

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

RECEIVED
C.F.T.C.
2002 DEC 24 A 10:31
OFFICE OF PROCEEDINGS
PROCEEDINGS CLERK

In the Matter of

CFTC Docket No. 03-04

STEPHEN C. COX,

**ORDER INSTITUTING PROCEEDINGS
PURSUANT TO SECTIONS 6(c) AND 6(d) OF
THE COMMODITY EXCHANGE ACT AND
MAKING FINDINGS AND IMPOSING
REMEDIAL SANCTIONS AS TO RESPONDENT
STEPHEN C. COX**

Respondent

I.

The Commodity Futures Trading Commission ("Commission") has reason to believe that Stephen C. Cox ("Cox") has violated Section 4o(1)(A) of the Commodity Exchange Act, as amended (the "Act"), 7 U.S.C. § 6o(1)(A), and Sections 4.41(a)(1) and 4.41(b)(1) of the Regulations promulgated under the Act (hereafter the "Regulations"), 17 C.F.R. § 4.41(a)(1) and 4.41(b)(1) (2002). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and they hereby are, instituted to determine whether Cox engaged in the violations set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of these administrative proceedings, Cox has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Cox

acknowledges service of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Act and Making Findings and Imposing Remedial Sanctions ("Order"). Cox, without admitting or denying the findings of fact or conclusions of law herein, consents to the use of the findings contained in this Order in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party.¹

III.

The Commission finds the following:

A. SUMMARY

Cox, who is registered with the Commission as a commodity trading advisor and is doing business as Natural Order Educators, has marketed a commodity futures trading method called the Natural Order ("Natural Order") since 1989. From January 2001 through August 2002 (the "relevant time period"), Cox advertised for Natural Order in various magazines. In those advertisements, Cox represented that he was a full-time trader and listed specific trades and resulting profits earned by using the Natural Order method, thus implying that he made a successful living trading commodity futures contracts using the Natural Order method.

Cox, however, did not earn his living as trader. Cox failed to disclose that during the first twelve months of the relevant time period that he was advertising his methodology, his personal commodity futures trading suffered a net trading loss, although during the last eight months he had a net trading profit. In addition, by identifying specific trades in his advertisements, Cox created the impression each trade represented an actual profitable trade he had made using the

¹ Cox does not consent to the use of the Offer or this Order, or the findings consented to in the Offer or this Order, as the sole basis for any other proceeding brought by the Commission other than a proceeding brought to enforce the terms of this Order. Nor does he consent to the use of the Offer or this Order, or the findings consented to in the Offer or this Order, by any other party in any other proceeding. The findings made in this Order are not binding on any other person or entity named as a defendant or respondent in this or any other proceeding.

Natural Order method when in fact half of the listed trades were hypothetical, which he failed to disclose. Cox also failed to provide the disclosure concerning the inherent limitations of hypothetical results, as required by the Commission's Regulations. Lastly, in promoting his trading methodology, Cox materially misrepresented the risks involved in trading commodity futures contracts by claiming that his trading method provided "uncanny accuracy" with "much less risk."

By making such material misrepresentations and omissions, Cox violated Section 4o(1)(A) of the Act and Section 4.41(a)(1) of the Commission's Regulations. Cox's failure to provide the required disclosure concerning hypothetical trades violated Section 4.41(b)(1) of the Regulations.

B. SETTLING RESPONDENT

Stephen C. Cox, a Las Vegas resident, is self-employed and markets the Natural Order Trading method. Cox was first registered with the Commission as a commodity trading advisor ("CTA") in 1980 and has been registered intermittently since that time. Cox is currently registered with the Commission as a CTA.

C. FACTS

A. Cox's Misrepresentation and Material Omission

Between January 2001 and August 2002, Cox used a magazine advertisement, which appeared in Futures magazine and Technical Analysis of Stocks and Commodities, to promote his Natural Order futures trading method. In each of his magazine advertisements, Cox represented that he was a full-time trader and falsely implied that he was earning his living from trading commodity futures contracts, that all the trades identified in the advertisement were

actual profitable trades achieved by using the Natural Order trading method, and that the Natural Order method minimized the risks involved in trading commodity futures contracts.

