UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

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| In the Matter of | : | |
| MARK B. FISHER, FRANK AMODEO, KENNETH L. CARTER, LOUIS D'AMICO, and JOHN J. ORLANDO | : | CFTC Docket No. 93-2 |
| | : | OPINION AND ORDER |

The Commission initiated this proceeding in October 1992 by issuing a seven-count Complaint that charged ten individuals with knowing participation in unlawful trade practices during the period October 1987 through May 1989.[1] Between 1992 and 1998, the Commission issued settlement orders that resolved the Complaint's allegations against four respondents.[2] In May 1999, an Administrative Law Judge ("ALJ") resolved most of the Complaint's allegations against the remaining six respondents in favor of the Commission's Division of Enforcement ("Division"). *In re Fisher*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,634 (Initial Decision May 7, 1999) ("I.D."). The ALJ revoked the registrations of all six respondents, and ordered them to cease and desist from further violations. He also imposed trading prohibitions that ranged from six months to five years, and civil money penalties that ranged from $50,000 to $350,000. I.D. at 48,030.

[1] A variety of trading practices are specifically prohibited by the Commodity Exchange Act ("Act") and Commission regulations. Throughout this opinion, we use the phrase "unlawful trade practices" as a generic reference to the group of prohibited practices. Prohibited practices generally involve conduct that tends to undermine public confidence in the *bona fides* of an open and competitive marketplace. For example, Commission Regulation 1.38 prohibits non-competitive trade execution, and Section 4c(a)(2)(B) of the Act prohibits the reporting of non-*bona fide* prices.

[2] Respondent James Kaulentis ("Kaulentis") agreed to the imposition of a cease and desist order, $30,000 civil money penalty, and three-week trading prohibition in December 1992. In March 1997, both respondent Craig Effron ("Effron") and respondent John Gandolfo ("Gandolfo") agreed to the imposition of a cease and desist order, $100,000 civil money penalty, registration revocation and one-year trading prohibition. Respondent Frank Mazzara ("Mazzara") agreed to the imposition of a cease and desist order, registration revocation and one-year trading prohibition in June 1998.

All active parties filed appeals from the ALJ's decision. Respondent Michael Singer ("Singer") then agreed to a settlement of the Complaint's allegations,[3] but both the Division and the five remaining respondents filed lengthy briefs accompanied by requests to exceed Commission Rule 10.12's 60-page limit.[4]

Respondents' briefs challenge many elements of the ALJ's analysis. The specific errors alleged fall roughly under three general themes: (1) the ALJ's conduct and procedural rulings denied respondents an opportunity for a fair hearing; (2) the ALJ based his analysis on credibility determinations and factual assessments unsupported by the record taken as a whole; and (3) the ALJ failed to assess whether the inculpatory inferences drawn by the Division's experts were sufficiently reliable to support findings under the weight of the evidence standard. The Division defends the ALJ's procedural rulings as well as the factual findings and legal interpretations underlying his liability analysis. It challenges the ALJ's choice of sanctions, however, as inadequate in light of the seriousness of the wrongdoing established on the record.

As explained below, we conclude that the ALJ committed material procedural errors that would warrant remand for additional proceedings in more normal circumstances. Given the age of this proceeding, however, and the overall balance in the record's support for inculpatory and exculpatory inferences, we dismiss the Complaint's allegations against the five remaining respondents for a failure of proof.

[3] Respondent Singer agreed to the imposition of a cease and desist order, registration revocation, $75,000 civil money penalty, and five-year trading prohibition in August 1999.

[4] These motions are granted.

## BACKGROUND

The Complaint's allegations involve transactions in commodities traded on three different New York futures exchanges: (1) silver futures contracts traded on the Commodity Exchange, Inc. ("COMEX"); (2) crude oil futures contracts traded on the New York Mercantile Exchange ("NYMEX"); and (3) sugar futures contracts traded on the Coffee, Sugar, and Cocoa Exchange ("CSCE"). Each of the respondents was a member of at least one of the relevant exchanges during the period at issue. This enabled them to participate directly in trade executions in the pit where one or more of the relevant contracts were traded.

Four of the five respondents were members of only one of the relevant exchanges. Louis D'Amico ("D'Amico") was a COMEX member who traded in the crude oil futures pit. Kenneth L. Carter ("Carter") and John J. Orlando ("Orlando") were NYMEX members who traded in the silver futures pit. Frank Amodeo ("Amodeo") was a CSCE member who traded in the sugar futures pit. These four respondents were all registered with the Commission as floor brokers, and they routinely executed trades for customer accounts as well as their own accounts.[5]

Mark B. Fisher ("Fisher") also was registered with the Commission as a floor broker, but he did not routinely execute trades for customer accounts. He was a member of all three of the relevant exchanges, and traded as a local in the crude oil futures pit, the silver futures pit, and the sugar futures pit. Fisher played a role in the bulk of the transactions challenged in the October 1992 Complaint.[6]

[5] In this decision, traders who execute transactions for customer accounts are frequently described as "brokers". Brokers who execute trades for their own account as well as for customer accounts are sometimes described as "dual traders." Traders who only execute trades for their own account are frequently described as "locals."

[6] Two of the original respondents were also members of more than one of the relevant exchanges. Mazzara was a member of all three exchanges. Effron was a member of COMEX and NYMEX.

Most of the challenged transactions were at least ostensibly the product of a trade-execution process commonly referred to as "open outcry" trading.[7] Over the years, the open outcry trading process has proved to be an efficient method for both trade execution and price discovery. It has, however, been subject to abuse by floor brokers and floor traders who have manipulated the process for their own benefit. Such schemes frequently involve maintaining an appearance of open outcry trading while evading the requirement that executions be open and competitive. When the public becomes aware of these schemes, they can lose confidence in the general *bona fides* of the affected exchange's market mechanism.

The Commission requires exchanges to develop and maintain a variety of systems that track information helpful in assessing the *bona fides* of an open outcry trading process. Some of these systems focus mainly on the overall legitimacy of the trading process's price discovery, while others focus more on safeguarding customers' statutory rights to fair, balanced treatment in the execution of their orders. Taken together, these systems are frequently called an exchange's "audit trail."

The Commission does not require exchanges to use uniform audit trail systems. Consequently, exchanges have developed different systems that reflect varied strengths and weaknesses. Exchanges also tend to vary in their approaches to enforcing the obligations underlying their audit trail systems. Consequently, the significance of an audit trail irregularity at one exchange may be quite different from the significance of the same audit trail irregularity at another exchange.

Because this case involves transactions on three different exchanges, a proper evaluation of the evidence requires some understanding of the specific audit trails maintained by COMEX,

[7] The exceptions are transactions executed in the context of an exchange "claims" process. Resort to a claims process is necessary when the open outcry process fails to produce the agreement necessary to an open and competitive execution in the trading pit.

NYMEX, and CSCE during the period October 1987 through May 1989. A full description of the different systems, however, would involve a detailed review of somewhat arcane exchange practices.

The ALJ covered some of this ground in the portion of his decision headed "The Markets and Trading Records." I.D. at 47,999-48,001. His description covers most of the major points of interest in the relevant audit trails. While our analysis takes this and similar audit-trail-related information into account, the circumstances of this case do not warrant a fuller description of the relevant exchanges' audit trails.

II.

The Complaint challenged 74 COMEX transactions executed between August 1987 and July 1988.[8] Respondent Fisher participated in 30 of the challenged transactions, and respondent D'Amico participated in 13. Fisher and D'Amico were the only participants in four transactions. In each transaction, Fisher was acting as a local and D'Amico was executing trades for a customer.

The Complaint challenged 66 NYMEX transactions executed between March 1988 and April 1989.[9] Respondent Fisher participated in 25 of the challenged transactions, and respondent Carter participated in nine. Fisher and Carter were the only participants in eight transactions. In each case, Fisher was acting as a local. Carter executed trades for a customer in some instances, and for his own account in other instances. Respondent Orlando participated in 22 of the challenged NYMEX transactions. In all but two instances, settling respondent Effron, acting as a

[8] Most of the challenged COMEX transactions involved two ostensibly independent trades. Several involved only one trade, and a few involved three or four trades. One challenged transaction involved 11 trades.

[9] Most of the challenged NYMEX transactions also involved two ostensibly independent trades. Several involved only one trade, and a few involved four trades.

local, was the opposite trader. Orlando executed most trades for his own account, but executed several for a customer account.

The Complaint challenged 36 CSCE transactions executed between May 1988 and March 1989.[10] Respondent Amodeo was a participant in 24 of the challenged transactions and respondent Fisher was a participant in 18. Amodeo and Fisher were the only participants in 9 transactions. In each case, Fisher was acting as a local. Amodeo executed trades for a customer in some instances, and for his own account in other instances.

