

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

ROBERT W. KAPS and DONNA C. KAPS

v.

MARK JEFFERY DYM, EXECUTIVE
COMMODITY CORPORATION and
THOMAS COURTLAND KENNEDY

CFTC Docket No. 06-204

OPINION AND ORDER

Office of
Proceedings
Clerk

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By order issued on February 26, 2008, and pursuant to Commission Rule 12.403, we took *sua sponte* review of this matter to determine whether the Administrative Law Judge (“ALJ”) was warranted in dismissing the complaint in the face of the non-settling respondents’ default. The ALJ deemed respondents Executive Commodity Corporation (“ECC”), an introducing broker, and its principals Mark Jeffery Dym (“Dym”) and Thomas Courtland Kennedy (“Kennedy”) to be in default upon their failure to answer the complaint. ALJ Order dated November 29, 2007. In the same order, he instructed complainants to file a motion for default judgment or proceed to a hearing. When complainants failed to do either, the ALJ dismissed the complaint. ALJ Order dated January 28, 2008.¹

Robert and Donna Kaps (“the Kaps”) alleged failure to supervise against Kennedy and Dym, and that ECC is also liable for their failure to supervise. The record does not indicate how closely the ALJ perused the record for allegations and evidence supportive of this claim before imposing additional litigating burdens on them. Our own review of the record persuades us that neither the complaint standing alone, nor the record as a whole, pleads a *prima facie* case of

¹ As indicated in our February 26, 2008 order, this case is final as to respondents International Commodity Clearing, LLC (“ICC”), Craig G. Nilsen (“Nilsen”) and Alberto Jimenez (“Jimenez”), who settled with complainants.

failure to supervise sufficient to allow the Kaps to prevail. A respondent's default never makes the complainant an automatic winner. Scrutiny of the record in this case reveals that the Kaps could not recover without coming forward with additional proofs and/or arguments. They thus suffered no prejudice from being required to litigate further, and from having their complaint dismissed when they elected not to do so. Accordingly, the decision below is affirmed.

BACKGROUND

The Kaps's complaint, received on June 26, 2006, alleged fraudulent solicitation, misrepresentation, negligence and non-disclosure by Nilsen and Jimenez, associated persons of ECC. Complainants alleged that in the course of one month—February to March 2005—they lost \$117,656, from which they paid \$51,500 in commissions to respondents. The complaint also alleged that Kennedy and Dym failed to supervise Nilsen and Jimenez. The complaint alleged derivative liability against EEC, which employed the individual respondents; and ICC, the non-guarantor futures commission merchant that carried the Kaps's account.

The Kaps live in St. Louis, Missouri. When they opened their account, they were in their early sixties and had no previous experience in commodity futures or options. Their liquid net worth, excluding their residence, amounted to about \$700,000.² Complainants' Pre-Hearing Memorandum at 2. In their complaint, the Kaps alleged that in early 2005, they were contacted by phone by respondent Nilsen, who aggressively solicited "investment funds" from them. Nilsen allegedly told complainants that there was little or no downside risk in futures and options. Nilsen also made seasonal claims, *i.e.*, assertions that unleaded gasoline futures were about to "explode" in anticipation of the summer driving season, which would enable the Kaps to make a substantial profit within a short period of time. The Kaps told Nilsen that they did not

² Robert Kaps indicated on an account opening form that he is a college professor with an annual salary of \$100,000 and a total net worth of \$1.25 million.

understand the futures market and “had no interest in opening an account.” Nilsen, however, persisted and the Kaps eventually gave in, opening an account with ECC on February 10, 2005.

Nilsen advised complainants that the account opening documents were just “a formality”—that they should sign them but “not to be too concerned with them.” Affidavit of Robert Kaps at 3. Nilsen also told complainants they did not have to complete a questionnaire entitled “Executive Commodity Corporation Compliance-Questionnaire,” even though the questionnaire came with a letter, signed by Kennedy, as president of ECC, specifically requesting complainants to fill out the questionnaire because of a “regulatory requirement that certain disclosures be made.” *See* Kennedy’s February 11, 2005 Letter to Robert Kaps (Complainants’ Exh. Cx-1-1). Kennedy also signed as vice-president of ECC on an undated Privacy Act Notice to complainants.