In each of the Natural Order advertisements, Cox proclaimed that “For me trading is not a career – it is a calling.” and asserted that he did not travel to conferences and seminars to market his methods because he traded the markets full-time. In a box captioned “Put Natural Order to work in your account!”, positioned directly under his claims of being a full-time trader, Cox provided a list of up to eight trades. Each trade in the box identified a specific contract such as the March S&P 500, the time period that contract was held (3 days) and the resulting profit per contract (\$8,125). Cox also included a disclaimer that “Past performance does not necessarily guarantee future results.”

By such representations, Cox effectively represented to prospective customers that he was a professional trader who made his living from trading commodity futures and that all the trades identified represented actual, profitable trading results he achieved pursuant to the Natural Order method. Cox’s actual contemporaneous trading, however, did not always follow the Natural Order method and yielded net losses during the first twelve months of the relevant time period, while during the last eight months it made a net trading profit. Moreover, half of the trades identified in his advertisements were not actual trades, as implied, but were hypothetical trades. Cox failed to disclose in his ads that some of the trades were hypothetical and to provide the disclosure statement concerning the inherent limitations of claims based on hypothetical performance, as required by Section 4.41 of the Regulations.

Finally, Cox minimized the significant risks of trading commodity futures contracts by maintaining that his trading method provided “uncanny accuracy” in trading and thus allowed customers to trade the markets with “much less risk.”

IV.

LEGAL DISCUSSION

A. Violations of Section 4o(1)(A) of the Act and Regulation 4.41(a)(1)

Cox, while registered and acting as a CTA, violated Section 4o(1)(A) and Regulation 4.41(a)(1) by implying to customers and prospective customers that as a full-time trader he earned a living by trading commodity futures using his Natural Order trading method, while at the same time failing to disclose that his personal trading did not always follow the Natural Order method and had produced net trading losses in 2001. Cox also violated these provisions by representing hypothetical trades as actual trades and by misrepresenting the risks associated with his trading method.

To violate Section 4o(1) of the Act, Cox must have acted as a commodity trading advisor ("CTA"). Section 1a(6) of the Act requires that to be deemed a CTA, a person must have advised another about the value or advisability of trading in futures contracts, either directly or through publications, writings or electronic media, for compensation or profit. 7 U.S.C. § 1a(6). Cox's principal business is selling his commodity futures trading method for compensation. Cox acted as a CTA by giving commodity futures trading advice for compensation or profit through the sale of the Natural Order trading method. *See CFTC v. British American Commodity Options Corp.*, 560 F.2d 135, 141 (2d Cir. 1977), *cert. denied*, 438 U.S. 905 (1978) (a firm that "offer[ed] opinions and advice, and issued analyses and reports concerning the value of commodities" to customers, was a CTA under the Act); *Gaudette v. Panos*, 644 F. Supp. 826, 839 (D. Mass. 1986) (defendants who represented their advisory skills to be exemplary, suggested that plaintiffs open a commodity account and then recommended certain futures contracts for investment were

CTAs). Moreover, he was also registered with the Commission as a CTA.

Section 4o(1)(A) prohibits both misrepresentations and omissions regarding futures and options transactions.² *In re R&W Technical Services, Ltd.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,582 (CFTC March 16, 1999), *aff'd in relevant part, R&W Technical Services, Ltd. v. Commodity Futures Trading Commission*, 205 F.3d 165, 170 (5th Cir. 2000) (prohibiting fraud by an unregistered CTA who sold trading systems to the public). Similarly, Commission Regulation 4.41(a)(1) prohibits a CTA from advertising in a misleading manner.³

Cox violated both Section 4o(1)(A) and Regulation 4.41(a)(1) by implying in his ads that he was a successful, full time commodity trader who traded profitably using his Natural Order method while failing to disclose the fact that he that he did not earn a living through his personal trading and for twelve months during the relevant time period sustained net losses in his trading. *See CFTC v. Commonwealth Financial Group, Inc.*, 874 F. Supp. 1345, 1353-54 (S.D. Fla. 1994), *citing, inter alia, Reed v. Sage Group*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) P 23,942 at 34,299 (CFTC Oct. 14, 1987) (misrepresentations regarding a firm or broker's trading record and experience are fraudulent because past success and experience are material facts to reasonable investors); *In re R & W Technical Services, Ltd.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,582 at 47,742 (CFTC Mar. 16, 1999), *aff'd in*

² Section 4o(1)(A) of the Act provides, in pertinent part:

It shall be unlawful for a [CTA] . . . by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly (A) to employ any device, scheme or artifice to defraud any client . . . or prospective client . . .