As for legal violations, the Complaint alleged that every respondent who participated in a challenged transaction knowingly executed trades that: (1) were not open and competitive as required by Commission Rule 1.38; and (2) were prohibited "fictitious sales" within the meaning of Section 4c(a)(A) of the Act.[11] The Complaint alleged that all respondents who acted as brokers while participating in the challenged transactions directly committed one or more types of fraud or deception prohibited by Section 4b of the Act.[12] As to respondents such as Fisher, who were acting as locals, the Complaint alleged that they aided and abetted the violations of Section 4b committed by the respondents executing trades for customers. In addition, it alleged that the conduct contributing to their aiding and abetting liability included knowing participation

[10] Most of the challenged CSCE transactions involved two ostensibly independent trades. The others involved only one trade.

[11] Frequently, a fictitious sale appears to be the result of open outcry but negates the risk and price competition incidental to an open and competitive market. Noncompetitive trades are a type of fictitious sale because, by their nature, they negate the risk incidental to an open and competitive market.

[12] Generally, the Complaint alleged that these respondents cheated and deceived their customers. It alleged some of the transactions involved more specific types of fraudulent conduct such as bucketing – knowingly taking the other side of a customer order through a noncompetitive transaction, or offsetting – matching opposite orders of different customers through a noncompetitive transaction.

in wash sales and accommodation trading, practices specifically prohibited by Section 4c(a)(A) of the Act.[13]

III.

After respondents submitted their answers denying the Complaint's allegations, the parties began their preparations for the oral hearing. As is typical in this type of case, both the Division and respondents intended to use experts to analyze the circumstantial evidence material to resolving their factual disputes. One of the ground rules established by the presiding ALJ obliged the parties to submit the direct testimony of their proposed experts in writing, prior to the oral hearing. Consistent with this requirement, in April 1995, the Division submitted the written testimony of two experts. Elizabeth Hastings ("Hastings") offered an analysis of the challenged transactions executed on COMEX and NYMEX. Martha Kozlowski ("Kozlowski") offered an analysis of the challenged transactions executed on CSCE. Both offered testimony based on expertise developed through direct observation and experience.[14]

Hastings and Kozlowski took a similar approach to the analysis of the challenged transactions. They performed a review of the written records documenting the trades underlying the challenged transactions. In the course of their review, they identified what they viewed as: (1) suspicious patterns or configurations of trades; and (2) material irregularities in the audit trail

[13] Both wash sales and accommodation trading are specific types of fictitious sales. Both generally involve two ostensibly independent trades that were actually envisioned as paired at the time of initiation. The paired trades are designed to offset each other with little or no change in the trader's financial position. When traders undertake a wash sale to assist a broker in achieving an unlawful purpose such as bucketing a customer's order, they are understood to be undertaking an accommodation trade with the broker. In these circumstances, market risk is negated because, by pairing the ostensibly independent trades at the time of initiation, the trader can predictably reduce risk to an inconsequential level.

The above description of the violations raised in the Complaint is not comprehensive. Nevertheless, it is sufficient to convey the overall nature and seriousness of the wrongdoing at issue.

[14] As we noted in *In re Gorski*, CFTC Docket No. 93-5 (Mar. 24, 2004), *slip op.*at 46-47, expert testimony in trade practice cases may rest either on direct observation and experience or the formal methods of empirical social science. Indeed, as discussed below, respondent Fisher employed both types of expert in support of his defense.

information associated with the identified trades. Hastings and Kozlowski also analyzed the surrounding circumstances and identified what they viewed as plausible motives for using unlawful trade practices in the circumstances presented. Both provided a transaction-by-transaction analysis of the various factors purporting to establish that knowing participation in unlawful trade practices was the most likely explanation for the conduct established on the record.

Hastings's written testimony emphasized a suspicious pattern that she believed played a central role in three common types of noncompetitive trading schemes. She claimed that the pattern was present: (1) when a broker uses an accommodating trader to disguise a noncompetitive trade opposite the broker's customer's order (the "bucketing variation"); (2) when a broker uses an accommodating trader to disguise a noncompetitive trade between two of the broker's customers (the "offset variation"); and (3) when a broker uses a noncompetitive trade to pass funds to (or receive funds from) an accommodating trader (the "money pass variation"). Hastings Written Testimony at 11, 16-17 and *infra*. In describing the pattern, Hastings focused on the trades executed by the alleged accommodating trader, noting that his trading card normally showed: (a) a purchase and sale of the same (or nearly the same) quantity of the same futures contract; (b) opposite the same broker (c) recorded within a few lines of each other.[15] She acknowledged that buying and selling between the same members at about the same time could happen competitively, but explained that when this conduct occurs repeatedly between the same members, it is not likely attributable to coincidence.

Hastings's written testimony also identified a series of what she viewed as material audit trail irregularities affecting the challenged transactions. These included indications that: (1) in

[15] Hastings explained that such recording indicated that the trades occurred close in time. She noted that the consecutive recording of trades was consistent with executions at or about the same time.

recording a particular trade, the trader inserted information after he had finished recording the other information on his card; (2) one or both traders changed a record when the surrounding circumstances did not suggest that a mistake had occurred;[16] (3) two traders recorded consecutive trades in contradictory sequences; and (4) one or both traders recorded a price that was not in sequence with the prices reported on exchange time and sales records. *Id.* at 17-24.

In discussing motivation, Hastings emphasized the complementary roles played by brokers and local traders. She noted that because local traders generally seek to profit by trading against brokers' customer orders, they valued brokers' "recognition."[17] Brokers' use of recognition to manage access to their customers' orders provides leverage that encourages local traders to accommodate their interests. According to Hastings, brokers may seek the assistance of locals when they discover an error in the execution of a customer order that cannot easily be corrected through an open and competitive transaction. They may also seek locals' assistance to disguise their efforts to use their customers' orders to gain an advantage in their personal trading. Because circumstances in the pit generally permit a cooperating local to earn a profit or at least minimize the financial cost associated with his accommodation trades, brokers can readily use their control over future recognition to obtain cooperation with noncompetitive trading schemes. *Id.* at 14-15.

Kozlowski's testimony offered a similar perspective. In discussing suspicious trading patterns, she focused on the bucketing variation described above. She stated that this pattern was unlikely to occur when trades are competitively executed, and added that when the pattern occurs

[16] For example, both the broker and the allegedly accommodating trader may have initially recorded the same price for a trade, but later changed the price in a manner that benefited the broker and hurt his customer.

[17] Such "recognition" is valuable in open outcry trading because, as a general rule, when a broker seeks an opposite trader for a customer order, several locals are willing to complete the transaction at an identical price. In these circumstances, the broker may fulfill his obligation to his customer by "recognizing" any of the competing locals.

repeatedly, involving the same people, it constituted strong evidence of noncompetitive execution. Kozlowski Written Testimony at 11.

As to material audit trail irregularities, she emphasized instances where both the broker and the trader initially agreed to the quantity at issue in a particular trade, but both then changed the amount.[18] Like Hastings, she also pointed to instances where: (1) in recording a particular trade, the trader inserted information after he had finished recording the other information on his card; (2) two traders recorded consecutive trades in contradictory sequences; and (3) one or both traders recorded a price that was not in sequence with the prices reported on exchange time and sales records. She agreed with Hastings that brokers' control over future recognition provides leverage that encourages locals to accommodate brokers' interests. As for brokers' motivation for using a noncompetitive execution to take the opposite side of customer orders, she noted that sometimes a noncompetitive execution ensures that better prices are available to brokers. In other circumstances, she continued, brokers can establish an advantageous position in their personal accounts with the assurance that they can use a noncompetitive execution to liquidate the position against a customer order at a predetermined profit.

Finally, like Hastings, Kozlowski presented an individual review of the specific circumstances affecting each of the challenged transactions, explaining how the particular combination contributed to her analysis of respondents' conduct.

A similar transaction-by-transaction analysis was offered by Mark S. Berens ("Berens") on behalf of respondent Amodeo and by Hugh J. Cadden ("Cadden") on behalf of respondent Fisher. Both Berens and Cadden emphasized that the type of suspicious trading pattern identified by the Division was not a reliable guide to determining whether the challenged

[18] In this regard, she noted surrounding circumstances suggesting that the change permitted the participating broker to trade opposite his customer at a price not then available in the pit.

transactions involved knowing participation in unlawful trading practices. They noted that many brokers are dual traders and claimed that it was not unusual for a dual trader to either buy for his customer while selling for his own account, or to fill his personal sell order opposite the same trader who sold to his customer. Moreover, both stated that it was not unusual for a trader to buy and sell the same futures contract at the same price for his own account. Berens explained that such wash results reflect the dynamics of trading in the marketplace.

Cadden sharply criticized Hastings and Kozlowski for claiming that the pattern's repeated appearance in transactions involving the same traders was particularly significant. He noted that neither expert provided an analytical basis for specifying the point at which the pattern's repetition became significant, and that neither made an effort to demonstrate that Fisher and the other respondents participated in transactions evidencing the pattern more frequently than others trading in the relevant pits during the period at issue. Cadden suggested that this and similar shortcomings in the Division's experts' analysis showed that identification of the allegedly suspicious pattern had no probative value in assessing the Complaint's allegations.