The Kaps initially invested \$3,000 in unleaded gasoline options. Shortly thereafter Nilsen introduced them to Jimenez, another associated person at ECC. Jimenez told the Kaps that based on his inside expert knowledge, ECC was “well situated with the currency market” and if the Kaps bought 100 Eurodollar options, they would double their investment. Echoing Nilsen, Jimenez also stated that the risk was minimal, and if there was a downturn in the market he would get complainants out “with little or no loss.”

The Kaps then invested \$70,000 in 75 Eurodollar futures options. After this purchase Nilsen continued to call, vouching for Jimenez’s “smart” business acumen, as well as assuring complainants that they were “in the money” and that Jimenez “would do nothing to hurt [complainants’] position.” Complaint at 3.

Jimenez then solicited complainants to invest in Japanese Yen and to increase the size of their Eurodollar position because it was “a sure thing.” Jimenez indicated again that his

knowledge was based on “insider’s information,” in this case from his wife, who worked at an investment banking firm handling institutional portfolios. Seeing a downward turn in the currency market that had resulted in a margin call on their account, complainants were reluctant to invest more money and told Jimenez that they wanted to liquidate their existing positions. According to complainants, Jimenez then threatened to sue complainants if they failed to send in additional funds to cover the margin deficit. Complainants then deposited an additional \$44,000. By March 2005, barely a month after they began trading, complainants’ account was reduced to a zero balance.

This action followed. The Commission’s Office of Proceedings served the complaint on all respondents on August 11, 2006. The docket sheet indicates that no answer was received from ECC, Kennedy or Dym during the entire course of the proceeding.³ The other respondents answered and the case went forward against them, leading to the above-mentioned settlements. The ALJ then found ECC, Kennedy and Dym in default and ordered the Kaps to move for a default judgment or proceed to hearing.

DISCUSSION

We begin with the axiom that a respondent’s default does not make a complainant an automatic winner. *Palomares v. Bradshaw*, [Current Binder] Comm. Fut. L. Rep (CCH) ¶ 61,289 at 61,294 (CFTC Dec. 7, 2007). Commission Rule 12.22(a) provides that when considering whether a default judgment in complainant’s favor is supported by the record, the Commission should treat a respondent’s default “as an admission of the allegations of the complaint.” Rule 12.22(b) states that a presiding officer faced with a defaulting respondent

³ A September 6, 2006 memorandum to the record by Office of Proceedings staff notes that the complaint served on ECC was returned as undeliverable. A similar memorandum of September 12 notes that the complaint served on Kennedy was returned as unclaimed. Postal records show that the complaint served on Dym was received and signed for by a third person on August 15.

“may . . . enter findings and conclusions concerning the questions of violations and damages and, if warranted, enter a reparation award against the non-responding party.” Rule 12.22(b) provides further that “[i]f the facts which are treated as admitted are considered insufficient to support a violation or the amount of damages sought, [the presiding officer] may order additional production from the party not in default and may enter a default order and an award based thereon.”

While Rule 12.22 does not directly state the nature of the allegations that will be deemed a sufficient basis for issuing a default judgment, the Commission has defined a well-pled complaint as one that provides “intelligible notice” of the complained-of conduct. Final Rules Relating to Reparations, 49 Fed. Reg. 6602, 6607 (Feb. 22, 1984). This does not require “a catalogue of the statutory or regulatory violations at issue.” *Hall v. Diversified Trading Systems*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,131 at 41,751 (CFTC July 7, 1994). The record must, however, contain a sufficient factual description of the conduct underlying a claim—taken as true by the respondent’s failure to oppose the description—to enable the trier of fact to find an intentional violation of the Act and to accurately calculate the damages resulting therefrom. *See id.* at 41,750-51 (discussing the sufficiency of allegations necessary to state a claim for relief in the context of the requirements of Commission Rule 12.13(b) (form of complaint)); *Dunmire v. Hoffman*, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,201 at 57,826 (CFTC Mar. 2, 2006) (to recover in reparations complainant must establish *scienter*).

