UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of

CHESTER GORSKI

CFTC Docket No. 93-5

OPINION and ORDER

The Division of Enforcement ("Division) appeals from an Administrative Law Judge's ("ALJ") dismissal of a complaint alleging that, during 1988 and 1989, respondent Chester Gorski ("Gorski") knowingly participated in more than 33 trade practice violations. The Division raises challenges to the ALJ's credibility determinations, factual assessments, and legal analysis. It urges us to undertake a *de novo* review of the factual record and conclude that Gorski violated Sections 4b(a) and 4c(a)(A) and (B) of the Commodity Exchange Act ("Act") and Commission Rule 1.38(a).[1]

In opposing the Division's appeal, Gorski contends that the ALJ did not err in any material respect. In addition, he emphasizes that the Division's factual analysis fails to give appropriate weight to his plausible, innocent explanations for the trading irregularities established on the record.

In light of our independent review of the record, we find that Gorski knowingly participated in several trade practice violations and impose appropriate sanctions.

[1] Citations are made to the Act as it existed during the relevant period.

BACKGROUND

I.

The Commission initiated this proceeding by issuing a Complaint in March 1993. The Complaint focused on gold futures trades that Lawrence Bilello ("Bilello") executed on the Commodity Exchange, Inc. ("COMEX") between March 1988 and June 1989. The other four respondents – Christopher Engel ("Engel"), Paul Marturano ("Marturano"), Ludwig Weingarten ("Weingarten") and Gorski – participated in some of the challenged trade sequences with Bilello.[2]

The Complaint alleged that Bilello violated Section 4b(a) of the Act in several ways,[3] Section 4c(a)(A) of the Act by knowingly participating in wash and fictitious sales, Section 4c(a)(B) of the Act by reporting prices that were not bona fide, and Commission Rule 1.38 by knowingly participating in non-competitive trades. It alleged that all the other respondents also violated Sections 4c(A) and (B) of the Act and Commission Rule 1.38.[4]

The Complaint divided the challenged trade sequences into three categories. Appendix I described 54 trade sequences in which Bilello traded largely with either Gorski or Engel. Gorski participated in 33 of these sequences. Appendix II described 12 trade sequences in which Bilello traded either with Engel or Marturano. Appendix III described 17 trade sequences in which

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[2] All respondents were registered as floor brokers and maintained COMEX memberships during the period at issue. Apart from Bilello, however, all respondents were trading for their own accounts when they participated in the alleged trade practice violations.

Most of the alleged violations involved two or more allegedly related trades. This opinion refers to the related trades, taken together, as a "trade sequence."

[3] It claimed that Bilello violated Section 4b(a)(i) of the Act by cheating and defrauding his customers, Section 4b(a)(ii) of the Act by willfully making false records, Section 4b(a)(iii) of the Act by willfully deceiving his customers, and Section 4b(a)(iv) of the Act by bucketing his customers' orders.

[4] In addition, the Complaint alleged that, in three instances, Gorski aided and abetted Bilello's violations of Section 4b(a). The Division's appeal is limited to one of these instances.

Bilello traded with Engel, Marturano, Weingarten, or Gorski. Gorski participated in one of these sequences.

Gorski filed an answer generally denying the Complaint's material allegations in May 1993.

II.

About five years passed between the date that Gorski filed his answer and the date that the hearing commenced. By that time, Gorski was the only remaining respondent. Many of the events that happened during this five-year period are tangential to the issues raised on appeal. It is worth reviewing, however, events leading to the resolution of the Complaint's allegations against the other respondents as well as selected disputes between the Division and the ALJ. The latter provides context that helps to explain the sharp tone of the ALJ's decision dismissing the Complaint.

A.

Respondent Marturano agreed to a settlement at the time that the Commission issued the Complaint. He admitted that he violated Sections 4c(a)(A) and (B) of the Act and Commission Rule 1.38 and agreed to the imposition of a cease and desist order, a three-month registration suspension, a one-month trading prohibition, and a $15,000 civil money penalty.[5]

Respondent Weingarten agreed to a settlement in August 1993, pursuant to which the Commission found that he violated Sections 4c(a)(A) and (B) of the Act and Commission Rule 1.38. As for sanctions, he agreed to the imposition of a cease and desist order and a one-month trading prohibition.[6]

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[5] Marturano also agreed to certain restrictions on his registration following the three-month suspension period.

[6] Weingarten also agreed that he would not apply for registration for a period of three years.

Respondent Engel did not agree to his settlement until four years later. He too was found in violation of Sections 4c(a)(A) and (B) of the Act and Commission Rule 1.38. He agreed to the imposition of a cease and desist order, a registration revocation, a nine-month trading prohibition, and a $75,000 civil money penalty.

Respondent Bilello waited until the eve of the hearing to settle. Like the other settling respondents, he was found in violation of Sections 4c(a)(A) and (B) of the Act and Commission Rule 1.38. He also was found to have violated Section 4b(a)(i)-(iv) of the Act. As to sanctions, he agreed to the imposition of a cease and desist order, a registration revocation, a three-year trading prohibition, and a $200,000 civil money penalty.

B.

During the prehearing phase of this proceeding, the Division engaged in two protracted procedural disputes with the ALJ. The first arose shortly after Gorski filed his answer. In the course of issuing prehearing orders, the ALJ made it clear that he intended to play an active role in encouraging settlement with respondents. The ALJ's approach was unprecedented in Commission enforcement proceedings, and the Division believed that Commission Rule 10.108 limited the role that the ALJ could play in the settlement process. When the ALJ persisted, the Division raised the issue before the Commission by filing an application for interlocutory review. In July 1993, the Commission stayed the parties' obligation to comply with the settlement-related duties imposed by the ALJ. In March 1994, the Commission issued an order granting the Division's application for interlocutory review and substantially endorsing its view of the ALJ's settlement role in Commission enforcement proceedings. *In re Bilello*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,032 (CFTC March 25, 1994).[7]

The second dispute arose in 1997, at a time when it appeared that a hearing was finally imminent. It related to the ALJ's views regarding the scope of the Division's obligation to produce exculpatory information when some, but not all, respondents settled during the course of a proceeding.[8] In May 1997, the ALJ conducted a prehearing conference to assess the Division's progress toward completing its production of exculpatory information. The ALJ initially focused on information that could be used to impeach the testimony of settling respondents who testified for the Division. May 6, 1996 Transcript at 5-6. He then indicated that the Division's search for exculpatory information should extend to written communications with the Commission, including any memoranda that: (1) recommended the institution of an investigation; (2) recommended the issuance of a Complaint; or (3) supported or opposed a settlement proposed by a respondent. In addition, he indicated that the Division should review tapes and transcripts of any relevant Commission meetings. Finally, the ALJ insisted that, if it were neither factually nor legally clear that a document need not be produced, the Division was required to produce the document for *in camera* inspection by the judge.

The May 1997 conference touched off an ongoing dispute that delayed the hearing for another year. The ALJ held additional prehearing conferences on this subject in July and

[7] In the meantime, the parties engaged in a lengthy dispute regarding requests for admission. The ALJ resolved the ongoing dispute in October 1994 by issuing an order granting all motions objecting to requests for admission and denying all motions challenging the adequacy of responses to admissions.

[8] 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 27,581 (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.

November 1997. In October 1997, the ALJ issued a detailed order clarifying how he believed the Commission's exculpatory information precedent applied to the Division.

This dispute reached its zenith after the ALJ made an *in camera* review of draft witness statements in December 1997 and ordered the Division to make several of them available to respondents. Once again, the Division sought Commission intervention by filing an application for interlocutory review. The Commission issued an order staying the ALJ's production order in December 1997. After reviewing the documents at issue *in camera*, however, the Commission denied the Division's application for review. *In re Bilello*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,345 (CFTC Apr. 23, 1998).

C.

A key prehearing conference took place between the events underlying these two procedural disputes. The November 1996 conference was ostensibly a forum for the ALJ to consider the Division's motion for partial summary disposition as to respondents Bilello and Engel. The ALJ, however, also used the conference to offer "certain observations" about both the Division's documentary evidence and the views offered by its primary expert, Martha Kozlowski ("Kozlowski"). November 20, 1996 Transcript at 6. These observations made it clear that the ALJ believed that the Division should seriously consider settling its dispute with respondents.[9]

The ALJ set the stage for the November 1996 conference by requiring the Division to submit a prehearing memorandum, including direct testimony of its experts and all documentary evidence, in December 1994. He required respondents Bilello, Engel, and Gorski to make

[9] The ALJ explained that his observations were intended to be:

> [H]elpful in resolving this complex matter, without putting the Division (and the taxpaying public that they represent) and the private parties through the quite substantial costs associated with proceeding to trial and litigated judgment in this matter.

similar submissions in June 1995. Because these written submissions play a key role in the November 1996 conference, we review them in some detail.

Kozlowski's written testimony reviewed her background and experience.[10] It also reviewed some basic information about the COMEX audit trail during the time at issue and the process that COMEX traders used to check completed transactions. *See generally* Kozlowski Written Testimony at 9-11. Finally, the written testimony provided an analysis of each of the challenged trade sequences.

As for the COMEX audit trail, the written testimony noted that COMEX required traders to record transactions that they executed for their own account (or a clearing member's house account) on trading cards in exact chronological order. It indicated that COMEX did not require traders to record customer transactions on trading cards, but that if a member chose to do so, COMEX required that the trader record transactions in exact chronological order.[11] COMEX rules also required that traders record the time a transaction was executed to the nearest minute.