Berens and Cadden also criticized the approach that the Division's experts took to assessing audit trail irregularities. They emphasized that rather than examining the nature and frequency of particular irregularities in the context of key market conditions, such as volume, volatility, and time of trading, the Division's experts offered only general assessments of the significance of particular irregularities. They also claimed that the Division's experts failed to properly differentiate between how exchange audit systems were intended to function and how they actually functioned on a day-to-day basis. For example, they claimed that the Division's experts failed to give adequate weight to commonly accepted practices such as "blocking" in evaluating the significance of changes to information previously recorded on a trading card.

Like Hastings and Kozlowski, Berens and Cadden presented an individual review of the circumstances affecting each of the challenged transactions relevant to his clients. These experts explained how the circumstances contributed to their conclusion that the most plausible explanation for the underlying conduct was innocent, and thus fundamentally inconsistent with the violations alleged in the Complaint.

Respondent Fisher also submitted expert testimony based on the more formal methods of empirical social science. Gordon C. Rausser's ("Rausser") written testimony explained that he had reviewed and analyzed data compilations derived from Fisher's trading records, as well as data obtained from COMEX and NYMEX.[19] In light of this review, he claimed that the opinions offered by the Division's experts were not based on a valid notion of statistical decision-making and inference. In addition, he charged that their opinions were based on a highly selective presentation of data designed to support the conclusions underlying the Complaint, and insisted that such a selective use of data failed to meet any professional standard for drawing reliable conclusions from available data. Rausser Written Testimony at 37 *et seq*. He noted that, in his view, a careful and balanced review of the available evidence undermined any hypothesis that Fisher was a knowing participant in the fraud allegedly committed by his co-respondents.

According to Rausser, the vast majority of traders executing transactions in the relevant COMEX and NYMEX pits during the period at issue participated in trades reflecting the type of pattern emphasized by the Division's experts – buying and selling the same contract, at the same or a similar price, with the same trader, with the purchase and sale completed within two minutes of each other. Moreover, the frequency with which Fisher participated in transactions reflecting this pattern was not significantly different from others trading in the relevant pits. *Id.* at 15 *et*

[19] The COMEX data pertained to trading in silver futures contracts during 1988. The NYMEX data pertained to trading in crude oil futures contracts in March 1988, June through December 1988, January through February 1989, and April 1989.

*seq.* Overall, Rausser stated that his analysis demonstrated that Fisher's general trading patterns were statistically indistinguishable from the trading patterns exhibited by other traders in the relevant pits. In view of this result, he claimed that Fisher's participation in transactions that revealed the pattern highlighted by the Division's experts did not provide any reliable indication that the underlying trades were executed noncompetitively.

Rausser also criticized the approach that the Division's experts took to analyzing alleged audit trail irregularities. *Id.* at 32 *et seq.* He emphasized what he viewed as their failure to follow a clear analytical approach in distinguishing normal, random errors from the type of errors indicative of a noncompetitive trading scheme. More specifically, he challenged the Division's experts' analysis of the significance of the price changes evident on several of the trading cards Fisher used to record trades included in the challenged transactions.[20] Rausser explained that he had reviewed all of Fisher's trading cards from the relevant periods that reflected a price alteration. His review showed that, generally, Fisher lost as much as he gained when prices were altered. In view of this result, Rausser suggested that the pattern of price changes reflected nothing more than their biased selection of trades from the available universe.[21]

IV.

A. Respondents' Access to Trade Register Data

Two disputes that played out during the oral hearing had their roots in the pre-hearing period. One involved respondents' access to computer tapes containing the trade register data

[20] These were instances in which Fisher was trading opposite a broker filling a customer order, and both Fisher and the broker initially recorded the same price. The cards at issue showed a price change that consistently benefited Fisher and harmed the broker's customer.

[21] Rausser acknowledged that due to lack of data, he was unable to fully analyze the results of these types of price changes in Fisher's CSCE trading.

that exchanges regularly provide to the Commission.[22] Early in the pre-hearing period, the Division provided respondents with trade register data for the dates that the trades underlying the challenged transactions were executed. When some respondents sought broader access to trade register data, however, the Division raised a variety of objections, and the ALJ consistently ruled in the Division's favor.

For example, in August 1994, settling respondent Mazzara sought a subpoena pursuant to Commission Rule 10.68(b).[23] The subpoena sought COMEX trade register data pertaining to silver futures contracts executed during October, November, and December 1987, and March, June and July 1988. Mazzara's motion noted that COMEX had informed him that it no longer maintained the relevant tapes, and explained that access was necessary to permit an independent analysis of trading in silver futures contracts for the period at issue in this proceeding.

The Division opposed Mazzara's application on several grounds. It claimed that it had already provided access to the trade register data relevant to the charges in this proceeding. It also noted that Mazzara's subpoena sought access to the documents prior to the hearing, and that Commission precedent held that Rule 10.68 subpoenas could not be used to obtain pre-hearing discovery. *See In re Ashman*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,221 (CFTC Aug. 4, 1994).

After the Division filed its experts' testimony, Mazzara took a different tack to obtaining COMEX trade register data. In May 1995, he filed a motion requesting the ALJ to order the Division to provide pertinent silver futures data pursuant to its production obligations under

[22] An exchange prepares its trade register on a daily basis. The register provides information for all futures contracts executed that day, including (1) time, (2) price, (3) quantity, (4) commodity, (5) delivery month, (6) buying and selling traders, (7) buying and selling clearing members, and (8) customer type indicator.

[23] Commission Rule 10.68(b) governs applications for subpoenas for Commission records and for the appearance of Commission employees.

Commission Rule 10.42 and Commission precedent imposing a duty to provide access to exculpatory material.[24] His motion claimed that the Division's experts had considered the trade register data in preparing their testimony, and that access to the data might refute the experts' claims that the trading pattern they highlighted would not be likely to occur in an open and competitive market.

The Division again opposed Mazzara's motion. It denied that trade register data was used in determining the violations alleged in the Complaint. In addition, it claimed that a reconstruction of silver futures trading during the period October 1987 through July 1988 would be essentially irrelevant.

Respondent Fisher then joined the ongoing dispute, arguing that in addition to the COMEX trade register data, the Division should be required to produce NYMEX and CSCE trade register data for the period January 1986 through May 1989, and January 1990 through June 1990. The Division reiterated its opposition to making further production. In regard to its experts' opinions on the significance of pattern evidence, the Division emphasized that Fisher had not adequately explained what the trade register data might contain that would show that the opinions were unfounded.

In June 1995, the ALJ denied Mazzara's and Fisher's motions. The ALJ conceded that the requested trade register data might include "interesting information," but held that such information was "irrelevant" to the issues raised in this proceeding. June 22, 1995 Order at 1.

[24] In 1980, the Commission endorsed an approach to information sharing that focused on information material to liability or sanctions. Under the principles announced in *In re First Guaranty Metals, Co.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,074 (CFTC July 2, 1980) ("*First Guaranty*"), and *In re First National Monetary Corp.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,853 at 27,582 (CFTC Nov. 13, 1981) ("*FNMC*"), the Division must share available information that meets the materiality test and tends to benefit respondent. Commission precedent refers to information that tends to benefit respondent as "exculpatory." Information tending to impeach the testimony of a witness the Division intends to call in support of its case on either liability or sanctions is exculpatory.

Fisher filed his pre-hearing memorandum, which included Rausser's expert testimony, in April 1996. In February 1997, as the date for the scheduled hearing approached, he filed an application for a subpoena pursuant to Commission Rule 10.68(b). The application focused on the trade register data previously requested, and expressly noted Rausser's use of comparable data obtained from COMEX and NYMEX in preparing expert testimony that directly challenged the legitimacy of the Division's experts' reliance on pattern evidence in assessing respondents' conduct. In this regard, Fisher noted that he had attempted to obtain similar data from CSCE, but had been advised that the exchange no longer had the relevant data.

Once again, the Division opposed the production as irrelevant. In this regard, it characterized Rausser's written testimony as making the "unpersuasive argument that the apparent existence of questionable trades by other brokers during the time period at issue somehow exculpates [Fisher]." February 25, 1997 Response at 3. In addition, the Division reiterated its claim that it did not use trade register data in determining whether respondents engaged in noncompetitive trades.

The ALJ had not issued a decision on Fisher's subpoena application by the time the hearing commenced in March 1997. Fisher's attorney raised the issue with the ALJ at the outset of the March 10, 1997 hearing session. After listening to argument from both sides, the ALJ ruled that Fisher was only entitled to trade register data dealing with his own trades. (Transcript at 20, 21).

