealings with the public." It held that McKnight had failed to live up to this standard because, despite knowledge that that there were problems with the May 1, 1995 disclosure document, he: (1) made no effort to learn the precise nature of the problems; and (2) actively advised customers on how to trade with Minogue Investment "in circumvention of the Commission's ban on solicitations for [Minogue Investment]." Appeals Panel Decision at 12.

> order recommendations. Moreover, as the compliance officer of the firm, McKnight had an obligation to ensure that the firm had obtained the required authorizations prior to placing the discretionary orders."

Id. (quoting Hearing Panel Decision at 22-23). The Appeals Panel concluded that "[t]he evidence fully supports the [Hearing] Panel's finding that McKnight included trades for at least five individuals when he initiated the block order December 13, 1995 'holiday trade' without having written authorization to make the trade for those individuals." *Id*.

Finally, the Appeals Panel affirmed the imposition of a $5,000 fine. In this regard, the Panel reiterated its view that McKnight solicited customers to open hotline accounts that would be indirectly managed by Minogue Investment despite his knowledge that there were significant deficiencies in its previously distributed disclosure document. Appeals Panel Decision at 16.

VI.

McKnight filed a timely notice of appeal with the Commission and submitted his appeal brief in December 2001. He generally claims that NFA denied him a fundamentally fair proceeding. In this regard, he claims that NFA brought its disciplinary action to drive him out of business and at the request of individuals with a grudge against him. In addition, he claims that NFA failed to comply with its rule requiring that investigations be concluded within four months.[20]

McKnight also challenges NFA's factual findings as unsupported by the record. He claims that NFA failed to take his intent into account, and did not properly consider either extenuating circumstances or alternative explanations for the documentary evidence in the record.

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[20] NFA Compliance Rule 3.2(b) states that "[i]nvestigations shall be completed within four months of commencement except for good cause." Rule 3-2 indicates that an investigation is initiated when the Compliance Director submits a written report to the BCC.

NFA opposes the appeal. It argues its proceedings were fundamentally fair and that the record fully supports the findings material to the Appeals Panel's liability and sanctions determinations. NFA additionally argues that McKnight waived any objection to the alleged failure to complete its investigation by the four-month deadline.

DISCUSSION

I.

We review NFA's disciplinary decisions pursuant to Commission Rule 171.34(a), which provides that the Commission shall affirm such decisions unless it finds that: (1) the proceedings were not conducted in a manner consistent with fundamental fairness or NFA's rules; (2) the weight of the evidence does not support the findings concerning the relevant acts or practices engaged in or omitted;[21] (3) the determination that the acts or practices engaged in or omitted violated NFA rules does not rest on a reasonable interpretation of the rules at issue; (4) NFA's application of its rules is not consistent with the purposes of the Act; or (5) NFA's choice of sanction is excessive or oppressive in light of the violations found, having due regard for the public interest. McKnight's arguments largely relate to the first two and last of the applicable standards.

II.

McKnight's arguments relating to fundamental fairness essentially amount to a claim that he is the victim of a selective or vindictive prosecution by NFA. In a somewhat similar context,

[21] Under the weight of the evidence standard, the Commission:

> does not mechanically reweigh the evidence to ascertain in which direction it preponderates. The Commission focuses its inquiry on whether the fact finder acted reasonably in reaching material findings in light of the evidence ... the reasonable inferences drawn therefrom, and other pertinent circumstances.

MBH Commodity Advisors, Inc. v. CFTC, 250 F.3d 1052, 1060 (7th Cir. 2001), *citing* Commission Review of National Futures Association Decisions in Disciplinary, Membership Denial, Registration, and Membership Responsibility Actions, 55 Fed. Reg. 24,254 at 24,256 (June 15, 1990).

we indicated that we would review such claims in terms of a "rigorous test" requiring a showing that: (1) respondent was singled out for prosecution among others similarly situated; and (2) the singling out was unjustified because it was based on race, religion, or another arbitrary classification. *In re Premex,* [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,364 (CFTC Feb. 1, 1984).

McKnight's showing falls short of these requirements. He claims that he was singled out from Castle APs who were vigorously involved in soliciting accounts for Minogue Investment. The record, however, clearly establishes that McKnight was more than an AP. He was a principal of Castle and served as a compliance manager. These dual roles gave NFA more than an adequate basis for treating his wrongdoing as more important than the alleged wrongdoing of other Castle APs.