The written testimony indicated that completed transactions were generally checked by the traders' clerks. It also discussed how the data recorded on the trading card was

[10] The written testimony stated that Kozlowski graduated from Bowling Green State University in 1970 with a Bachelor of Arts in Business Administration. It indicated that she had worked with the Commission or its predecessor agency since 1971 and listed the positions she has held, including: (1) staff investigator for the Division of Enforcement (1971 through January 1978); (2) chief regional investigator for the Division of Enforcement, Chicago region (January 1978 through September 1980); (3) branch chief, Division of Enforcement Market Integrity Section, Chicago region (September 1980 through May 1982); (4) assistant branch chief, Division of Enforcement Market Integrity Section, Chicago region (May 1982 through June 1983); (5) senior investigator, Division of Enforcement Manipulation and Special Operations Section, Washington, D.C. (1993 through date of written testimony). The written testimony also noted that Kozlowski had received some training at the Chicago Mercantile Exchange and had qualified as an expert witness both in Commission proceedings and a United States district court proceeding.

[11] The written testimony stated that COMEX rules required that customer trades be recorded on order tickets.

communicated to COMEX for inclusion in its computer system.[12] The written testimony also addressed the type of information included in the daily brokerage recap that COMEX produced and shared with the Commission.[13]

Kozlowski's written testimony emphasized four types of factors in analyzing the challenged trade sequences: (1) a characteristic trading pattern or configuration; (2) audit-trail irregularities; (3) other irregularities; and (4) a potential motive for undertaking unlawful conduct. In discussing the first factor, the testimony described two patterns or configurations that Kozlowski found significant. Both patterns shared characteristics, but had different purposes. One trader (the "floor broker") executes one or more transactions for a customer and one or more transactions on the opposite side of the market for his own account. The opposite trader executes one or more purchases and one or more sales for his own account. According to the written testimony, the related transactions are usually written within a few lines of each other on the respective traders' cards.[14]

The written testimony differentiated the patterns by noting that the floor broker employed each for a different purpose. One pattern allowed the floor broker to trade opposite his own

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[12] The written testimony indicated that, after a trader completed a trading card, he gave it to a clerk to check the trade with the clerk for the opposite trader. For customer trades, a different clerk took information from the card and recorded it on the customer's order ticket. The order ticket was then submitted to the clearing futures commission merchant ("FCM") and that firm entered the necessary data into the COMEX computer. For trades made for the trader's own account, either the trading card itself or a brokerage form completed by a clerk was submitted to the clearing FCM. Again, that firm entered the necessary data into the COMEX computer.

[13] According to the written testimony, the daily brokerage recap was the official record of trades executed and cleared on COMEX, and included information regarding the commodity, contract month, quantity bought or sold, opposite trader, executing and opposite clearing firm, executing and opposite customer type indicator ("CTI") and trade execution time.

[14] While the written testimony does not explain this point, trades written within a few lines of each other would often be executed within a relatively brief period of time.

customer in what the written testimony referred to as an "indirect bucket."[15] In such a case, all transactions take place within the same contract month. The other pattern allowed the floor broker to purchase or sell for himself the same type of futures contract ordered by the customer, but in a different delivery month.[16] The written testimony noted that there were several ways that a floor broker might employ transactions reflecting these patterns to obtain an advantage.[17] It claimed that a desire to gain "recognition" from floor brokers with customer orders to fill was a plausible motive for the opposite trader to undertake transactions reflecting either of these patterns.[18] Kozlowski Written Testimony at 26-27.

Kozlowski's written testimony explained that neither the indirect bucketing pattern nor facilitation trade pattern were likely to appear if trades are competitively executed. It indicated that these patterns were especially significant when the same two traders were repeatedly involved in transactions reflecting them.

The written testimony discussed several types of audit irregularity that could indicate that the trader did not contemporaneously and accurately record information pertinent to the trade.

[15] In an indirect bucket, a floor broker trades against his customer in a non-competitive transaction. The opposite trader, often called the accommodator, assists the floor broker by making it appear that the customer traded with him, rather than with the floor broker. Because the transaction is arranged in a manner that permits the opposite trader to buy and sell the same month of the same futures contract at the same or similar price, he is able to negate market risk while sometimes earning a small profit.

[16] The written testimony generally referred to this pattern as the floor broker's use of a customer order in one contract month to facilitate a trade for the floor broker's own account in another contract month. As a matter of simplification, this opinion calls a transaction reflecting this pattern a "facilitation trade."

[17] A floor broker such as Bilello, it explained, could use his order to establish or offset a position at a better price than he could achieve through open outcry. Additionally, a floor broker could obtain a risk-free, predetermined profit by "trading ahead" of the customer's order to establish a position for his own account, secure in the knowledge that he could offset that position opposite his customer by means of a non-competitive trade. Kozlowski Written Testimony at 24.

[18] The written testimony explained the concept of recognition in terms of five traders simultaneously bidding the same price in response to a customer order. Because the floor broker representing the customer could fulfill his duty to the customer by trading with any of the five traders, he may be influenced by a history of past cooperation in determining which trader he selects. Kozlowski Written Testimony at 26.

For example, the written testimony noted instances where both traders initially recorded information pertinent to the transaction in a consistent manner, but subsequently changed the information, again in a consistent manner. It noted that, in several of the challenged transactions, both traders increased the quantity of a trade Bilello made for customers and then completed a transaction whereby Bilello traded in the same amount as the increase on the side of the market opposite to his customer's trade. According to the written testimony, it was likely that the floor broker and the opposite trader entered into a competitive trade, and then the floor broker instructed the opposite trader to "increase the quantity by a certain quantity and 'give him back' the same quantity, either of the same or a different contract month." Kozlowski Written Testimony at 14.

Another audit irregularity discussed in the written testimony involved information recorded: (1) in handwriting different than that used to record other information on the card; or (2) with a writing instrument different than that used to record other information on the card. The written testimony also highlighted information recorded in a manner contrary to a COMEX rule limiting the recording of two trades on a single line of a trading card, as well as certain anomalous information clerks working for the participating traders recorded on their cards.[20] In addition, the written testimony emphasized instances where a trader did not maintain an accurate running total of his net position,[21] or recorded a time and price for a trade in a manner

[20] In this regard, Kozlowski's written testimony noted instances where a clerk's count of the total number of contracts purchased and sold did not appear to reflect certain trades, and when a clerk recorded trades from the same card on different brokerage forms.

[21] For example, a trader may periodically record his net exposure on his trading card. If he begins a card with no position, then records a buy of 5 contracts, a buy of 3 contracts, a sell of 10 contracts, and a buy of 8 contracts, his net position would be 6. If the trader recorded his net position as 3 rather than 6, it could suggest that his purchase of 3 contracts was not recorded on the card at the time he calculated his position, but was inserted at a later time.

inconsistent with the information reflected in the COMEX price change register.[22] Kozlowski Written Testimony at 15-16.

Kozlowski's written testimony acknowledged that errors in recording trades could be innocent. It emphasized, however, that both Commission and COMEX rules required that trades be recorded in a particular manner. In addition, it noted that accurate recordkeeping was important to the traders because:

> Recording their trades is their way of knowing with whom they traded, how many contracts they have bought and sold and the price at which they traded. This information is essential in the case of disputes with other traders over the specifics of trades. Also, by recording trades at the time they execute the trades, traders know their positions at any given point in time and where they stand from a profit or loss standpoint.

Kozlowski Written Testimony at 15.

The written testimony noted two other types of irregularity pertinent to identifying non-competitive trades. It stated that Bilello generally traded no more than five contracts at a time for his own account and that Gorski was a "small trader, although he did trade 20 or more contracts in a single trade more often than Bilello." Kozlowski Written Testimony at 17.[23] The written testimony claimed that traders base the typical size of their trades on the level of risk they are willing to incur and that that it is unusual for traders to establish positions larger

[22] Kozlowski's written testimony noted that the price change register is the official COMEX record of price changes and when those changes occurred. It noted that, for some trades included in the challenged sequences, the price reflected in the change register did not show a print of the price recorded on the traders' cards at the time recorded on one or both of the traders' cards. In other instances, the sequence of prices reflected in the price change register was not consistent with the sequence one or both traders used in recording the trades on his card. As an example of the latter irregularity, the written testimony explained that, if a trader sequentially recorded trades during the same minute at prices of 387.10, 387.20, 387.00, 387.30, but the price change register showed that during that minute a price of 387.00 was only reported prior to prints of 387.10 and 387.20, that would indicate that the trade at 387.00 may have been executed non-competitively.

[23] The written testimony indicated that the determination of Bilello's typical trading size was based on an examination of his trading cards for the periods June through September 1988, November through December 1988, February 1989, April through June 1989, and 14 dates during the period February through May 1988. It indicated that the determination of Gorski's typical trading size was based on an examination of his trading on 182 unspecified days.

than their typical size because it substantially increases their risk. It acknowledged that some traders are willing to trade larger quantities when markets become more active, but indicated that this did not adequately explain the times that Bilello and Gorski traded larger than normal quantities during the challenged trade sequences.