The final chapter of this dispute was played out on November 14, 1997, the last day of the hearing. As part of its rebuttal case, the Division recalled Hastings so that she could testify about the accuracy of some of the statements included in Cadden's written testimony. Hastings indicated that she had created a report based on trade register data in order to check the accuracy

of the prices reported in affidavits attached to Cadden's written testimony. In the course of objecting to the Division's attempt to introduce the report into evidence, Fisher's attorney noted that the Division had previously argued that such trade register data was irrelevant, and the ALJ had sustained that position. (Tr. at 1826.) The ALJ agreed, but ruled that the particular trade register data at issue was relevant to determining the accuracy of Cadden's written testimony. (Tr. at 1829). The ALJ also overruled objections to the Division's use of trade register data to challenge elements of Fisher's testimony concerning his transactions with then-respondent Singer (Tr. at 1847) and elements of Rausser's written testimony identifying the individuals that Fisher most frequently traded with in the silver and crude oil pits. (Tr. at 1854-55.)

B. Limitations on the Scope of Cross-examination

The second dispute involved the ALJ's ground rules for qualifying experts and regulating the cross-examination of experts. By April 1996, the parties had submitted the written testimony of their proposed experts. The written testimony addressed each expert's qualifications for offering testimony on the issues material to this proceeding. As noted above, Hastings, Kozlowski, Berens, and Cadden claimed expertise based on direct observation and experience

with futures trading.[25] Rausser indicated that he had training and experience as a social scientist.[26]

In July 1996, the ALJ issued an order indicating that he had reviewed the qualifications claimed by these experts in their written testimony. He explained that each appeared "eminently qualified to testify as an expert witness by reason of their knowledge, skill, experience, training, and education." Nevertheless, he gave the parties an opportunity to file motions challenging the qualifications of a proposed expert. The ALJ noted, however, that "at trial, cross-examination of

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[25] Hastings's Written Testimony indicated that she was a senior investigator with the Division who began her employment with the Commission in 1983. Prior to this case, she participated in two major investigations of alleged market manipulations. She was the principal investigator of trade practice complaints that resulted in this proceeding and three other matters. Hastings Written Testimony at 2-3.

Kozlowski's Written Testimony noted that she began her career in 1971 at the Commission's predecessor agency, the Commodity Exchange Authority, as a staff investigator. Kozlowski estimated that she had worked on 75 to 100 investigations during her first seven years with the Commission. From January 1978 through September 1980 Kozlowski served as the Chief Regional Investigator for the Division's Chicago regional office; she was subsequently appointed Branch Chief of the Market Integrity Section of the Chicago regional office. From 1983 to the time of this proceeding, Kozlowski served as the senior investigator in the Manipulation and Special Operations Section of the Division, where she conducted and supervised many of that unit's price manipulation, trade practice, and speculative limit investigations. Kozlowski Written Testimony at 1-3.

Berens's Written Testimony stated that he had been employed by various FCMs and had both observed floor trading at the CSCE and reviewed trade documents and other CSCE trading records. He assisted Cadden in the preparation of expert testimony presented in another trade practice case. Berens Written Testimony at 3-5.

Cadden's Written Testimony indicated that he had been employed by the Commission as a senior trial attorney and regional counsel responsible for conducting investigations and prosecution of injunctive and administrative proceedings. He subsequently served as Deputy Director of the Division of Enforcement and Director of the Division of Trading and Markets. Cadden stated that his government career and his subsequent private practice and industry experiences have involved the organization, operation and regulation of exchange, auction and open outcry markets as well as all aspects of trade practice investigation programs and their related policies, practices and procedures. He stated that he had been qualified as an expert on commodity futures markets and trading in state and federal courts as well as in CFTC, National Futures Association and NASD proceedings. Cadden Written Testimony at 1-3.

[26] Rausser's Written Testimony noted that he has held positions teaching economics and statistics at a number of universities and has published extensively in academic and professional journals in the areas of industrial organization, public policy, agricultural and natural resource economics, and the application of statistical methods. It indicated that Rausser served as a principal of Law & Economics Consulting Group, Inc., an economics consulting firm that specialized in the application of economics and finance to complex legal and public policy issues. It also stated that Rausser had testified in modeling trading behavior and all aspects of economic issues in commodities. Rausser Written Testimony at 1-2.

all expert witnesses shall be limited to the substance of their direct testimony." July 1, 1996 Order at 1.

Several respondents filed timely motions objecting to the qualifications of the experts proffered by the Division. For example, then-respondent Singer emphasized that Kozlowski's experience was mostly limited to investigating trading on Chicago exchanges, but that she now claimed that she was qualified to testify as an expert on CSCE trading. Respondents' common theme, however, was that Commission Rule 10.66(d) gave them a right to cross-examine experts who submitted testimony in writing, and that this right extended to material issues such as an expert's qualifications. In its response, the Division defended both the qualifications of its proposed experts and the limits on cross-examination proposed by the ALJ. According to the Division, the ALJ was aware of Hastings's and Kozlowski's qualifications, and his proposed limitation "properly disposed of unnecessary, lengthy examination of those qualifications." July 29, 1996 Response at 4.

On August 16, 1996, the ALJ issued an order finding that each person who submitted proposed expert testimony was qualified to testify as an expert. The ALJ did not directly address respondents' claim that Rule 10.66(d) gave them a right to cross-examine expert witnesses regarding their qualifications. He did note, however, that parties intending to cross-examine expert witnesses should "be prepared to cite the page and line of the direct testimony in propounding questions to the witness." August 16, 1996 Order at 1.

This ruling did not resolve the dispute over the scope of the right to cross-examination granted in Rule 10.66(d). For example, during his cross-examination of Hastings, counsel for Fisher attempted to question her about a hypothetical situation relating to a broker's use of one customer's order to offset another. The ALJ sustained the Division's objection because the

written testimony did not address the hypothetical. (Tr. at 306-307.) The ALJ also sustained the Division's objection: (1) when Fisher's counsel sought to question Hastings about subpoenas issued during the course of the Division's investigation (Tr. at 375-376); (2) when counsel for D'Amico and Orlando sought to question Hastings about inconsistencies in her analysis and the testimony offered by one of the settling respondents who testified for the Division (Tr. at 380-83); and (3) when counsel for respondent Carter sought to ask Hastings about the universe of transactions she considered in determining that trading between Carter and Fisher evidenced a suspicious pattern. (Tr. at 396.) The ALJ imposed similar limitations on cross-examination by Division counsel. (Tr. at 800, 1399.)

The ALJ, however, did not consistently apply these strict limitations. For example, he permitted counsel for then-respondent Singer to question Kozlowski about subjects that were not mentioned in her written testimony, including Hastings's testimony about the legitimacy of price changes in the absence of a print cancellation, and the practice of "blocking." (Tr. at 525, 527.) He also permitted Carter's and Amodeo's counsel to ask Kozlowski about hypothetical situations relating to dual trading. (Tr. at 556.) Indeed, at several points, the ALJ indicated that he would be more liberal in overruling objections if counsel agreed to a strict limit on the time available for cross-examination. (*See, e.g,* Tr. at 811.)

This ongoing dispute resulted in several contentious exchanges between the ALJ and counsel for respondent Fisher. Counsel was, at best, grudging in his acceptance of the ALJ's rulings restricting the scope of his examination. (*See, e.g.*, Tr. at 271.) The ALJ responded by threatening to impose strict time limits on counsel's examination. (Tr. at 272.) Eventually, the ALJ cut short counsel's cross-examination of Hastings when counsel began questioning her

about subpoenas issued in the course of the Division investigation leading up to this proceeding. (Tr. at 376.)

V.

Respondent Fisher filed two motions seeking recusal of the ALJ during the pre-hearing period. The first, filed in February 1996, was based on comments that the ALJ included in his ruling in an enforcement case raising similar trade-practice-related issues. *In re Reddy*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. ¶ 26,544 (Initial Decision Nov. 2, 1995). According to Fisher, the ALJ's remarks indicated that he was predisposed against both brokers and local traders, and thus harbored a deep-seated favoritism or antagonism that would make fair judgment impossible.[27] After the ALJ denied the motion without specific comment, Fisher sought interlocutory review from the Commission. In July 1996, the Commission denied review, noting that " [w]ithout regard to their wisdom or accuracy," the ALJ's remarks did not establish that he held an unfavorable disposition toward Fisher or his case. *In re Fisher*, CFTC Docket No. 93-2 (CFTC July 22, 1996), *slip op.* at 5-6.

Shortly before the hearing commenced, Fisher filed a second motion seeking recusal. Once again, he focused on remarks made by the ALJ, this time in both a May 1996 decision in another enforcement case raising similar trade-practice-related issues, *In re Mayer*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,736 (Initial Decision May 15, 1996), and a January 1997 interview with an industry publication. According to Fisher, the new remarks indicated that the ALJ believed that traders of ordinary intelligence and rectitude were likely to

[27] Fisher relied on a variety of remarks in the ALJ's *Reddy* opinion, including the observation that:

> [A] driving reason behind the exchanges' dogged objection to implementing more modern and precise methods of trading and documenting trades . . . [is that] the arcane, chaotic method of trading and record keeping makes the detection of deliberately made errors, intentional lapses made for the broker's personal gain at the customer's expense, a long, arduous undertaking.