The Kaps’s complaint, taken as a whole, alleges with sufficient clarity that their account was opened based on Nilsen’s and Jimenez’s fraudulent inducements to Robert Kaps.⁴ The

⁴ All contacts were between Robert Kaps and respondents. Donna Kaps had no conversations with Nilsen or Jimenez.

complaint alleges boiler-room tactics (*e.g.*, repeated calls, urgent sales pitches and short shrift given to trading risks). While the complaint does not allude specifically to a sales script, the fact that Nilsen and Jimenez worked in tandem to induce the Kaps to keep trading raises the inference of a well-orchestrated scheme of fraud. In addition, the complaint alleges promises of high returns based on seasonal trends, which are a type of statement we frequently have held to be fraudulent. These allegations, taken as true, clearly establish a *prima facie* case for a violation of the antifraud provisions of the Commodity Exchange Act (“CEA”). But there is no longer a dispute regarding the fraudulent solicitation claim, which has been settled between the Kaps, Nilsen and Jimenez.

The failure to supervise claim against Kennedy and Dym, on the other hand, is much weaker and simply does not withstand scrutiny, even under our flexible pleading standards.

Commission Regulation 166.3 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.

In adopting the rule, the Commission stated that its “basic purpose . . . is to protect customers by ensuring that their dealings with the employees of Commission registrants will be reviewed by other officials in the firm.” Customer Protection Rules, 43 Fed. Reg. 31,886, 31,889 (July 24, 1978) (Final rules). *See also Modlin v. Cane*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) P 27,392 at 46,809 (CFTC July 30, 1998), *citing In re Paragon Futures Association*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. ¶ 25,266 at 38,850

(CFTC Apr. 1, 1992). Failure to supervise is an independent and primary violation of the Commission's rules. *Paragon*, ¶ 25,266 at 38,849.

Nonetheless, in proposing this rule, the Commission specifically recognized that “the performance of a wrongful act by an employee . . . does not [always] mean that the employee was improperly supervised, although it is often a strong indication of a lack of proper supervision.” Protection of Commodity Customers, 42 Fed. Reg. 44,742, 44,747 (Sept. 6, 1977) (Proposed rules). In a reparations case, to establish a violation of Rule 166.3, a complainant must show more than a supervisory relationship and a violation of the Act leading to damages. *Bunch v. First Commodity Corp. of Boston*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,352 at 39,168 (CFTC Aug. 5, 1992). To hold an individual supervisor liable, the complainant must show the following: that the respondent had actual knowledge of wrongdoing and failed to take reasonable steps to correct the problem; that the respondent failed to have an adequate supervisory system in place; or that the respondent failed to diligently discharge specific responsibilities of supervision. *Id.* at 39,168-69; *See also In re Thomas Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 (CFTC Dec. 10, 1997) (if a supervisory system is in place, then the registrant must diligently administer it); *CFTC v. Trinity Financial Group Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,179 at 45,635 (S.D. 1997), *aff'd in relevant part, vacated in part and remanded sub nom. Sidoti v. CFTC*, 178 F.3d 1132 (11th Cir. 1999) (respondent’s failure to have an adequate supervisory system in place to detect wrongdoing).

Beyond the bare assertion that Dym and Kennedy failed to perform their supervisory duties, the complaint alleges no facts whatsoever about the nature of their supervisory roles or how they fell short in executing them. Nothing in the developed record indicates that Kennedy

or Dym had knowledge of Nilsen's or Jimenez's wrongful conduct. The record contains Kennedy's letter requesting complainants to fill out the compliance questionnaire and the allegation that Nilsen advised Robert Kaps to "ignore the compliance form." In the absence of an allegation or evidence that Kennedy was aware of Nilsen's statement, no basis exists for finding a supervision failure. On the contrary, the letter may be viewed as evidence that Kennedy took steps to impose a system of compliance.