Finally, Kozlowski's written testimony noted that several of the trades included in the challenged transactions were the result of the COMEX claims procedure. It indicated that it was routine for COMEX traders to have a clerk check their trading cards with the clerk for the opposite trader If a discrepancy was discovered, the clerk for the trader who had not recorded the trade made a notation on the back of the card indicating that a specified trader "CTB" (claims to buy) or "CTS" (claims to sell) a specified quantity at a certain price. Conversely, the clerk for the trader who had recorded the trade on his card made a notation on the back of the card indicating that the specified trader "DKs" (did not know) the trade. Sometimes, instead of (or in addition to) a clerk noting the "out" on the back of the card, the clerk identified an "out" by placing brackets around the trade on the face of the trader's card. Kozlowski's Written Testimony at 20.

Kozlowski's written testimony acknowledged that claims were sometimes legitimate because traders may fail to record a trade or a clerk may fail to notice a trade during the review process. It indicated that such an innocent explanation was unlikely, however, when the claim involved a purchase and sale for the same quantity. In addition, the written testimony noted that "claiming a trader on a trade or trades is a method that was used by traders on the COMEX in 1988 and 1989 as a way to execute non-competitive trades." Kozlowski Written Testimony at 21.

The written testimony provided a separate analysis for all but one of the challenged trade sequences.[24] In concluding that each of the challenged trade sequences involved non-competitive trading, the written statement generally cited some combination of the factors discussed above. For example, a substantial number of the challenged trade sequences included trades that reflected either the indirect bucket or facilitation trade pattern and some combination of audit trail irregularity, unusual trade size, or claim. A number of the trade sequences, however, did not include trades that reflected a trading pattern that Kozlowski viewed as suspicious. In analyzing these trades, the written testimony drew inferences solely from audit trail irregularities and Kozlowski's judgment that Bilello and Gorski routinely executed non-competitive trades with each other. In some of these instances, Kozlowski also drew an inference that Gorski had intentionally lost money when trading with Bilello in order to pass him money.

Respondents Bilello, Engel, and Gorski submitted a prehearing memorandum in June 1995. For the most part, these respondents emphasized that the Division's expert consistently drew adverse inferences from irregularities with plausible innocent explanations. For example, they noted that the Division's expert drew an adverse inference from the fact that respondents frequently traded together, but did not analyze whether this simply reflected the fact that respondents stood in the same vicinity in the gold pit. They also noted that the Division's expert drew adverse inferences when the recorded time and price for a trade did not match information reflected in the COMEX price change register, but did not analyze whether this simply reflected the fact that the price change register did not perfectly reflect trading in the pit.

[24] Kozlowski did not analyze trade sequence 44, and the Division later acknowledged that it had dropped the Complaint's allegations relating to this trade sequence.

Respondent Engel submitted written expert testimony prepared by Edward W. Schwarz. Schwarz's written testimony described his background and expertise[25] and analyzed each of the challenged trade sequences involving Engel. The written testimony observed that it is not unusual: (1) for traders who stand in close proximity to one another to trade with each other more often than with those across the pit; and (2) for scalpers such as Engel to buy and sell a contract at the same price.[26] It also emphasized that traders often miscount, miswrite, or mistake what they've heard, and that during the period at issue it was normal practice for a trader to depend on a clerk to correct some errors. As for the COMEX price change register, Schwarz's written testimony indicated that the prices reported could be off by fifty cents in either direction and that time gaps did occur. Finally, the written testimony reviewed each of the challenged trade sequences and concluded that the circumstantial evidence did not reliably establish that Engel knowingly participated in unlawful trade practices.

The prehearing memorandum Bilello submitted included an admission that 17 of the challenged trade sequences in Appendix III were part of an effort by respondents Bilello and Weingarten to pass funds to a business associate of Bilello. In light of this admission, the Division moved for partial summary disposition on liability against both Bilello and Engel. These respondents filed their oppositions to the motion in September 1995.

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[25] It indicated that he had been employed in the futures industry for over 20 years, most recently as the president of Index Futures Groups, Inc., a large clearing firm. The written testimony indicated that he was a COMEX member for 13 years, had served as a member of COMEX's supervisory committee, and been a member of arbitration panels at the New York Stock Exchange dealing with futures-related issues. Finally, the written testimony indicated that Schwarz had authored two futures-related books and had lectured on financial futures at New York University, Columbia University, and the University of Pennsylvania.

[26] At one point Schwarz's written testimony stated that 30 to 40 percent of all trades industry-wide are "scratch" trades – a term he used to describe a purchase and sale of the same contract month of the same futures contract at the same price. It indicated that clearing firms charge a reduced commission on such trades. Schwarz's Written Testimony at 13.

D.

At the outset of the November 1996 conference, the ALJ initially analyzed the Division's motion for partial summary disposition.[27] The ALJ then offered an extended critique of both the methodology underlying the analysis offered by the Division's expert and the reliability of the conclusions derived from the analysis.

The ALJ described the expert's reliance on a methodology focused on trading patterns and audit trail irregularities as "hardly scientific" and "weakly-tied to the realities of the marketplace on the exchange." November 20, 1996 Transcript at 46. As to the indirect bucket pattern, the ALJ noted that:

> [G]iven the high volume of dual trading and scalping that characterize the pit's open outcry trading, one might even expect to regularly observe the clusters of buys, sells and wash results that characterize the Division's trade configuration for indirect buckets.

Id. at 47. Regarding the Division's evidence of audit trail irregularities, the ALJ observed that recordation errors are a regular feature of open outcry trading and that the Division's expert did not present information showing how unusual the noted irregularities were, and "what, if anything, . . . they really tell us." In this regard, the ALJ noted that the Commission's Division of Trading and Markets had issued an audit report in August 1988. It found that 13 percent of the trades in a selected COMEX trading sample were executed more than a minute from the time that the COMEX price change register showed the price recorded for the trade. *Id.* at 48.

The ALJ also raised questions about the existence of a plausible motive for some of the challenged trade sequences. He indicated that in some instances of alleged bucketing, it appeared that Bilello could have obtained an equivalent position through a competitive trade, and

[27] He granted the motion as to respondent Bilello but denied it as to respondent Engel.

that in others, the price selected for the allegedly non-competitive trade was better for Bilello's customer than the price the customer received for contemporaneous competitive transactions.

Summarizing his concern with the Division's expert's analysis of the trades reflected in Appendix I, the ALJ stated that:

> [T]he Division's approach to the Appendix I trades appears far too impressionistic to be convincing, and it turns up far too many trades where even the impression fades on examination. Without a systematic analysis of the respondents' thousands of trades, the selection of 54 trade sequences alone does not establish a "pattern" and certainly not one bound by more than speculation and conjecture. If you are looking hard enough for the man in the moon you are going to see him – whether he exists or not. Metaphors aside, the Division's Appendix I trade by trade methodology appears statistically and intuitively unconvincing, and appears to do little in assisting the Division in meeting its burden of proof that respondents engaged in the trade practice violations as alleged with respect to the Appendix I trades.

Id. at 54.[28]

Toward the end of this conference, the ALJ reviewed the objections respondents had filed to the Division's use of testimony and documentary evidence. None of these objections related either to the qualifications of the Division's expert or the admissibility of her testimony.[29]

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[28] Responding to the ALJ's observations, the Division's counsel noted that, "I don't believe as yet the Commission's case law requires a thoroughgoing statistical analysis, which I don't know if the [ALJ] was requesting, but may have implied is necessary." *Id.* at 60.

[29] The Division submitted only Kozlowski's written testimony with its prehearing memorandum. After the ALJ determined that three of the Division's other anticipated witnesses were testifying in an expert capacity, it submitted the written testimony of Elizabeth Hossa ("Hossa"), Michael Campanelli (Campanelli"), and David Schneiderman ("Schneiderman"). Hossa's testimony addressed the Commission's Exchange Data Base System ("EDBS") project. Campanelli was COMEX's Director of Trading Operations. His testimony addressed how the COMEX audit trail worked between March 1988 and June 1989.

Schneiderman had been a COMEX member from 1984 through December 1992. At that time he became an analyst focusing on trade practice investigations at the New York Mercantile Exchange ("NYMEX"). In November 1996, he became director of the trade practice group of the Office of Compliance, with responsibility for both COMEX and NYMEX trade practice cases. Schneiderman's testimony addressed the factors that "may exist" if a COMEX member engaged in non-competitive trading. These included: (1) trades listed in conflicting sequence on the two traders' cards; (2) alterations to the information relating to price, quantity, contract month or opposite trader recorded on one or both traders' cards; (3) a trader's recording trades that are not part of a straddle or cross-trade on the same line as another trade; (4) a trader's failure to include a position in the running computation of his net position; (5) a clerk's failure to include a position in his calculation of the total number of contracts bought or sold on a trading card; (6) a trader's use of different inks or different handwriting when recording trades on a trading

III.

As noted above, Gorski was the only respondent when the ALJ conducted an oral hearing in New York, New York on July 6 through 9, 1998. The Division based its case on both documentary evidence and expert testimony. As to the former, it relied primarily on the trading cards documenting the trades included in the challenged trade sequences and the time and sales records created and maintained by COMEX. The Division offered the testimony of its four expert witnesses, as well as the testimony of William Burnes ("Burnes"), a clerk who formerly worked for Gorski. Finally, the Division sponsored the testimony of William Lenox ("Lenox"), an attorney formerly employed by the Division who participated in settlement discussions with Gorski. Gorski testified in his own behalf and presented the testimony of Norman Sweeney ("Sweeney"), a clerk he employed after the transactions at issue were completed.