*Id.* at 43,425.

disregard prohibitions on unlawful trade practices. On this basis, he argued that the ALJ was improperly predisposed to rule in the Division's favor. Respondents Carter and Amodeo joined in the motion, but the ALJ once again denied it without specific explanation. Respondent Fisher then sought interlocutory review from the Commission. The Commission denied review in April 1997, reiterating its previous view that such remarks did not establish that the ALJ was "either unable or unwilling to act impartially in assessing whether the weight of the evidence demonstrates that Fisher actually committed the specific wrongdoing alleged in the [C]omplaint." *In re Fisher*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,047 at 44,965 (CFTC Apr. 24, 1997).

VI.

The ALJ commenced the oral hearing in March 1997 and completed the eleventh, and final, hearing session in November 1997. As noted above, the expert witnesses were subject to cross-examination based on their written testimony. Hastings and Kozlowski also offered testimony in the context of the Division's rebuttal case.

Apart from its experts, the Division sponsored two types of witnesses. It presented four exchange officials to address aspects of the audit trail systems used by COMEX, NYMEX, and CSCE during the relevant period. For the most part, the Division elicited testimony about how the various systems were designed to operate and their practical significance in the context of pit trading on the relevant exchanges. Respondents' cross-examination focused on eliciting testimony about the practical problems that affected the precision of the information derived from the day-to-day operation of the systems at issue.

The Division also sponsored the testimony of three settling respondents who traded in the COMEX silver futures pit or the NYMEX crude oil futures pit during the period at issue.[28] The Division sought to elicit two types of testimony: (1) statements directly inculpating then-active respondents; and (2) general statements about trading practices in one of relevant pits during the period at issue. Gandolfo, for example, testified that during the period at issue, he filled customer orders against Fisher and D'Amico through noncompetitive transactions. (Tr. at 82.) He also indicated that as an accommodation to D'Amico, he executed noncompetitive transactions to help D'Amico fill his customer orders. (Tr. at 89.) In addition, he acknowledged that he had seen Fisher "helping out" another broker who missed a customer order. (Tr. at 90.)

When the Division questioned Gandolfo about some of the transactions specifically challenged in the Complaint, however, his testimony was strikingly ambivalent. He testified, for example, that he did one trade as a recognition-related "payback" to Fisher. (Tr. at 96.) When asked to explain this reference, however, he vacillated, referring to "market conditions" and stating that it was not a "predetermined pay back." (Tr. at 97, 100.) When asked whether he had used price changes in the context of noncompetitive trades with Fisher, he replied "not really." (Tr. at 104.) When the ALJ overruled Fisher's counsel's objection and permitted Division counsel to repeat the question, Gandolfo agreed that price changes were one of the ways he traded noncompetitively with Fisher (Tr. at 105.) Later, however, he indicated that he did not recall the reason the prices at issue were changed, and testified that it was not in his nature to change prices to the detriment of his customers. (Tr. at 121.)

Mazzara testified that after he discovered an error that resulted in the failure to properly execute a customer stop order, he used the claims process to fill the order against Fisher and

[28] Settling respondents Effron and Mazzara were members of both NYMEX and COMEX. Settling respondent Gandolfo was a member of COMEX.

Effron. (Tr. at 619.) He also acknowledged that if a local helped him out with an error correction, he would "trade more often" with that local. (*Id.*) He claimed, however, that it was not his practice to arbitrarily change prices in order to reward a local who helped him with errors. (Tr. at 619-20.)

Effron testified that he accepted errors from brokers in order to facilitate the filling of customer orders. (Tr. at 160.) He explained that it was "sort of understood" that locals would take care of such errors so that brokers could report "the proper prices and the proper quantities to their customers." (*Id.*) He indicated that this was his sense of the protocol in the pit, but that he was not saying that "every local had that protocol." (Tr. at 161.) He also acknowledged that he mostly accepted errors from the traders that stood around him (Tr. at 182.) and that he believed it would be economically "to his detriment" to stop accepting broker errors. (Tr. at 162.) He identified enhanced broker recognition as the expected "payback" for his cooperation in resolving errors. (Tr. at 163.)

Effron acknowledged that his trades involved price changes, but insisted that he had "as many against as . . . for." (Tr. at 164.) He denied that price changes were a vehicle for repayment of errors. (*Id.*) He claimed that he didn't stop his trading to discuss why prices were being changed, but acknowledged that whenever there was a price change in his favor, he "counted it" against an error that he might have accepted earlier. (Tr. at 170.)

Effron was asked about his participation in trades that resulted in a financial wash, which counsel referred to as "passouts." He explained that if someone asked him to do a passout, it didn't "cross [his] mind to say no." (Tr. at 174.) He noted that these requests often arose in the context of the exchange's claims procedure. (Tr. at 180.)

On cross-examination, Effron acknowledged that innocent crossouts and changes to trading cards are frequently a product of trading volatility and the frantic pace of activity in the trading pit. (Tr. at 186.) He agreed that some mistakes are noticed and corrected immediately, while others are not caught until late in the trading day. (Tr. at 187.) In regard to locals cooperating to resolve errors affecting customer orders, he noted that exchange officials encouraged the practice. (Tr. at 188.)

When asked about Fisher, Effron acknowledged that they stood close together in the COMEX crude oil pit. He said that he never observed Fisher engaging in passout trading. (Tr. at 196.) He speculated that Fisher had learned his lesson from an earlier exchange disciplinary proceeding, but acknowledged that Fisher had never spoken to him about it. (Tr. at 201-02.)

In addition to their experts, respondents sponsored the testimony of three types of witnesses. The first was a group of exchange officials who addressed exchange audit systems and common trading practices during the period at issue. For the most part, these witnesses indicated that the then-current audit systems were somewhat rudimentary and did not measure the pertinent data in a particularly precise manner. They also testified that the processes exchanges used to resolve disagreements about information material to trades executed by open outcry were pragmatic rather than precise. For example, NYMEX President R. Patrick Thompson ("Thompson") testified that traders received training on procedural methodologies for resolving disagreements, but received little or no "particular guidance." (Tr. at 674.) Addressing price changes that might have been made to resolve disagreements, he noted that:

> [C]hanging the details of a price of a trade to the detriment of a customer or something, comes under more general honesty and fraud issues. But in terms of the methods or the accepted ways in which an error could be corrected for any other purpose, there simply wasn't a tried and true mechanical rule that said one has to go through these procedures to the letter.

> It was something that was really left to the . . . members to be able to work out themselves, because even among themselves it was not necessarily agreed that an error could be resolved in a particular way, and so while we recognized that errors occur, the ways in which they occur and the ways in which they can be resolved are probably too numerous to mention.

(Tr. at 674-75.) He acknowledged that traders often used what he referred to as an "ex pit" method to resolve error situations. (Tr. at 678.) Thompson agreed that Commission personnel were aware of how exchanges were dealing with errors during the period at issue. (Tr. at 716.)

Thompson was also asked about the wash-result pattern of trading discussed in the testimony offered by each side's experts. He agreed that the pattern suggested that close scrutiny of the trades at issue was appropriate, but explained that, in his view, it did not justify a presumption that wrongful conduct had taken place. (Tr. at 769-71.) On cross-examination, he elaborated on what he would look for in determining the character of the underlying conduct:

> There are crossing procedures which we can [use to] execute customer-to-customer business [where a] flat market is made openly in the [pit]. But taking the opposite side of a customer's order or making a market in that way, potentially would be a violation.
>
> The person in the middle potentially could be the accommodator of that violation, and accommodation trading is prohibited as well.
>
> So those are things that might cross your mind if you saw that sequence of trading that you would look into and try to decide whether or not that had actually occurred through other documentation.
>
> It's just that the violation is not presumed from the face of that trading sequence. More information is necessary.

(Tr. at 776.)[29]

Respondents also offered the testimony of various individuals who used respondent brokers to transact business for them. In general, these witnesses indicated that they were

[29] Thompson and some of the other exchange officials were also asked about their views about the character of certain respondents. They consistently offered praise in response to these inquiries. (*See, e.g.*, Tr. at 704-09, 733-35, 871-74, 887-88).

representatives of sophisticated customers who closely monitored both the relevant pits and the quality of the fills they received on their orders. They indicated that circumstances affecting their trading made it likely that they would detect any attempt to cheat them by changing prices on fills. They also endorsed the overall honesty of their respondent brokers, as well as the quality of the executions they received.[30]

Finally, respondents Amodeo, Carter, D'Amico, Fisher, and Orlando offered testimony on their own behalf. Each respondent's testimony included innocent explanations of varying detail for the transactions challenged in the Complaint.