³ Commission Regulation 4.41(a) provides, in pertinent part:

No . . . commodity trading advisor, or any principal thereof, may advertise in a manner which (1) [e]mploys any device, scheme or artifice to defraud any . . . client or prospective client; or (2) [i]nvolves any transaction, practice or course of business which operates as a fraud or deceit upon any . . . client or any prospective . . . client.

relevant part, *R&W Technical Svcs., Inc. v. CFTC*, 2000 WL 217498 (5th Cir. Feb. 24, 2000) ("The use of a trading system by its developers is important to reasonable consumers because it reflects a meaningful vote of self-confidence and a sign of authenticity"). Cox also violated Section 4o(1)(A) and Regulation 4.41(a)(1) by representing hypothetical trades as actual profitable trades obtained by following the Natural Order trading method. *R&W Technical Svcs., Inc. v. CFTC*, 205 F.3d 165, 170 (5th Cir. Feb. 24, 2000) ("Because simulated results inherently overstate the reliability and validity of an investment system, and because extravagant claims understate the inherent risks in commodities trading, a reasonable investor would find [such] fraudulent misrepresentations to be material."). See also *CFTC v. Skorupska*, 605 F. Supp. 923,933 (E.D. Mich. 1985) (misrepresenting performance tables as being actual trading results violates anti-fraud provisions of the Act).

Cox further violated both Section 4o(1)(A) and Regulation 4.41(a)(1) by claiming that his method allowed trading with much less risk. It is well established that claims of minimal risk in options and futures trading are false as a matter of law even when presented with risk disclosure. *Keller v. First Nat'l Monetary Corp.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) P22,402 at 29,823 (CFTC Oct. 22, 1984) ("statements that lead investors to believe that a particular investment is risk free and will almost certainly yield a profit are not protected from claims of fraud simply because the broker has made pro forma disclosure of risk").

Finally, in order to establish a violation of Section 4o(1)(A) of the Act and Regulation 4.41(a)(1) it must be shown that Cox acted with scienter. Cox violated Section 4o(1)(A) of the Act and Regulation 4.41(a)(1) with scienter because he had no reasonable basis to claim his trading method could be traded with much less risk and he knew that his personal trading had resulted in net losses in 2001 when at the same time he advertised that he was making profits by

trading the Natural Order method.

B. Violations of Regulation 4.41(b)(1)

Pursuant to Section 4.41(b)(1)(i) and (ii) of the Regulations no person may present commodity interest trading performance results based upon hypothetical or simulated data, unless such performance results are accompanied by one of the following:

- (i) The following statement; “Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under- or over-compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown.” or
- (ii) A statement prescribed pursuant to rules promulgated by a registered futures association pursuant to section 17(j) of the Act.

Cox violated this regulation by presenting simulated performance results in his advertisements without accompanying those results with a prescribed cautionary statement.

V.

OFFER OF SETTLEMENT

Cox has submitted an Offer of Settlement in which he, subject to the foregoing, acknowledges service and receipt of this Order; admits the jurisdiction of the Commission with respect to the matters set forth in the Complaint and Order; waives the filing of a complaint and notice of a hearing, a hearing, all post-hearing procedures, judicial review by any court, any objection to the staff’s participation in the Commission’s consideration of the Offer, any claim of

double jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief, and all claims which he may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 and 28 U.S.C. § 2412 (1994), as amended by Pub. L. No. 104-121, §§ 231-32, 110 Stat. 862-63, and Part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1, et seq. relating to, or arising from this action.

Cox stipulates that the record basis on which this Order is entered consists solely of the Order and the findings consented to in the Offer which are incorporated in this Order. Cox consents to the Commission's issuance of this Order, which makes findings, as set forth above, and orders that Cox cease and desist from violating the provisions of the Act and Regulations he has been found to have violated; that requires Cox pay a civil monetary penalty of \$25,000; that suspends his registration with the Commission for three months, and that Cox comply with his undertakings as set forth in his Offer and incorporated in this Order.

VI.