During cross-examination concerning his written testimony addressing factors that may exist if a COMEX member engaged in non-competitive trading, Schneiderman agreed that: (1) local traders normally look to initiate positions with floor brokers who are trading for customers; (2) most traders trade more with traders who stand in their vicinity; (3) audit irregularities are more likely in fast market situations and periods of high trading activity; and (4) a trader would be more likely to accumulate a position larger than normal in periods of high market activity and in a contract month that was not the active month. (Oral Hearing Transcript at ("Tr. at") 68-73.) Schneiderman also acknowledged that the elements discussed in his written testimony could be present but not provide a reasonable basis for determining that the affected trade was non-competitive. (Tr. at 70.)

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card; (7) a trader's submission of a trade to the exchange or a clearing member on a different brokerage form than other trades recorded on the same trading card; and (8) inconsistencies in the sequencing of times on the order ticket, the trader's cards and/or the price change register. Schneiderman's Written Testimony at ¶ 5.

On redirect, Schneiderman stated that a hope of "recognition" by a floor broker with customer orders to trade could motivate a local trader to accommodate the floor broker by purchasing and selling the same contract month of the same futures contract at the same price. (Tr. at 74-77.) He agreed that it was to the local trader's benefit to record all trades, and that it would be unusual for such a trader to forget to record both a buy and a sell. (Tr. at 78-79.)[30]

During her cross-examination, Kozlowski agreed that: (1) Gorski was acting as a local trader during the challenged trade sequences (Tr. at 93); (2) local traders tend to trade more with traders in their vicinity than with those outside their area (Tr. at 107); (3) local traders tend to trade more with floor traders who are trading for customers than with other local traders (Tr. at 107); (4) during the relevant period, Bilello was a floor broker who both traded for himself and filled orders for customers (Tr. at 107); (5) Bilello stood close to Gorski in the gold pit (Tr. at 107); (6) Gorski frequently traded as a "scalper" (Tr. at 100-06);[31] and (7) there is nothing inherently wrong with a scalper liquidating all or part of his position with the trader with whom he initiated that position. (Tr. at 106) Kozlowski was asked whether she would be surprised that traders such as Gorski and Bilello, who stood in the same vicinity in the pit, did a fairly significant amount of trading together during an eighteen- month period. Her response drew a distinction based on the relative frequency of the trading:

[30] During cross-examination concerning his written testimony addressing the COMEX audit trail during 1988 and 1989, Campanelli acknowledged that during the closing period of trading it was possible that the sequence of prices reported on the price change register was not accurate. (Tr. at 35.) Similarly, he acknowledged that during a fast market period, some prices might not be reported at all and that it was possible that the sequence of prices reported on the price change register would not be accurate. (Tr. at 38-40.) He also admitted that it was possible prices might not be accurately reported during a non-fast market period. (Tr. at 41.)

Hossa's cross-examination did not add anything significant to the information provided in her written testimony.

[31] During their colloquy regarding Gorski's style of trading, Kozlowski and Gorski's counsel did not agree on a precise description of the term "scalping." At one point, Kozlowski agreed that Gorski generally initiated a position and liquidated it within a minute or so. (Tr. at 100.) At a later point0, she agreed that Gorski tended to go from "plus two [to] flat to minus two [to] flat" or from "plus two to minus two back to flat." (Tr. at 103.)

> I would expect to see, since there are obviously other people besides just Mr. Bilello that stood in Mr. Gorski's area, I would expect to see a large percentage of his trading done with all of those people not just one person in particular.

(Tr. at 108.) After several other questions, she amplified on this response by explaining:

> What I would expect to see is not something that stands out over and above the amount of trading that other people who stood near to each other did.

(Tr. at 109.) When asked about three specific traders that stood in Gorski's vicinity in the pit, however, Kozlowski conceded that she would not be surprised that Gorski traded less with these traders than with Bilello. (Tr. at 114-16.)

Gorski's counsel also questioned Kozlowski about Bilello's and Gorski's typical trading size. Kozlowski testified that Gorski's typical trading size was "around five contracts, maybe five to ten." (Tr. at 112.) She explained that she had examined 182 days of Gorski's trading and identified 78 occasions when he had traded 20 or more contracts. (Tr. at 123.) She acknowledged that certain market conditions could make it more likely that a trader would establish positions larger than his typical trading size. One condition was when the market was active because there was "more liquidity." (Tr. at 116.) She indicated that a local might see an advantage to trading in a "back" month because the bid/ask spread would usually be wider. (Tr. at 117.) Kozlowski noted, however, that such trades could be risky due to limited liquidity. (Tr. at 117-18.) Nevertheless, she acknowledged that the local trader could generally liquidate the position by using a spread, and that the spread market in gold futures contracts was "not that volatile." (Tr. at 118.)

When questioned about how local traders deal with claims made by floor brokers, Kozlowski explained that:

> Different traders and their clerks have different arrangements. There are some traders who have told their clerks that if you get claims by a specific broker, go ahead and accept the trade. If you get claims and it has no effect on my position,

> you can accept the trade. If you get a claim and it doesn't affect me financially, you can accept the trade. So it depends on the arrangement that the broker has or the local has with his clerk.

(Tr. at 137.) In Kozlowski's view, it was improper for a local trader to acknowledge claims when he did not recall whether the underlying trades were done through open outcry. (Tr. at 138-39.) Both the ALJ and counsel for Gorski questioned whether this view could be reconciled with the practical realities of the COMEX claims procedure. In response, Kozlowski maintained that there was an important distinction between a disagreement over the price of a trade both traders recalled and a disagreement over the very existence of a trade. (Tr. at 155-58.) She also emphasized that the claims at issue involved both the purchase and sale of the same month of the same futures contract at the same or a similar price. In this context, she explained:

> If the local has a habit of accepting these claims from the broker and he's accepting these claims for trades that he does not recall doing and the broker knows that this is an unusual sort of a claim or the local knows these claims by their very nature, are unusual, then I think the local is, by accepting those claims, the local is also announcing an attempt to engage in non-competitive trading.

(Tr. at 158.)

Finally, Kozlowski acknowledged that there could be situations that fell into a "very gray area":

> What if [two traders] really did do the trade with each other and one of the people involved in the trade just didn't record it on its cards and is not sure whether he did or not. There may have very well been a legitimate trade, and this is the gray area where you have a problem distinguishing what happened. But I think what you have to look at, again, from the local's point of view is, you know, if this happens once and he's not sure he did the trade or not, well, you know, maybe he didn't take the trade.
>
> If it keeps happening again and again and again with the same trader claiming him, then I think the local has to take a much more serious look at this and, you know, say to himself, are these trades legitimate.

(Tr. at 164-65.)

When asked about the role that clerks played in the claims process, Kozlowski acknowledged that during the relevant period neither COMEX nor the Commission had rules governing a clerk's participation in the claims process. (Tr. at 170-71.) She also agreed that there are circumstances where clerks will write on both the front and back of a trader's card. (Tr. at 171-74.)

Counsel then reviewed each of the challenged trade sequences involving Gorski with Kozlowski. During this review, Kozlowski answered several questions relating to the accuracy of the information reflected on COMEX's price change register. When asked about the appropriate period to examine when trying to determine whether a broker had properly filled a stop order, Kozlowski agreed that, depending upon market conditions, a time period between one and two minutes would not be unreasonable. (Tr. at 199.) Kozlowski acknowledged that "once in a while" trades are missing from the price change register and that a report prepared by the Commission's Division of Trading and Markets found that the times recorded for COMEX trades were inconsistent with the price change register 13 percent of the time. (Tr. at 354.) Finally, she admitted that a price might not appear on the price change register because it was cancelled prior to actually being entered into the reporting system. (Tr. at 358.)

Kozlowski emphasized that:

> Mr. Gorski and Mr. Bilello, over the course of about at least one year that I examined, repeatedly traded opposite each other in the same pattern.

(Tr. at 246.)[32] Kozlowski later testified that when such a pattern occurs repeatedly among the same individuals, it is sufficient to support a conclusion that trades were non-competitive. (Tr. at 265.) She said that 100 instances in a universe of 10,000 trades would meet her criteria for "repeatedly." When asked her basis for developing this standard, she pointed to her:

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[32] Kozlowski testified that during the year she examined, 16.85 percent of Gorski's trades were done with Bilello. (Tr. at 258.)

> [O]bservations, in looking at numerous, numerous traders' activities over the years and looking at trading cards, has been that that pattern does not occur frequently and certainly does not occur frequently involving the same individuals.

(Tr. at 265.)

On redirect, Kozlowski contrasted the typical conduct of a scalper from the conduct at issue, explaining that scalpers normally buy and sell opposite numerous people rather than "buying and then turning around and selling the same quantity at or about the same price to the same person." (Tr. at 374.) She also testified that evidence of fast market or heavy trading conditions in the market is not significant to identifying non-competitive trading because additional price volatility and an increase in the number of customer orders gives floor brokers more opportunities to trade against their customer orders. (Tr. at 376-77.)