VII.

Following a post-hearing briefing period, the ALJ issued his I.D. concluding that Fisher, Amodeo, Carter, D'Amico, Orlando, and Singer had knowingly participated in unlawful trade practices. After reviewing the procedural history, providing background information about each respondent, and identifying the witnesses who provided expert testimony, the ALJ made 28 factual findings relating to the COMEX, NYMEX, and CSCE markets at issue and the audit trail systems used by each of the exchanges.

The ALJ then undertook a seriatim analysis of the challenged transactions. In the course of this analysis, he sometimes specifically weighed the inculpatory explanation offered by the Divisions' experts against the exculpatory explanation offered by respondents' experts. *See, e.g.*, I.D. at 48,002, 48,009. For the majority of the challenged transactions, however, the ALJ adopted the Division's inculpatory explanation with little or no specific analysis. *See, e.g.*, I.D.

[30] Most of this testimony addressed trading by respondent Amodeo. Some addressed trading by respondent Carter.

at 48,003.[31] In two instances, he rejected the Division's inculpatory explanation with little or no specific analysis. *See* I.D. at 48,003, 48,004.

The ALJ made few express credibility determinations. He did specifically find that portions of D'Amico's testimony were not credible. *See* I.D. at 48,005, 48,023. He also specifically found that Effron and Gandolfo were "credible witnesses." I.D. at 48,025. Because the testifying respondents offered exculpatory explanations for their participation in all the challenged transactions, the ALJ's contrary liability findings suggests that he implicitly rejected the credibility of this testimony.

In the discussion portion of the I.D., the ALJ explained his evaluation of the divergent expert testimony that the parties had offered. He acknowledged that Berens and Cadden were familiar with trading practices, but explained that, in his view, their opinions rested more on "near conjecture" than valid analysis. As for Rausser, the ALJ characterized the focus of his analysis as trades "as they occur generally." According to the judge, this type of analysis had "the most minimal relevance" to the issues raised in this proceeding. The ALJ also commented that Rausser's methodology was "questionable," and criticized him for failing to address how often the wash result pattern he evaluated should randomly appear in the context of open and competitive trading. I.D. at 48,022 and n.52.

Turning to his own analysis, the ALJ rejected respondents' challenge to the relevance of pattern evidence in evaluating allegations of unlawful trade practices. He acknowledged both that the suspect pattern may appear in trading that is open and competitive and that he lacked rigorous statistical evidence showing how often this occurs in particular trading pits. He emphasized, however, that the existence of the pattern takes on additional meaning when it is

[31] This was particularly evident when the challenged transaction involved initial agreement about price between a broker and a local, but a later price change benefited the local and hurt the customer. *See, e.g.*, findings 69, 71, 72, 82, 90.

accompanied by audit trail irregularities. According to the ALJ, the irregularities established on the record, which unfailingly did not benefit customers, "discount the likelihood that the patterns simply reflect random trades." I.D. at 48,022. He added that the circumstantial evidence in this case demonstrated that:

> [B]rokers changed the quantities and prices of trades to conform to their requirements, e.g., making sure that brokers would not have to pay out of pocket if a fill was missed or to pay back other brokers for helping them.

I.D. at 48,023.

The ALJ apparently based this conclusion on findings he made in the portion of his decision discussing Effron's and Gandolfo's testimony. According to the ALJ, this testimony established that "respondents had a sense of comradery," I.D. at 48,025, that enabled two groups[32] to help one another out and ensure a profit for all involved. The judge noted that this comradery explained how "innocent mistakes that might have happened consistently led to one broker managing to profit or reduce a loss at the expense of another party," *id.* at 48,026, and why a trader would be "willing to accept a loss until an opportunity to pay the favor back arose." *Id.*

In this regard, the ALJ acknowledged that Fisher had presented evidence that price changes were sometimes to his detriment, and that such evidence was "facially exculpatory." I.D. at 48,027. According to the judge, however, changes to Fisher's detriment "consistently appear to be voluntary losses until such time as when he could be repaid." *Id.*

Finally, the ALJ addressed respondents' evidence suggesting that the audit trail systems in use during the time at issue were somewhat rudimentary and imprecise. He acknowledged that time and sales data was an "unfortunately imprecise" indicator. *Id.* at 48,024. He

[32] One group revolved around McCann, Effron, Cornell, and Orlando, while the other centered on Fisher and Carter. *Id.* at 48,025.

emphasized, however, that the public relies on the reports, and brokers watch the boards reflecting time and sales data so as not to miss executed orders. I.D. at 48,024 n.55. As to claims that changes on trading cards were a normal occurrence in pit trading during the period at issue, the ALJ emphasized that the changes at issue in this case were "neither impartial nor an even division," but "invariably accrue[d] to a trader's benefit." I.D. at 48,028.

In light of this analysis, the ALJ found all respondents liable for knowing participation in unlawful trading practices, and imposed sanctions.

VIII.

As noted above, the errors raised in respondents' appeals fall roughly under three themes. They cite a wide variety of ALJ conduct in support of their argument that he denied them a fair hearing. Several complain that the ALJ displayed the type of deep-seated antagonism to respondents' interests that required recusal. In this regard they emphasize: (1) the statements by the ALJ previously noted in Fisher's two applications for interlocutory review; (2) the limitations the ALJ imposed on all respondents' cross-examination of the Division's two experts; (3) the ALJ's abrupt termination of Fisher's counsel's cross-examination of Hastings; (4) the ALJ's skeptical questions about accepted trading practices such as "balance trades;" (5) the ALJ's refusal to permit respondents to question Gandolfo and Effron about alleged Division attempts to coach and threaten them; (6) the ALJ's refusal to grant respondents' objection to the Division's introduction of trade-register-related information into evidence when the judge had previously ruled that the information was not material to issues raised in this proceeding; and (7) the ALJ's review of the orders of settlement resolving the Complaint's allegations against co-respondents.

Respondents also argue that the ALJ based his analysis on credibility determinations and factual assessments unsupported by the record. Among the errors included under this theme are:

(1) the ALJ's failure to acknowledge exculpatory portions of Gandolfo's and Effron's testimony despite his general conclusion that their testimony was credible; (2) the ALJ's finding that there were two groups with a type of comradery that ensured a profit for all involved; 3) the ALJ's finding that price changes during the period at issue consistently favored locals over customers; 4) the ALJ's finding that the alleged aiders and abettors were aware that the opposite trader was executing a customer order rather than a personal order.

Finally, respondents argue that the ALJ failed to hold the Division to its burden of proof. In this regard, they claim that the ALJ emphasized alleged shortcomings in the analysis offered by respondents' experts while ignoring at least equally material flaws in the analysis offered by the Division's experts. Overall, they contend that because the inferences drawn by the Division's experts are inherently speculative, they lack the level of reliability necessary to support findings under the weight of the evidence standard.

The Division argues that respondents' challenges to the ALJ's procedural rulings do not establish that he abused his broad discretion. Even if the ALJ erred to some degree, the Division insists that the errors neither establish the type of bias that justifies recusal nor amount to a denial of respondents' opportunity for a fair hearing. As to the substance, the Division defends the ALJ's findings as consistent with the record and stresses that the judge's analytic approach comports with the methodology consistently endorsed in Commission and court precedent.

## DISCUSSION

### I.

A. Alleged ALJ Bias

Respondents' broadest challenge to the overall fairness of the proceedings below focuses on the ALJ's alleged bias. As our two orders denying respondents' applications for interlocutory

review suggest, their focus on the ALJ's general criticisms of aspects of the open outcry trading process is largely misplaced. The Supreme Court has noted that impartiality is not the equivalent of "'child-like innocence.'" *Liteky v. United States*, 510 U.S. 540, 552, (1994) (internal citation omitted). Consequently, opinions formed by a judge on the basis of facts introduced or events occurring in the course of the current proceedings, or of prior proceedings, "do not constitute a basis for a bias or partiality motion unless they display a deep-seated favoritism or antagonism that would make fair judgment impossible." *Id*. at 555.

Respondents argue that the ALJ's many erroneous rulings confirm that his statements arose from a predisposition that made fair judgment impossible. As discussed below, our review does show that the ALJ committed several fundamental errors. Nevertheless, we have repeatedly held that a judge's rulings, standing alone, "almost never constitute a valid basis for a bias or partiality motion." *Nixon v. Lind Waldock & Co.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,935 at 44,517 (CFTC Jan. 17, 1997). As explained by the United States Court of Appeals for the Seventh Circuit: "[a]dverse rulings should be appealed; they do not form the basis for a recusal motion." *In re Huntington Common Associates*, 21 F.3d 157, 158 (1994). When viewed in context, the ALJ's rulings and remarks support neither an inference of personal bias nor an inference that he harbored a deep-seated favoritism or antagonism that made a fair judgment impossible. *See Reddy v. CFTC*, 191 F.3d 109, 120 (2d Cir. 1999).