McKnight's focus on the dominant roles played by Nakazawa and Minogue is, at best, shortsighted. Schemes to defraud customers generally involve both leaders and followers. Sometimes a participant's role falls somewhere in between. NFA's Hearing Panel credited McKnight's claim that Nakazawa and Minogue were the leaders of the scheme at issue.[22] Indeed, neither the Hearing Panel nor the Appeals Panel seriously questioned McKnight's claim that he felt threatened by Nakazawa and remained at Castle in an effort to recover his investment from Nakazawa. Both Panels, however, properly recognized that these factors did not excuse McKnight's knowing participation in a scheme to deceive customers. Moreover, both properly recognized that a firm principal acting as a compliance manager could not credibly claim to be a mere follower of Nakazawa's and Minogue's lead.

McKnight's reliance on the time limit in NFA Compliance Rule 3-2 is equally flawed.

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[22] In this regard, the Hearing Panel found that McKnight: (1) was not the driving force behind the scheme; (2) did not intend to harm customers; and (3) realized very little financial gain from his association at Castle.

The relevant portion of the rule provides that "Investigations shall be completed within four months of commencement *except for good cause*" (emphasis supplied). Because McKnight failed to raise the timeliness issue before NFA, Compliance did not have a fair opportunity to address whether there was good cause for an exception to the four-month limitation. In any case, McKnight has not shown that his ability to defend himself was materially prejudiced by NFA's delay in completing its investigation. *Compare Jaunich v. Minneapolis Grain Exchange*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,597 at 39,865 n.9 (CFTC Oct. 16, 1992).

III.

McKnight also challenges the findings underlying NFA's conclusion that he was a knowing participant in Nakazawa's and Minogue's scheme to deceive customers. In this regard, McKnight emphasizes that: (1) his November 21, 1995 letter did not include a solicitation to open an account; (2) the purpose of his November 21, 1995 letter was to inform the recipients of the whereabouts of checks they had submitted to Castle; and (3) Minogue insisted that he include information about taking advantage of Minogue Investment's holiday trade. He also insists that he had no intent to harm customers, apparently a reference to earlier claims that he (1) believed Minogue's claim that the flaw in the May 1, 1995 disclosure document's performance table related to a fee that Castle customers did not pay; and (2) based his November 21, 1995 letter on the November 16, 1995 letter drafted by Vision's senior vice president.

The record, however, does not establish that NFA failed to act reasonably in light of the evidence, the reasonable inferences drawn therefrom, and other pertinent circumstances. The record clearly establishes that McKnight knew that the recipients of his November 21, 1995 letter had received Minogue Investment's May 1, 1995 disclosure document and that Staff members at both the Commission and NFA had identified a serious problem with information in

the disclosure document relating to Minogue Investment's past trading performance.[23] Nevertheless, McKnight included language in the letter that essentially invited recipients to consider both opening an account with Castle and subscribing to Minogue Investment's hotline. NFA was reasonable in concluding that the language at issue amounted to a solicitation.

McKnight insists that his intent was entirely innocent at the time he signed the November 21, 1995 letter. Clearly, the letter did inform recipients that their checks could not presently be used to open accounts at Castle managed by Minogue Investment. The checks, however, were not immediately returned to the recipients and McKnight's letter suggested an alternative use for the funds. Moreover, by referring to the "traditional Minogue holiday trade" but providing no context, the letter essentially referred the recipients back to the defective May 1, 1995 disclosure document for further explanation. In these circumstances, McKnight could not help but realize that recipients were likely to interpret his November 21, 1995 letter in the context of Minogue Investment's defective May 1, 1995 disclosure document.

In these circumstances, McKnight's claim to innocent intent rests on his allegations that: (1) Minogue told him that the flaw in the May 1, 1995 disclosure document's information relating to past trading performance involved a fee that Castle customers did not pay; and (2) he believed Minogue's innocent explanation.