Kozlowski also explained some statistical analysis of Gorski's trading that she prepared after the November 1996 prehearing conference. She noted that she had examined Gorski's trading cards for days "more or less randomly selected" from the period June 1988 through June 1989. Kozlowski then isolated: (1) trades that reflected one of the suspicious patterns that characterized the challenged trade sequences; and (2) trades that reflected audit trail irregularities. She also analyzed trade data to determine how frequently Gorski traded with various traders. (Tr. at 377-78.)

According to Kozlowski, on the twenty-four days that she selected, Gorski executed 72 roundturn trades that reflected one of the suspicious trading patterns. Fifty-three percent of those trades were with Bilello. (Tr. at 388.) In addition, she testified that Gorski's trades on these days involved 64 claims, but only three of the claims involved both purchases and sales, and those three involved Bilello. (Tr. at 389.) She also noted that 23 trades appeared to be inserted and that 44 trades involved an increase in the quantity initially recorded on the card.

Burnes testified about the process used by clerks at Wilkund Trading Company ("Wilkund") to check COMEX silver and gold trades.[33] During the relevant period, Burnes worked with Wilkund traders who traded gold and silver, among them Chester Gorski. (Tr. at 597-98.)[34]

Burnes testified that Wilkund brokers such as Gorski prepared a daily list of the trades that they had done and faxed it to Wilkund's offices in Chicago. Wilkund then checked these reports against the trading statements they received. Burnes did not recall receiving a call from Wilkund concerning a trade listed on these statements that it did not know about. (Tr. at 593.)

Burnes said that Wilkund clerks were not authorized either to accept claims without speaking to the trader or to write in trades on the face of a trading card. (Tr. at 590.) When questioned about Gorski's handwriting, he acknowledged that during his investigatory deposition he had indicated that Gorski wrote differently outside the trading ring because he was not rushed. (Tr. at 593-94.)

On cross-examination, Burnes indicated that during the relevant period, Wilkund clerk Frank Diaz ("Diaz") was principally responsible for checking Gorski's trading cards. (Tr. at 597-98.) He said that if Wilkund had a question about a discrepancy between its clearing information and Gorski's written report of his trading, it would contact Diaz and accept his word if he said the discrepancy had been reconciled. (Tr. at 600.) Burnes also agreed that if there

[33] Gorski owned a small interest in Wilkund and filled gold orders for the company. He also independently initiated trading positions for Wilkund. (Tr. at 436-37.)

[34] Burnes testified that Wilkund clerks reviewed trades with the opposite trader and slashed through the opposite trader's name if the exchanged information matched up. If the exchanged information was inconsistent, the clerk "wrote it up as an out." (Tr. at 588.) Claims were written on the back of the card and reported to the trader. (Tr. at 588.) If the trader was not available, the clerk would try to contact him at home. If this was unsuccessful, the claim would be left for the next day. (Tr. at 590.) At that time, a clearing sheet listing the trades for each broker was made available. If there was a problem, the clerk checked the trading cards against the clearing sheet. (Tr. at 591.)

were written insertions on Gorski's trading cards that were not in Gorski's handwriting, a clerk probably wrote them. (Tr. at 597.)

The Division offered Lenox's testimony to establish that Gorski made inculpatory comments at a meeting with Division personnel in April 1993. The meeting was arranged so the Division could assess what kind of cooperation Gorski could offer in return for favorable settlement terms. (Tr. at 565.) The conditions applicable to the meeting were reduced to writing and signed by Lenox, Gorski and Gorski's then counsel, Gary Stumpp. One condition authorized the Division to use Gorski's statements at the meeting, as well as evidence obtained directly or indirectly as a consequence of those statements:

> [F]or purposes of cross-examination should Gorski testify, or to rebut any evidence offered by or on behalf of Gorski in connection with the trial of any enforcement proceeding against Gorski.

Div. Ex. 236.

According to Lenox, during the April 1993 meeting Gorski said that he traded non-competitively with Bilello whenever Bilello asked him to do so. (Tr. at 567.)[35] Lenox acknowledged that Gorski stated that he had no recollection of the individual trades included in the challenged trade sequences. He claimed, however, that Gorski reviewed the trading cards for his transactions and confirmed that certain audit trail anomalies that had captured the attention of Division investigators (such as quantity changes, scratch outs, trades that were not recorded,

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[35] Lenox indicated that Gorski explained that:

> [H]e pretty much would do what [Bilello] would ask him to do, because even though he was not technically a local, he was trading on behalf of the firm, that he was essentially trading as a local with most of his income coming from the profit and loss of his own individual trades.
>
> Mr. Bilello stood near him and was trading with a lot of customer paper and it was important for locals to get along with people, and that when asked he would do trades with Mr. Bilello.

(Tr. at 567.)

trades recorded as claims, or not included in Gorski's position count) were indications that the transactions were executed non-competitively. (Tr. at 567-68.)

Lenox recalled that Gorski had a strong reaction to one of the transactions that they reviewed. He testified that the trade involved a $1,000 loss for Gorski, and explained that Gorski had participated with Bilello in this kind of trade with an understanding that he was helping to fill a customer order. (Tr. at 568.) As Lenox recalled it, Gorski became "somewhat angry" when he realized that he had lost $1,000 on this transaction in circumstances where Bilello was essentially taking the other side of his customer's order. (Tr. at 568.) Lenox maintained that this aspect of the meeting stayed with him because Gorski's reaction produced a sort of "emotional shift" in the room. (Tr. at 687.)

On cross-examination, Lenox acknowledged that he did not recall specific circumstances related to the meeting with Gorski. (Tr. at 644, 652, 665.) He also admitted that he could not recall exactly what Gorski said about trading non-competitively with Bilello. (Tr. at 672.) Gorski's counsel asked Lenox several questions about his knowledge of trading terminology. (Tr. at 678.) When asked whether Gorski specifically used the word "non-competitive," Lenox said "[y]es, well, that was the point of the . . . meeting." (Tr. at 681.)

Gorski's counsel also asked Lenox why he did not take notes memorializing Gorski's statements during the meeting. Lenox explained that it was Division policy not to take notes. (Tr. at 654.) Counsel for the Division explained that the Division was involved in a joint investigation with the U.S. Attorney's office and had been asked not to take notes. (Tr. at 655.) When Lenox was asked whether his recollection would be better if he had taken notes, he replied that he was "not prepared to say." (Tr. at 710.)

Gorski focused his defense on the role that he alleged his former clerk, Frank Diaz, played in some of the trades included in the challenged trade sequences. In support of this defense, Gorski presented Sweeney's testimony about events that occurred after Diaz began working for Bilello.

Sweeney testified that, in January 1990, Bilello's clerks made claims on Gorski with a frequency that attracted his attention. (Tr. at 411-12.) He explained that when he raised the issue with Bilello's clerks, they said that in the past Gorski had accepted such claims. (Tr. 412.) According to Sweeney, when he mentioned the issue to Gorski, he (Gorski) expressed surprise about the number of claims and assured Sweeney that he would discuss the matter with Bilello. (Tr. at 413.) Thereafter, Sweeney testified, the claims were substantially reduced. (Tr. at 426.). Sweeney acknowledged, however, that he did not know whether Gorski had allowed other clerks to accept Bilello's claims without his specific authorization. (Tr. 419-21.)[36]

Gorski followed up on Sweeney's testimony by claiming that until Sweeney spoke with him in January 1990, he was not aware that Diaz had been routinely accepting Bilello's claims.[37] He insisted that his policy was to require his clerks to obtain specific permission before accepting claims. (Tr. 416, 445-46, 481.) Gorski also testified that he did not authorize anyone to insert trades on his trading card and never inserted information about trades after the actual time they were executed. (Tr. at 448-49.) Gorski said that he "assumed" that all inserted trades

[36] Sweeney testified that Gorski carefully reviewed his trading cards, but that if he ended with a flat position, Gorski would raise a question only if a money discrepancy emerged. Tr. 416-17; 425. He related that it was Gorski's practice to keep his own copy of his trading cards and that, while trading on the floor, Gorski liked to keep track of whether he was long, short or flat. He testified that when Gorski forgot to keep track, he would let Gorski know his net position. (Tr. 422-23.)

[37] He represented that the number of claims diminished after he spoke to Bilello. (Tr. at 446.)

reflected in the trading cards relating to the challenged trade sequences were written by Diaz or another Wilkund clerk. (Tr. at 449.)[38]

Gorski testified that during the period at issue, he generally would accept a claim from a broker that he knew was trading customer orders. (Tr. at 443, 523.) He said that the process worked differently if the opposite trader was another local. (Tr. at 444-45) He explained that COMEX thought that customers generally deserved fills on their orders and agreed that "[l]ocals often were put in the position of helping [brokers] get those fills." (Tr. at 523.) In this regard, Gorski acknowledged that he did not know whether the broker at issue really had an "out" but generally assumed that the broker "had a problem with the customer." (Tr. at 524.)

Gorski confirmed that he recorded his trades on three-ply trading cards that had a white top copy, a pink carbon and a yellow carbon. (Tr. at 451.) He provided the white copy to his clerks so that they could check his trades, provided the pink copy to Wilkund, and retained the yellow copy himself for a limited period of time. (Tr. at 451-52.)[39] Gorski explained that he prepared a list of the trades he had independently initiated based on the yellow copy of his cards. He faxed a copy of the list to Wilkund after trading closed. (Tr. at 488-90.) He claimed that Wilkund did so many trades that it did not check trade by trade but merely focused on the "profit and loss at the end of the day." (Tr. at 489.)