B. Access to Trade Register Data

Respondents' challenge to the ALJ's refusal to require the Division to produce trade register data hits closer to the mark. The data at issue related to trading in the relevant contracts during the period at issue in the Complaint. Respondents were able to obtain some of the requested data from COMEX and NYMEX, and Fisher's expert Rausser used the data to study

how frequently a wash result pattern was reflected in the silver and crude oil trades that these exchanges reported. According to Rausser's written testimony, his study demonstrated that Fisher's general trading patterns were statistically indistinguishable from the trading patterns exhibited by other traders in the relevant pits. Consequently, in his view, Fisher's participation in COMEX and NYMEX transactions revealing the wash result pattern did not provide any reliable indication that the underlying trades were executed noncompetitively.

Both the ALJ and the Division recognized that, in the circumstances presented, the relevance of the requested trade register data almost inevitably turns on the relevance of the portion of Rausser's written testimony addressing the wash result pattern. As noted above, the ALJ generally dismissed Rausser's testimony as minimally relevant because it focused on statistics relating to how trades "occur generally," rather than addressing the issues in this case. I.D. at 48,022. The Division offers a similar argument on appeal, emphasizing that Rausser's study "cannot be used to determine whether, in any particular trading sequence, Fisher and the other respondents did or did not trade lawfully." Division's Answering Brief at 59.

The party seeking to subpoena material from the Commission pursuant to Rule 10.68(b) must establish the material's relevance "to the matters at issue in the proceeding."[33] We agree that Rausser's testimony does not directly address ultimate liability issues at the heart of this case. It does, however, directly challenge various elements of the analysis offered by the Division's two experts. In particular, the portion of Rausser's testimony addressing trading pattern challenges Kozlowski's claim that when the wash result pattern appears repeatedly in transactions involving the same people, the pattern, "standing alone, constitutes strong evidence that the trades were executed noncompetitively." Kozlowski Written Testimony at 11-12.

[33] The requesting party must also show that: (1) the proposed subpoena is reasonable in scope, and (2) the requested material is not available from other sources. The Division has not challenged respondents' showing on these elements.

The weight properly accorded an expert's testimony is clearly a matter "at issue" in this proceeding. Indeed, in permitting the Division to introduce trade register data during its rebuttal case, the ALJ implicitly recognized that evidence tending to impeach views expressed in an expert's written testimony is relevant to the proceeding. The portion of Rausser's testimony addressing pattern was equally relevant in the context of the views expressed by the Division's expert witnesses. Because this was evident at the time Fisher sought access to trade register data in February 1997, the ALJ had no legitimate basis for denying the subpoena request. By denying respondents access to the data, the ALJ deprived respondents of a fair opportunity to impeach Kozlowski's testimony.[34]

C. Cross-Examination of Experts

The ALJ also erred by imposing undue limitations on all parties' rights to cross-examination under Commission Rule 10.66(d). That rule authorizes an ALJ to require that the direct testimony of expert witnesses "be made by verified written statement rather than presented orally at the hearing." The rule, however, specifically mandates that any expert whose testimony is presented in this manner "be available for oral cross-examination." Rule 10.66(b) indicates that the scope of cross-examination is generally limited to "the subject matter of the direct examination and matters affecting the credibility of witnesses." Rule 10.66(c), however, indicates that the presiding ALJ has the discretion to permit cross-examination "without regard to the scope of direct examination, as to any matter which is relevant to the issues in the proceeding."

Our precedent recognizes that rules establishing a right to cross-examination do not entitle parties to conduct their examination in whatever way and to whatever extent they desire.

[34] As noted above, Kozlowski's testimony addressed trading on CSCE. Because Rausser lacked data on the trades reported by CSCE during the period at issue, his study was limited to trading on COMEX and NYMEX.

*In re Rousso*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,133 at 45,306 (CFTC Aug. 20, 1997). Commission Rule 10.8 makes the ALJ responsible for the "fair and orderly conduct of the proceeding," and grants him the authority to "regulate the course of the hearing." If the ALJ provides an opportunity for "effective" cross-examination, we will not interfere with his efforts to impose reasonable limits on the scope of counsel's examination. *In re Reddy*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,271 at 46,209 (CFTC Feb. 4, 1998). Nevertheless, an ALJ abuses his discretion when he uses an arbitrary test to restrict the scope of cross-examination. *In re JCC, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. ¶ 26,080 at 41,574 (CFTC May 12, 1994.) *See also*, *Weiss v. Monex International Ltd.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,354 at 39,182 (CFTC Aug. 10, 1992.)

As noted above, the written testimony submitted by the parties addressed each expert's qualifications for offering testimony on the issues material to this proceeding. Consequently, such qualifications were part of "the subject matter of the direct examination" within the meaning of Rule 10.66(d). Nevertheless, the ALJ repeatedly ruled that questions related to this subject were outside the scope of legitimate cross-examination because he was already satisfied with the proposed experts' qualifications.

The parties, however, have a right to make a record on disputed issues of material fact. Indeed, the record parties develop during a proceeding is not solely for the presiding ALJ's benefit. It plays a vital role in the Commission's ability both to undertake *de novo* fact-finding on appeal and to provide courts of appeal with a meaningful record for their review. As we have frequently noted, decisional efficiency is an important goal, but its pursuit must be moderated when a party's right to develop the record on relevant issues is implicated. *In re Zuccarelli*,

[2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,637 at 52,432 (CFTC Sept. 7, 2001). The ALJ's exclusion of all questions about the experts' qualifications was an abuse of his discretion.[35]

The ALJ also abused his discretion in determining when cross-examination strayed from the "the subject matter of the direct examination" for purposes of Rule 10.66(d). As noted above, prior to the hearing, the ALJ notified the parties that any counsel planning to cross-examine an expert witness "should be prepared to cite the page and line of direct testimony in propounding questions to the witness." August 16, 1996 Order at 1. At the hearing, the ALJ did not consistently insist on strict compliance with this procedure. When he granted objections to the scope of cross-examination, however, he erred by focusing on the words included in the relevant expert's written testimony rather than the subject matter covered in the testimony. For example, in ruling that Fisher's counsel could not ask Hastings about a hypothetical situation related to her analysis of one of the challenged transactions, the ALJ emphasized that "she didn't put testimony here to that effect." (Tr. at 307.) Similarly, when counsel for the Division attempted to ask Rausser about his knowledge of Commission precedent and the methodology for assessing allegations of unlawful trade practices it endorsed, the ALJ cut him off with the comment, "[t]hat's not in his testimony." (Tr. at 1411.)

More troubling, the ALJ frequently suggested that he would relax his strict limitations on the scope of cross-examination if counsel were willing to accept specific limits on further questioning. For example, while Fisher's counsel was examining Kozlowski, the ALJ interrupted him to insist that he specify the portion of the expert's written testimony relevant to his questions. After counsel advised the judge that he would complete his examination in 15

[35] This is not a situation where the Division's expert was repeatedly asked, "to compare her own qualifications with those of respondents' expert." *Rousso*, ¶ 27,133 at 45,306. Nor does it involve a "belaboring of the obvious" or attempts "to score debating points against the opposing party's witness." *Reddy*, ¶ 27,271 at 46,209.

minutes, however, the ALJ ruled that he could proceed with "[n]o interruptions." (Tr. at 498.) Similarly, during counsel for the Division's examination of Cadden, the ALJ granted an objection, but advised counsel that "if we could have a little agreement that your examination was not going to take more than 20 more minutes, we could liberalize the rules a lot." (Tr. at 811.)[36]

We understand that in a proceeding this complex, involving multiple respondents and more than 150 transactions, a presiding ALJ is presented with significant challenges. Consequently, as our precedent indicates, we do not lightly interfere with an ALJ's good faith efforts to regulate the course of the hearing. Here, however, the record shows that the ALJ imposed arbitrary limits on the scope of the parties' cross-examination of experts, then enforced the limits in a manner that failed to maintain a reasonable balance between decisional efficiency and the parties' right to develop the record on disputed issues of material fact. In these circumstances, the ALJ deprived all parties of the cross-examination right granted by Rule 10.66(d).[37]

C. Remand Is Not Appropriate

In more normal circumstances, we would proceed to an analysis of the harm arising from the ALJ's procedural errors and the steps on remand necessary to address any demonstrated

[36] The ALJ's emphasis on brevity apparently arose from his skepticism about the value of cross-examining experts. During the Division's examination of Cadden, for example, the ALJ remarked that: "for the umpteenth time, I seriously question the value of cross-examination of expert witnesses. You gave your opinion. You're not going to convert these people up here on the stand. It's very unlikely that Mr. Cadden is going to become a witness for the Division." (Tr. at 800.)