FINDING OF VIOLATIONS

Solely on the basis of Cox's consent, as evidenced by the Offer, and prior to any adjudication on the merits, the Commission finds that Cox violated Section 4o(1)(A) of the Commodity Exchange Act, as amended (the "Act"), 7 U.S.C. § 6o(1)(A) and Sections 4.41(a)(1) and 4.41(b)(1) of the Commission's Regulations, 17 C.F.R. § 4.41 (a)(1) and 4.41(b)(1) (2002).

VII.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

1. Cox shall cease and desist from violating Section 4o(1)(A) of the Act, 7 U.S.C. § 6o(1)(A), and Sections 4.41(a)(1) and 4.41(b)(1) of the Commission's Regulations, 17 C.F.R. § 4.41(a)(1) and 4.41(b)(1);

2. Cox shall pay a civil monetary penalty in the amount of twenty-five thousand dollars (\$25,000);⁴

3. Cox's registration with the Commission as a CTA shall be suspended for a period of three months commencing on the date of this Order; and

4. Cox shall comply with the following undertakings as set forth in his Offer:

A. Cox shall not misrepresent, expressly or by implication:

1. the performance, profits or results achieved by, or the results that can be achieved by, users, including himself, of any commodity futures or options trading method, system or advisory service; and
2. the risks associated with trading pursuant to any commodity futures or options trading method, system or advisory service.

B. Cox shall not present the performance of any simulated or hypothetical commodity interest account, transaction in a commodity interest account or series of transactions in a commodity interest account unless such performance is accompanied by the following statement, as required by 17 C.F.R. § 4.41(b):

Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may

⁴ Cox shall pay the total amount within ten days (10) of the date of the Order by electronic funds transfer, or by U.S. postal money order, certified check, bank cashier's check, or bank money order, made payable to the Commodity Futures Trading Commission, and sent to Dennese Posey, Division of Enforcement, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581, under cover of letter that display Cox's name and the docket number of the proceeding. Cox shall simultaneously transmit a copies of his cover letter and the form of payment to Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 20581. In accordance with Section 6(e)(2) of the Act, 7 U.S.C. § 9(a)(2), if Cox fails to make payment of his penalty within fifteen days (15) of the due date, he shall be automatically prohibited from the privileges of all registered entities and his registration with the Commission shall be suspended automatically until he shows to the satisfaction of the Commission that payment of the full amount of the penalty with interest thereon to the date of payment has been made.

have under- or over-compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown.

In doing so, Cox shall clearly identify those hypothetical or simulated performance results which were based, in whole or in part, on hypothetical trading results.

C. Cox shall not make any representation of financial benefits associated with any commodity futures or options trading method, system or advisory service without first disclosing, prominently and conspicuously, that futures trading involves high risks with the potential for substantial losses.

D. Cox shall not represent, expressly or by implication:

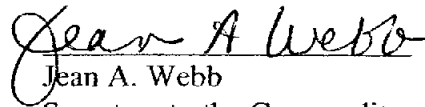
1. the performance, profits or results achieved by, or the results that can be achieved by users, including himself, of any commodity futures or options trading method, system or advisory service;
2. the risks associated with trading using any commodity futures or options trading method, system or advisory service;
3. the performance, profits, results achieved by any user, or represented in any testimonial or endorsement of the commodity futures or options trading method, system or advisory service represents the typical or ordinary experience of members of the public who use the method, system or advisory service;

unless: (a) Cox possesses and relies upon a reasonable basis substantiating the representation at the time it is made; and (b) for two (2) years after the last date of the dissemination of any such representation, Cox maintains all advertisements and promotional materials containing such representation and all materials that were relied upon or that otherwise substantiated such representation at the time it was made, and makes such materials immediately available to the Division of Enforcement for inspection and copying upon request.

E. **Public Statements.** By neither admitting nor denying the findings of fact or conclusions of law, Cox agrees that neither he nor any of his agents or employees under his authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in the Order, or creating, or tending to create, the impression that the Order is without a factual basis; provided, however, that nothing in this provision shall affect Cox's (1) testimonial obligations, or (2) right to take legal positions in other proceedings to which the Commission is not a party. Cox will undertake all steps necessary to assure that all of his agents and employees under his authority and control understand and comply with this agreement.

Unless otherwise specified, the provisions of this Order shall be effective on this date.

By the Commission.

A handwritten signature in cursive script that reads "Jean A. Webb". The signature is written in black ink and is positioned above the printed name.

Jean A. Webb
Secretary to the Commodity
Futures Trading Commission

Date: December 24, 2002