Gorski testified that if Wilkund discovered a discrepancy between the information he had provided and its other trade records, it would check with his clerks prior to contacting him. (Tr.

[38] Gorski testified that he did not get along with Diaz after they had a confrontation at Gorski's home over Diaz's drug use. (Tr. at 438.) On cross-examination, Gorski acknowledged that prior to his testimony, he had never advised the Division of his suspicion that Diaz accepted claims from Bilello without his knowledge. (Tr. at 535.) In this regard, Gorski claimed that he had forgotten the whole incident until Sweeney reminded him in the previous six months. (Tr. at 535.)

[39] Gorski acknowledged that if he had retained his yellow copies instead of discarding them as he did, it would have been possible to determine whether an "insert" had occurred. (Tr. at 454.)

at 492.) He claimed that he was rarely notified of a problem unless there were a "big out." (Tr. at 493.) He also stated that Wilkund probably would not catch a discrepancy of "up to $1,000." (Tr. at 493.) Finally, he testified that he normally trusted Wilkund to correctly calculate the payment due him, explaining that he "would take their word for it basically, as long as it was within reason." (Tr. at 503.)

During cross-examination, Division counsel questioned Gorski about the handwriting appearing on trading cards that Kozlowski believed included inserted trades. Gorski had difficulty determining whether the handwriting was his own.[40] On redirect, however, Gorski had no hesitancy in identifying trading information that was not in his handwriting. Tr. at 540-44.

Division counsel questioned Gorski about his meeting with Lenox and other Division personnel in April 1993.[41] Gorski said that he neither remembered the meeting nor the letter that he signed prior to the meeting. (Tr. at 550.) When specifically asked whether, at the meeting, he stated that some trades included in the challenged trade sequences were executed non-competitively, Gorski said that he did not recall and did not know "why [he] would say that." (Tr. at 554-55.)

IV.

Following briefing by the parties, the ALJ issued his decision dismissing the complaint as to Gorski. *In re Gorski,* [1998-99 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,742 (ALJ Aug. 23, 1999) ("I.D.").

The ALJ assessed the credibility of only two of the witnesses at the hearing. He expressly found that it was not necessary to assess the credibility of the testimony offered by

[40] *See, e.g.,* (Tr. at 455, 458, 460, 468, 473, 480, 483, 486.)

[41] Both Lenox and Burnes testified as part of the Division's rebuttal case. Consequently, at the time that Gorski was asked about the meeting, he did not specifically know what Lenox would say about his comments.

Sweeney and Gorski. I.D. at 48,518 n. 300.[42] The ALJ addressed the testimony of Hossa, Campanelli, and Schneiderman, but did not specifically address their credibility. In effect, he found that the weight attributable to the facts established by their testimony was insufficient to substantially aid the Division's case. I.D. at 48,508-09.

The ALJ specifically concluded that Lenox's testimony was incredible. I.D. at 48,510-14. He characterized Lenox's direct testimony as either "extremely well-rehearsed" or reflecting the "eloquence of a seasoned attorney," *id.* at 48,510, but indicated that the witness "suffered on cross-examination." I.D. at 48,511. He found it troubling that Lenox had used the Complaint and notes prepared prior to the meeting to refresh his recollection, and observed both that Lenox had memory lapses about what transpired at the meeting and that there had been a decline in Lenox's ability to meaningfully interpret the information he did recall. I.D. at 48,512. The ALJ also emphasized that Lenox's recollection of a discussion about a trade where Gorski lost $1,000 to Bilello in the context of a trade reflecting the indirect bucket or facilitation trade pattern could not be squared with any of the trades included in the challenged trade sequences. I.D. at 48,512-13. Finally, he noted Lenox's insistence that his recollection was "quite strong" after the passage of five years and failure to straight-forwardly acknowledge that contemporaneously-recorded notes could have improved his recollection. I.D. at 48,513.

The ALJ found that the testimony offered by Kozlowski was not credible because it was biased. The judge found that Kozlowski's personal connection to the case suggested that she had an implied bias.[43] Illustratively, he emphasized: (1) her employment by the prosecutor; (2) her

[42] Apparently the ALJ also found it unnecessary to address Burnes's testimony, which related solely to Gorski's defense that he lacked knowledge of Bilello's claims.

[43] The ALJ interpreted this concept in terms of court decisions dealing with bias in members of a jury. He indicated that the determination of implied bias rested on an objective determination that the person at issue "could not help but be biased under the circumstances." I.D. at 48,505 (footnote omitted).

dependence on the prosecutor for job retention, professional advancement, performance bonuses, and recognition for a job well done; (3) her limitation of her professional associations primarily to prosecutors; and (4) her involvement in nearly every aspect of the case up to and including the oral hearing. I.D. at 48,505.

Second, the ALJ noted that Kozlowski had not responded to evidence suggesting that not every variation between information a COMEX trader recorded on his trading card and the COMEX price change register amounted to reliable evidence that the trade was executed non-competitively. The judge interpreted Kozlowski's testimony as implicitly assuming either: (1) that COMEX members voluntarily complied with the requirement that they record the time for each trade to the nearest minute; or (2) that COMEX had eliminated non-compliance by strictly enforcing an absolute one-minute standard. I.D. at 48,506. He contrasted these assumptions with information that he drew from the Division of Trading and Markets' 1988 audit of COMEX trading which, in the judge's view, indicated that "in ordinary trading on the COMEX floor, the one-minute rule was often honored in the breach." I.D. at 48,507. Finally, he noted that he had raised the 1988 audit report at the November 1996 prehearing conference, but that armed with the knowledge that the report undermined a portion of her analysis "Kozlowski apparently did nothing." *Id.* In light of these factors, the ALJ explained that:

> Regardless of the precise nature of the [Kozlowski's] bias, it is a bias that favors the Division in this case and a bias that seems to have affected her analysis. Accordingly, even if Kozlowski's unorthodox methods had not discredited her opinions to the point of insignificance, her bias would have done so substantially.

Id.

The ALJ based his conclusion that Kozlowski's methods were unorthodox on his application of standards that the United States Supreme Court had discussed in *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993) ("*Daubert*"), and *Kumho Tire Co., Ltd. v.*

Carmichael, 526 U.S. 137 (1999) ("*Kumho Tire*").[44] In describing these standards, the ALJ offered brief quotes from recent decisions by United States Courts of Appeals and District courts and a variety of articles in learned journals *See generally* I.D. at 48,496-99. In light of these standards, the judge offered an extended critique of the Division's analysis of the challenged trade sequences. *Id.* at 48,499 *et seq*.

The ALJ began by noting what he considered to be gaps in Kozlowski's training and experience.[45] He then turned to what he described as a failure to demonstrate that her method was one of those generally accepted for drawing reliable inferences from market data. In this regard he found that:

> [T]here is no indication that academics, consultants or others who want to understand trading with some level of reliability close to what this and other courts demand use such soft, standardless methods in reaching conclusions or testing ideas.

I.D. at 48,502 (footnote omitted). He also stressed that the Division had not tested the accuracy of its underlying premises or the validity of its methods. In addition, he criticized the failure to

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[44] The ALJ stated that the Commission had adopted the *Daubert/Kumho* approach to evaluating expert testimony in *In re Ashman*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,336 (Apr. 22, 1998) *("Ashman")*, I.D. at 48,496, and had relied on it in discussing issues in *In re Zuccarelli*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,597 (CFTC April 15, 1999) ("*Zuccarelli*"). *See id.* at n.88. The Commission's *Ashman* decision involved a statutory disqualification from registration. It included a brief discussion of the difference between the character witnesses that Ashman presented and those that had testified in two cases previously resolved by the Commission. *Ashman*, ¶ 27,336 at 46,549. The *Zuccarelli* decision referred to the *Ashman* discussion in explaining the factors it would consider in evaluating the weight properly accorded to a lay opinion on the subject of respondent's rehabilitation since the time of his wrongdoing. *Zuccarelli*, ¶ 27,597 at 47,833.

[45] He emphasized that:

> There is no indication that Kozlowski received any training in mathematics, statistics, econometrics or quantitative sociology. Similarly, the record does not show that she studied any other courses related to compiling market data, and drawing inferences from the data or testing theories based on the observations of market phenomena or other social phenomena. Similarly, it is unclear as to whether her education included any economics or finance studies beyond – or even at – a rudimentary level. Finally, there is no proof that she received any instruction in the implementation of the scientific method (as it relates to either science or social science) of proceeding from observation to what would be considered validated knowledge.

I.D. at 48,501 (footnotes omitted).

enunciate standards or thresholds other than plausibility, and claimed that the Division had attempted to mask this deficiency by using "vague quasistatistics." *Id.*[46]

The ALJ faulted the Division's analysis of the significance of the patterns in some of the challenged trades because it did not quantify either the likelihood that the identified patterns would occur in competitive trading or the level of recurrence of the pattern that met the requirement for the category "repeated occurrences." I.D. at 48,502. He emphasized that the Division had not gathered general market data and that Kozlowski did not record her own observations of competitive trading contemporaneously. In addition, he noted that the Division apparently had not considered whether the distribution of dual traders in the gold pit (which the ALJ identified as an important contributor to the patterns that the Division identified) was similar to the distribution in the other pits that Kozlowski had observed. Finally, the judge observed that the Division did not consider whether deviations from the norm were due to something other than chance. I.D. at 48,503.