The fact that complainants lost nearly \$120,000 in the course of one month is similarly equivocal: it may indicate a systemic breakdown of supervision within EEC or support the contention that the money was lost too quickly for Kennedy or Dym to discern wrongdoing. This fact, standing alone, is not sufficient to establish respondents' failure to supervise.

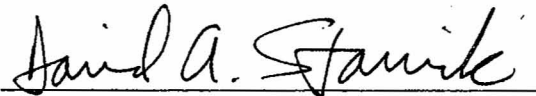
Commission precedents dealing with failure to supervise are often fact-specific. Even in cases where a supervisor may have been aware of the rapidly declining status of a complainant's account, and even had spoken directly to the complainant about certain trades or trading strategies, we would hesitate to assess liability for failure to supervise if we could not find any support in the record that a supervisor had constructive notice or knowledge of his subordinates' material and repeated misrepresentations to customers. *See, e.g., Sanchez v. Crown*, [2006-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,183 (CFTC January 18, 2006); *Rider v. Apache Trading Corp.*, [1995-1996 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 26,338 (CFTC March 27, 1995). In this case, which turns on the sufficiency of the pleadings, complainants raised the failure to supervise claim but did not support it with allegations pertaining to Kennedy's and/or Dym's supervisory roles, or their constructive notice or actual knowledge of Nilsen's or Jimenez's material misrepresentations.

The ALJ's November 29, 2007 order asking the Kaps to come forward with additional evidence thus did not prejudice them by imposing a litigation burden on them that could have been avoided and therefore was not an abuse of discretion. *Compare* our decision issued today in *Moss-Thomas v. East Coast Commodities*, Docket No. 07-R007 (finding sufficient record evidence to support damage awards against defaulting respondents). The ALJ in the instant case ruled correctly in a strict legal sense. Nevertheless, his order was less than helpful to the Kaps in pursuing their claim. The ALJ did not indicate how much scrutiny he gave the record before determining, pursuant to Rule 12.22(b) that "the facts which are treated as admitted are considered insufficient to support a violation or the amount of damages sought." Nor did he provide appropriate guidance to the Kaps regarding the kind of evidence needed to establish their claim against respondents with whom they did not deal directly, and who did not appear in this proceeding. Moreover, in a default proceeding, we fail to see the need to require that additional evidence be submitted at an oral hearing or in a complex motion for default judgment. Form should not trump substance. "Congress designed the reparation procedure to provide a forum through which persons could seek relief in the event they had been wronged by conduct of industry professionals As remedial legislation, the reparations procedure should be liberally interpreted to effectuate that congressional purpose." *Cook v. Monex International, Ltd.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,532 at 30,295 (CFTC Mar. 19, 1985) (citations to legislative history omitted), *quoted with approval* in *Wade v. Chevalier*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,781 at 61,680 (CFTC Feb. 27, 2008).

Based on the Kaps's decision not to litigate further, the ALJ dismissed the case against Dym, ECC, and Kennedy on January 28, 2008. The order of dismissal is AFFIRMED.

IT IS SO ORDERED.⁵

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



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

Dated: March 3, 2009

⁵ Under Sections 6(c) and 14(e) of the Commodity Exchange Act (7 U.S.C. §§ 9 and 18(e) (2000)), a party may appeal a reparation order of the Commission to the United States Court of Appeals for only the circuit in which a hearing was held; if no hearing is held, the appeal may be filed in any circuit in which the appellee is located. The statute also states that such an appeal must be filed within 15 days after notice of the order, and that any appeal is not effective unless, within 30 days of the date of the Commission order, the appealing party files with the clerk of the court a bond equal to double the amount of the reparation award.