NFA acted reasonably in rejecting these allegations. McKnight was well aware that Vision had instructed Castle not to open new accounts managed by Minogue Investment. If the flaw in the May 1, 1995 disclosure document did not affect Castle customers, Vision's

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[23] The seriousness of the problem was evident in light of (1) the Staff directive to cease using the document after September 8, 1995; and (2) Vision's notification that, due to the problem identified by Commission and NFA Staff, it would not accept new customer accounts traded by Minogue Investment. Vision's November 16, 1995 letter made it clear that the problem related to Minogue Investment's past trading performance.

instruction would have been, at best, anomalous. In such circumstances, we would at least expect McKnight to consult with Vision prior to drafting his letter. McKnight, however, acknowledges that he did not consult with Vision.[24]

As to NFA's conclusion that he exercised trading discretion over at least five customer accounts in the absence of a written grant of authority, McKnight argues that NFA drew inferences that are unsupported by the record. First, he argues that NFA erred by inferring that documents missing during NFA's 1996 investigation of Castle did not exist when McKnight prepared the order tickets for trades executed on December 13, 1995. In addition, he argues that preparing order tickets for trades cannot be construed as an "exercise of discretion" within the meaning of NFA Compliance Rule 2-8(a).

McKnight admitted that one of the individuals included in the orders he prepared on December 13, 1995, Mitchell, did not grant him authority in writing. He claimed, however, that he did not exercise discretion on Mitchell's behalf because Mitchell specifically authorized the trade. He also insisted that all other individuals included in the orders had executed a writing that granted trading discretion to his or her Castle broker. NFA did not present the testimony of any of the individuals included in the December 13, 1995 orders.

The record supports NFA's implicit conclusion that McKnight's testimony claiming that Mitchell gave specific authorization for the trade was not credible. In addition, NFA reasonably concluded that, in the circumstances presented, McKnight's preparation of the orders amounted

[24] McKnight's claim that he based his November 21, 1995 letter on Vision's November 16, 1995 letter is clearly disingenuous. Vision's letter clearly noted that there was a serious question about the accuracy of the May 1, 1995 disclosure document's discussion of past performance; indicated that it would permit continued management by Minogue Investment only if the customer executed a broad waiver of legal rights; and suggested that customers might wish to consult counsel. McKnight's letter did not include any comparable information.

to an exercise of discretion within the meaning of NFA Compliance Rule 2-8.[25] Accordingly, we affirm NFA's finding that, with respect to the order placed for Mitchell, McKnight exercised discretion without written authority to do so.

The record, however, shows that NFA did not act reasonably when it concluded that at least four other customers who participated in December 13, 1995 orders had not executed a written power of attorney at the time the trades were executed. As to these customers, NFA relies on evidence showing that powers of attorney completed by the customers were not available when NFA requested them. Although there may be circumstances in which the inability to locate such records could result in an adverse inference being drawn against a compliance officer such as McKnight, the record was not sufficiently developed in this case to find liability solely on this basis. In the absence of other direct or circumstantial evidence showing that the four customers at issue did not execute written powers of attorney on or before December 13, 1995, NFA could not have reasonably concluded that McKnight's violation of Rule 2-8 extended to them.

IV.

Finally, there is no basis for inferring that the limited civil money penalty NFA imposed on McKnight is excessive or oppressive in the context of the violations established on the record. In essence, McKnight claims that a $5,000 civil money penalty is excessive because he was primarily trying to protect his own interests rather than harm the recipients of his November 21, 1995 letter. NFA, however, has an interest in deterring any conduct that falls short of high standards of commercial honor and just and equitable principles of trade. To encourage conduct

[25] McKnight essentially argues that Minogue actually exercised discretion because he called the orders down to the trading floor. As NFA notes, however, McKnight determined both the terms of the orders and the customers who would participate. These tasks involve far more discretion than the task of communicating the information to floor personnel. NFA interpreted and applied its rule in a reasonable manner.

consistent with these standards, NFA must be free to create effective incentives for members and associates to take risks – even significant risks such as the loss of their jobs – to avoid involvement with schemes that are unjust or inequitable. In our view, a $5,000 fine is close to the minimum necessary to create the appropriate incentive in the circumstances of this case.

CONCLUSION

For the foregoing reasons, NFA's liability determinations are affirmed, in part, and reversed, in part. Its choice of sanctions is affirmed.

IT IS SO ORDERED.

By the Commission (Chairman NEWSOME and Commissioners HOLUM, LUKKEN, and BROWN-HRUSKA)

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Jean A. Webb
Secretary of the Commission
Commodity Futures Trading Commission

Dated: December 30, 2002