In light of these factors, the ALJ found that "the stated quantitative basis for [Kozlowski's] testimony seems to rest on nothing more than intuition." I.D. at 48,503.

Finally, the ALJ turned to the Division's analysis of audit trail irregularities. In his view, this analysis failed to properly distinguish between causation and coincidence. He emphasized that the Division merely considered whether the observed irregularities could have occurred in the context of a non-competitive trade and made "observations about coincidental and sequential occurrences in one context and, from those observations, proceed[ed] directly to conclusions of causation." I.D. at 48,504 n.173.

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[46] The judge essentially found that Schneiderman's testimony indicating that COMEX used a methodology similar to Kozlowski's in evaluating its member's trades was inapposite because the exchanges "seem[ed] to use [the methodology] as an investigative tool." I.D. at 48,502 and n.147. He also found it unimportant that Commission adjudicatory decisions resolving trade practice allegations had "looked favorably upon the type of testimony" that Kozlowski offered, apparently because those decisions did not follow the "*Ashman* approach." *Id.*

The ALJ then summarized his evaluation of Kozlowski's testimony:

> However logically and reliably Kozlowski proceeded from her initial premises, the Court cannot find those premises reliably formed. They have no basis in academic literature. They have no basis in any other deliberate study. They have no basis in logic. Instead, their only basis appears to be Kozlowski's gut feeling. *Ashman's* adoption of *Daubert*'s principles requires the Court to consider the reliability of her methods. Kozlowski has not shown her methods to be trustworthy and, instead, the Division asks the Court to simply trust her intuition. The Court cannot follow Kozlowski's leaps of intuition with its own leap of faith.

Id. at 48,504.

Having set aside Kozlowski's opinions on the ultimate issues as "inherently unreliable," I.D. at 48,507, and entitled to no weight, the ALJ considered whether the Division could prevail in light of the other evidence in the record. The ALJ determined that the testimony offered by Hossa, Schneiderman, and Campanelli was insufficient and that the Division's statistical analysis did not address fundamental concerns such as how frequently the cited irregularities occurred during competitive trading. I.D. at 48,508-10.[47]

Finally, the ALJ addressed the inferences arising from the circumstantial evidence established on the record. He offered this general characterization:

> The circumstances in this case are suspicious. This is because they are consistent with the Division's theory of the case regarding Gorski and, to some degree, consistent with prior cases in which the Commission has found liability. However, the circumstantial evidence is also consistent with theories under which Gorski was not a knowing participant in non[-]competitive trading.

I.D. at 48,514. In discussing how to resolve this apparent dilemma, the ALJ noted that he lacked substantial experience adjudicating the merits of trade practice cases, I.D. at 48,515, and that cases decided by the Commission or courts were not helpful because the guidance provided was "fact specific and often provided in summary form." *Id.* Finally, he explained that common

[47] The ALJ also commented that, while the statistics suggested that Gorski's trading opposite Bilello differed from his trading as a whole, they did not indicate whether his trading opposite Bilello was unique in the context of his trading as a whole or that, on a trader-by-trader basis, Gorski's trading opposite Bilello significantly exceeded the mean. *Id.*

sense was not a reliable basis for making the required determination, emphasizing that "[a]dvances in science and the social sciences have repeatedly demonstrated the inaccuracy of common sense." *Id.* (footnote omitted).

Given his conclusion that he lacked workable tools, the ALJ determined that he could not "make the inferences necessary to find violative conduct on Gorski's part with the requisite certainty." I. D. at 48,517. Accordingly, he dismissed the Complaint against Gorski due to a failure of proof.

V.

The Division filed a timely appeal from the ALJ's decision and submitted an appeal brief in November 1999. It challenged the ALJ's negative credibility assessment of Lenox and Kozlowski. The Division argued that the ALJ erred by rejecting all of Lenox's testimony due to flaws that were isolated and relatively minor. It claimed that it was natural that Lenox remembered more about the main point of the April 1993 meeting –whether Gorski could provide the Division with potentially useful testimony about the challenged trades—than the sanctions discussed or the details of setting up the meeting. In addition, the Division argued that, contrary to the ALJ's analysis, the circumstances of trade sequence 34 were consistent with Lenox's testimony about Gorski's remarks regarding a trade sequence where he lost $1,000 to Bilello.

As to Kozlowski's alleged bias, the Division emphasized that both Commission and court precedent recognize that an inference of bias does not arise from an expert witness's employment by the Division and or supervision by Division attorneys prosecuting the case. In addition, it argued that the ALJ gave undue weight to Kozlowski's purported failure to consider the Division of Trading and Market's 1988 COMEX audit in determining the weight properly accorded to discrepancies between the information recorded by traders and information reflected in the COMEX price change register. In this regard, the Division emphasized that Kozlowski never gave controlling weight to such a discrepancy, but rather considered it in the context of other evidence of a suspicious pattern or additional irregularities. In addition, it noted that the 1988 COMEX audit indicated that, for 87 percent of the trades examined, the times recorded by traders were consistent with COMEX's one-minute requirement.

The Division claimed that the ALJ had misinterpreted the guidance that the Supreme Court had offered in *Daubert* and *Kumho Tire*. The Division noted that because the ALJ found that Kozlowski provided "social-science-based opinion," he applied standards similar to those the Supreme Court discussed in *Daubert*, a case involving expert scientific testimony. The Division argued, however, that the type of experience-based testimony that Kozlowski offered was more properly evaluated under the more flexible standards that the Supreme Court discussed in *Kumho Tire*. In this regard, the Division contended that the ALJ erred by ignoring the Supreme Court's acknowledgement that the list of factors identified in *Daubert* may not be pertinent depending on the nature of the issues presented, the particular expertise of the witness, and the subject of her testimony.

Finally, the Division argued that the ALJ had erred in evaluating the significance of two factors that clearly demonstrated the reliability of Kozlowski's methodology. First, it noted that the ALJ's finding that futures exchanges used Kozlowski's methodology only as an investigatory tool could not be squared with Commission opinions reviewing exchange disciplinary decisions that imposed sanctions for trade practice violations. Division Appeal Brief at 22, *citing In re Clark*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,370 (CFTC July 22, 1998). Second, the Division emphasized that the Commission itself has relied on suspect trading patterns, in combination with audit trail and other evidence, as a basis for determining whether trades were non-competitive.

According to the Division, the acceptance of Kozlowski's methodology by the Commission and commodity exchanges, without more, was sufficient to demonstrate the reliability of Kozlowski's opinion testimony. It argued that this approach to reliability was comparable to the "common sense inquiry" that the United States Court of Appeals for the Tenth Circuit used to assess the reliability of opinion testimony offered by a police officer with specialized knowledge of drug trafficking in *United States v. Muldrow*, 19 F.3d 1332, 1337 (10^{th} Cir. 1994).

The Division then discussed audit trail and other irregularities, emphasizing that three of the challenged trade sequences involved claims for both a purchase and sale, 19 involved insertions of a purchase or sale on Gorski's trading cards, and five involved an increase in the size of a position that Bilello had established for a customer followed by a trade for the same amount on the opposite side of the market for Bilello's own account. It also mentioned that there were discrepancies between the information recorded on trading cards and COMEX's price change register and that several of Gorski's trades involved a position larger than that which Gorski normally traded.

Finally, the Division emphasized Gorski's posthearing argument that 19 of the challenged trade sequences involved claims that Bilello had arranged with Gorski's former clerk Diaz. The Division treated this argument as a concession of non-competitive trading by Gorski and argued that, regardless of whether he actually knew of Diaz's actions, Gorski should be held vicariously liable for the wrongdoing.[48] It also noted that the characteristics of the 19 trade sequences identified by Gorski are consistent with those Kozlowski found material in analyzing the remainder of the challenged trade sequences.

In his answering brief Gorski argued that the ALJ justifiably concluded that the Division's primary expert was unreliable and biased. Gorski's Answering Brief at 21-22. In addition, Gorski emphasized post-*Daubert* decisions indicating that trial judges have significant discretion in determining how to go about assessing the reliability of the testimony offered by a particular expert witness.

Gorski also defended the ALJ's negative assessment of Lenox's credibility. He argued that Lenox's lack of recollection was surpassed only by his lack of understanding of basic aspects of futures trading. In addition, he claimed that a review of the record showed that Lenox's testimony was "misleading and evasive" and "lacking [in] candor." *Id.* at 33.

Gorski claimed further that the testimony he, Sweeney, and Burnes offered showed that Diaz and Bilello had conspired against him. He disputed the Division's claim that he failed to raise this point until the hearing, arguing that notes taken by the counsel who represented him at his April 1993 meeting with Division personnel showed that he had mentioned that Bilello's claims stopped after he hired a "new clerk." *Id.* at 20. In addition, Gorski emphasized that the Division had failed to call Diaz to refute the testimony about the conspiracy offered by his witnesses. As for his alleged admission that some of the 19 trade sequences affected by the conspiracy included trades in his writing, he noted that his responses during his deposition were

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[48] The Division asserted that Gorski's testimony regarding Diaz was not credible. It noted that Gorski testified at the hearing that trades in three of the 19 trade sequences that he identified were recorded in his handwriting. The Division also claimed that Gorski offered similar testimony during his investigatory deposition -- albeit with varying degrees of certainty -- as to trades in six more of the group of 19 identified sequences. Division Appeal Brief at 50. The Division also pointed out that Gorski learned about Diaz's conduct in January 1990, but did not raise a defense based on the conduct until the hearing in 1998.

equivocal and that he had corrected errors in his testimony at the hearing following an "initial bout with nerves." *Id.* at 21.