[37] As noted above, the ALJ cut short Fisher's counsel's cross-examination of Hastings when counsel sought to question her about subpoenas issued during the Division's investigation of Fisher. On appeal, Fisher argues that this denied him a fair opportunity to develop the record regarding an alleged Division plot to "get" Fisher. Fisher Appeal Brief at 55-56. In this instance, the record does not establish that the ALJ abused his discretion. Fisher's counsel had already examined Hastings at length, and the focus of this line of inquiry was largely tangential to the material issues in this proceeding. Moreover, the ALJ had already admonished counsel about his persistent efforts to evade the judge's rulings.

prejudice. In view of the age of this case, however, and the flaws in the record as it currently exists, we find it more appropriate to proceed directly to the substantive issues raised on appeal.

II.

A. Credibility Determinations and Factual Assessments

As noted above, the ALJ specifically concluded that Effron and Gandolfo were "credible witnesses." Based on their testimony, he found that respondents had a sense of comradery that enabled two trading groups to help one another out and ensure a profit for all involved. Respondents claim that, at best, these findings rest on a selective reading of Effron's and Gandolfo's testimony, one that ignores these witnesses' exculpatory statements.

Our review of their testimony discloses significant problems with the ALJ's interpretation. As illustrated above, much of Effron's and Gandolfo's testimony was either strikingly ambivalent or essentially contradictory. For example, Gandolfo denied that he had used price changes to trade noncompetitively with Fisher, then changed his mind and admitted it, and then insisted that it was not in his nature to change prices to the detriment of his customers. (Tr. at 104, 105, 121.) Effron admitted that he participated in transactions involving price changes, but insisted that as many of the changes went against him as went for him. (Tr. at 164.) He specifically denied that price changes were a vehicle for repayment of errors, but acknowledged that when a price was changed in his favor, he counted it against errors he had accepted earlier. (Tr. at 170.)

The ALJ's failure to either note or address the problematic aspects of the settling respondents' testimony raises substantial questions about the reliability of his credibility determination. Even apart from these problems, the testimony simply does not support a finding that there were two trading groups whose special "comradery" helped assure that a fellow trader

would be "willing to accept a loss until an opportunity to pay the favor back arose." I.D. at 48,025, 26.[38]

B. Weighing the Expert Testimony

The ALJ also erred in a finding crucial to determining the weight properly accorded the testimony of the Division's experts. As noted above, several of the transactions challenged in the Complaint involve price changes. In these transactions, a local trading for his own account executed a trade opposite a broker trading for a customer account. Both the local and the broker initially recorded the same price for the transaction. Their trading cards revealed that both later changed the price to a level that financially benefited the local but harmed the broker's customer. According to the Division's experts, this type of noncompetitive price change was a device brokers used to repay traders who had accommodated them in earlier trades.

The record includes significant evidence that during the period at issue, there were at least two plausible innocent explanations for the type of price change described above.[39] (Tr. at 686-87, 903-04, 1599-1600.) The plausibility of the innocent explanation respondent offered, however, was undermined by the Division's showing that all the price changes benefited the local and harmed the broker's customer.

A portion of Rausser's testimony directly challenged the significance of this factor. He claimed that a review of all Fisher's trading cards reflecting price changes showed that Fisher lost as much as he gained through price adjustments. On this basis, Rausser charged that the

[38] Effron did testify that he accepted errors to help out brokers, and that he mostly accepted errors from those who stood around him. He did not, however, even hint that these traders were part of an organized group with any shared goal. Moreover, in discussing his practice of generally accepting passouts, Effron did not suggest that he limited his cooperation to traders in his vicinity. (Tr. at 174.)

[39] This evidence contradicts statements in Hastings's and Kozlowski's written testimony indicating that the single available innocent explanation was implausible in the circumstances at issue. Hastings Written Testimony at 26; Kozlowski Written Testimony at 26.

pattern of price changes in the challenged transactions reflected nothing more than a biased selection of trades from the available universe. Rausser's Written Testimony at 37-39.

While generally dismissing the relevance of Rausser's testimony, the ALJ indirectly acknowledged this portion of the testimony when he noted that Fisher produced "facially exculpatory" evidence that price changes were sometimes to his detriment. I.D. at 48,027. He found the evidence insignificant, however, because the changes to Fisher's detriment "consistently appear to be voluntary losses until such time as he could be repaid." *Id.*

The ALJ did not explain the basis for this finding and we find nothing in the record that supports it. Given this error, the ALJ's repeated reliance on the fact that changes in the challenged transactions "invariably accrue[d] to a trader's benefit," I.D. at 48,028, was simply misplaced.

III.

In view of these substantive errors, a *de novo* evaluation of the record as a whole becomes the key to resolving this matter. Given the contradictions and related flaws in the testimony offered by the settling respondents, we conclude that the views they expressed are insufficiently reliable to merit significant weight. Similarly, the testimony offered by Fisher, Amodeo, Carter, D'Amico and Orlando tends to raise as many questions as it answers. We conclude that their versions of the events at issue also lack fundamental reliability.

We find that the witnesses who addressed the exchange audit systems and common trading practices during the period at issue were generally credible. These witnesses establish that there was a noticeable gap between the goals of the audit systems and their day-to-day operation. The systems were somewhat rudimentary and more pragmatic than precise. In this context, it is unreasonable to infer that each audit trail irregularity that can be identified merits

significant weight in a reliable analysis of the challenged transactions. Any legitimate effort to reliably distinguish irregularities of only apparent importance from irregularities of actual importance must carefully consider the surrounding circumstances.[40]

Respondents offered the testimony of various individuals who used respondent brokers to transact business for them. These witnesses reliably established that some respondents who were brokers represented sophisticated customers who closely monitored the relevant pits and the quality of the fills they received on their orders. While we don't accord this type of generalized testimony controlling weight, it is fair to say that a broker who believes detection is more likely due to the sophistication or vigilance of his customers is more likely to carefully weigh the likely benefits of any noncompetitive trading scheme he is invited to join.

This leaves us with the expert testimony and the trading records that the experts analyzed. As noted above, Rausser's testimony does not directly address ultimate liability issues at the heart of this case. Nevertheless, Rausser's social-science based expertise brought a useful new perspective to the proceeding, and the failure of the Division's experts to forthrightly respond to his challenges relating to pattern and price changes undermines our confidence in their analysis.[41]

As noted above, the ALJ held that Berens's and Cadden's analysis rested more on "near conjecture" than valid analysis. He failed, however, to explain how either their general

[40] For example, in evaluating the significance of an error in a trader's count of his open position, the time of day is likely to be significant. Errors committed in the middle of the day are more likely to be caught and corrected by the close of trading. Errors committed toward the close of trading would be of greater concern to a trader who intends to end the day with no open positions.

[41] There are shortcomings in Rausser's approach that lessen the weight we accord his testimony. For example, as the Division notes, Rausser based his pattern analysis on all reported trades and made no effort to limit his universe to open and competitive trades. Moreover, though one might expect that traders who consistently scalp the market would have more frequent (though legitimate) wash results, Rausser did not consider the effect of trading style on his frequency analysis. Finally, in analyzing price changes, Rausser did not limit himself to circumstances comparable to those analyzed by the Division's experts -- where the traders at issue initially recorded the same price.

methodology or specific application of the methodology to the relevant facts was significantly different than those underlying Hastings's and Kozlowski's testimony. In our view, all four experts made a good faith effort to apply the traditional facts and circumstances approach to their analysis of the Complaint's unlawful trade practice allegations. All four can be criticized to varying degrees for failing to adequately explain their approach to ensuring that the inferences they drew were reliable rather than speculative.

This failing weighs more heavily against the Division, because it bears the ultimate burden of proof. As we have emphasized in the past, cases focused on allegations of unlawful trade practices frequently involve complex transactions that could be explained in several ways. The decision-maker's primary task is to separate "appearance from reality," and determine not "what could have happened, [but] what the preponderance of the evidence shows most likely did happen." *In re Citadel Trading Co.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,082 at 32,190 (CFTC May 12, 1986). The Division, of course, must establish more than suspicious circumstances. *In re Buckwalter*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,995 at 37,684 (CFTC Jan. 25, 1991). In identifying the line between the level of circumstantial evidence that supports reliable inferences under the weight of the evidence standard and circumstantial evidence that only supports a suspicion or uncertain estimate, we must balance "our desire to identify and sanction traders who knowingly participate in illegal trade practices" with "appropriate concern for the effect our linedrawing may have on legitimate trading activity." *Id.*

In this instance, we acknowledge that there are a great many suspicious circumstances disclosed on the record, but conclude that they don't fit together in a manner that produces a coherent, compelling picture. Put simply, there is a rough balance in the evidence supporting

inculpatory and exculpatory inferences. Accordingly, we dismiss the Complaint's allegations against respondents Fisher, Amodeo, Carter, D'Amico, and Orlando for a failure of proof. *Compare*, *In re Rosenberg*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,992 (CFTC Jan. 25, 1991).

IT IS SO ORDERED.

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

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

Dated: March 24, 2004