Gorski also challenged the Division's claim that his identification of 19 trade sequences affected by the Diaz/Bilello conspiracy amounted to a concession of culpability. In this regard, Gorski emphasized Commission precedent holding that the Division must establish that a respondent's participation in a trade practice violation was knowing. *Id.* at 18-19. As for the circumstantial evidence, Gorski reiterated his posthearing claim that the Division's showing amounted to nothing more than suspicious circumstances.[49]

DISCUSSION

I.

We begin with the Division's challenges to the ALJ's credibility determinations. Commission precedent recognizes that a presiding officer's access to demeanor-based evidence confers certain advantages in determining witness credibility. Consequently, the Commission normally defers to a presiding officer's credibility determinations in the absence of clear error. *In re Mayer,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,259 at 46,136 n.63.[50]

Lenox testified about a meeting that had taken place more than five years before he testified. He did not take any notes during the meeting and did not record his recollection of the discussion at any time during the five-year interval. The ALJ did a careful analysis of the

[49] In this regard, Gorski criticized Kozlowski's analysis for: (1) giving significant weight to trades reflecting a particular pattern but no weight to the fact that the vast majority of his trades did not reflect such a pattern; (2) failing to articulate a standard for determining whether an observed pattern was the result of something other than random chance; and (3) consistently drawing negative inferences from certain irregularities (such as an error in a position count or Bilello's customer receiving a less favorable price when trading with him) but never drawing a positive inference from the absence of such irregularities.

[50] On the other hand, the Commission has held that a credibility determination does not warrant deference when it rests on derivative, rather than testimonial, inferences and is "strongly contradicted by other compelling evidence." *In re Elliott*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,243 at 46,007 (CFTC Feb. 3, 1998).

apparent flaws in Lenox's testimony. The ALJ also specifically found that Lenox's demeanor on cross-examination undermined his credibility. I.D. at 48,514.

Notwithstanding the ALJ's ability to observe the witness, our review of the entire record reveals that the ALJ's characterization of Lenox's testimony as "evasive" or designed to "mislead the Court in his capacity as a witness," is a harsh exaggeration. The Division correctly notes that it would be unreasonable to expect Lenox to remember the details of a meeting held five years earlier. In the context presented, however, these problems with the ALJ's credibility assessment do not rise to the level of clear error. Indeed, our review of the record confirms the ALJ's finding that the only disputed trade sequence involving Gorski's loss of $1,000 to Bilello does not include circumstances that would normally lead a trader to believe that the opposite trader was seeking to indirectly bucket a customer's order. Consequently, the record does not justify an exception to our deference policy in the context of Lenox's testimony.

We regard the ALJ's remarks concerning Kozlowski's alleged bias as a type of indirect credibility determination. Consequently, we have considered whether it was the product of clear error. We conclude that it was, and decline to give it deference.

Commission precedent clearly holds that bias cannot be inferred simply because a proposed expert witness is a Division employee who has acted as an investigator with respect to the case at issue. *In re Citadel*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,082 at 32,189 (CFTC May 12, 1986). Indeed, courts have allowed experts with a similar interest in the outcome of a prosecution to testify in criminal proceedings. *See U.S. v. Abonce-Barrera*, 257 F.3d 959 (9th Cir. 2001) (holding that a district court did not abuse its discretion when it qualified an undercover agent who participated in the recorded conversations as an expert regarding the transcription and translation of tapes of the conversation).

Rather than apply this straightforward guidance, the ALJ chose to apply federal cases discussing the doctrine of "implied bias." The ALJ acknowledged that courts developed this doctrine in the context of assessing an individual's fitness to act as a juror in a criminal case, yet, without explanation, implicitly concluded that the standard derived from that doctrine was an appropriate guide for assessing the bias of an expert witness in an administrative proceeding before an ALJ. This was a clear error.[51]

In any case, the ALJ's remarks concerning Kozlowski's response (or lack of response) to the Division of Trading and Markets 1988 COMEX audit are misplaced. Respondent's counsel made limited use of the 1988 COMEX audit in his cross-examination of Kozlowski. When questioned on the issue, Kozlowski acknowledged the 13 percent error rate discussed in the audit and conceded that there were sometimes errors in the price change register. When asked about the appropriate period to examine when trying to determine whether a broker had properly filled a stop order, Kozlowski agreed that, depending upon market conditions, a time period between one and two minutes would not be unreasonable. This response suggests that Kozlowski recognized that it was reasonable to analyze information reflected in the price change register in the context of a range of times rather than the single time indicated. Neither respondent's

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[51] The "implied bias" doctrine was developed in the context of protecting the right to a jury trial guaranteed by the Sixth Amendment to the United States Constitution. That amendment does not apply in the context of administrative adjudications. Moreover, respondent's interest in this case is simply not comparable to the interest of a criminal defendant.

The ALJ's analysis also ignored critical contextual differences between the role of a juror in a criminal case and the role of an expert witness in an administrative adjudication. Most jurors lack training or experience with the adjudicatory process. Moreover, to protect the independence of jurors, there are only limited checks on a juror's role in the decision-making process. Experts in administrative proceedings, in contrast, generally have experience with the process and understand the nature of their role in the process. They testify in public and are subject to cross-examination. As this case demonstrates, they are subject to a significant risk of reputational harm from arguments made by opposing counsel and comments offered by judges who disagree with the positions they advocate. Finally, the testimony offered by one expert is generally balanced by the testimony offered by an opposing expert. Given these distinctions, there is no basis for concluding that the bias standard applicable to an expert testifying in an administrative proceeding should be comparable to the bias standard applied to a potential juror in a criminal case.

counsel nor the ALJ, however, chose to follow-up by questioning Kozlowski about the implications this apparent concession had for her analysis.

Finally, as discussed below, our independent review of the record leads us to reject material elements of Kozlowski's analysis. Nevertheless, it does not disclose any reliable basis for questioning the *bona fides* of Kozlowski's views. Kozlowski's willingness to maintain her view in the face of the ALJ's evident disdain for her common-sense approach to analyzing trade practice disputes evidences nothing more than the vigorous disagreement that should be expected in the context of a healthy adjudicatory process. The ALJ erred by treating it as evidence of bias.

II.

As noted above, the ALJ failed to assess the credibility of the testimony offered by several witnesses. Because we find that a determination of Gorski's credibility is necessary to our independent review of the factual record, we have undertaken that task ourselves.[52]

Gorski's testimony suggested that he was the victim of a conspiracy between Bilello and Diaz. He also claimed that he was unaware of some of the trading irregularities emphasized by the Division or that the irregularities were an innocent product of trading conditions and his informal approach to record keeping.

His testimony, however, was inconsistent with his own version of the events at issue. For example, in his posthearing brief Gorski claimed that 19 of the challenged trade sequences involved trades that Diaz arranged with Bilello without Gorski's knowledge. At different times, however, Gorski acknowledged that he recorded several of the trades that play a role in the 19 trade sequences in his own handwriting. Moreover, as noted above, Gorski initially had great

[52] The ALJ apparently took this step in the interest of decisional efficiency. We note, however, that a failure to fully develop the record at the trial level often results in significant inefficiencies at the appellate level. With this in mind, presiding officers should err on the side of completeness in developing the record and making credibility determinations.

difficulty in determining whether the handwriting on certain trading cards was his. When questioned by his own counsel, however, Gorski showed little hesitancy. While Gorski claims that he simply corrected his testimony after a bout with nerves, his benign explanation is simply unconvincing.[53]

There is also a fundamental conflict between Gorski's own testimony about his policy of accepting claims relating to customer orders and his defense alleging that Diaz conspired with Bilello. Gorski testified that during the period at issue, he generally would accept a claim from a broker that he knew was trading customer orders. He explained that COMEX thought that customers generally deserved fills on these orders and agreed that locals often were put in the position of helping brokers get fills. Gorski also acknowledged that he often did not know whether the broker at issue really had an out trade, but generally assumed that the broker had a problem with the customer.

The record shows that Bilello was trading for customers in more than half of the trade sequences that Gorski identified as affected by Bilello's alleged conspiracy with Diaz. It seems unlikely that Diaz would have risked dismissal by failing to seek Gorski's approval for claims raised in a context consistent with Gorski's self-professed policy of agreeing to any claim that apparently involved a customer order.[54] Therefore, we decline to credit Gorski's testimony.

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[53] The Division also points out that Gorski learned about Diaz's conduct in January 1990, but did not raise a defense based on the conduct until the hearing in 1998. Gorski counters by claiming that former counsel's notes show that at the April 1998 meeting with Division personnel, he mentioned that there had been a change in his claims after he hired a new clerk. Because Gorski did not introduce the notes into evidence, we decline to give them any weight. In any case, in his own testimony, Gorski acknowledged not raising the issue and offered the incredible excuse that he had forgotten the whole incident until Sweeney reminded him. *See supra* at note 37 and related text.

[54] Gorski also fails to explain how many of the trade sequences he identified fit within the common understanding of claims. In many instances, the trade sequences he identifies involve information written on the front of trading cards rather than information recorded on the back of the card, where claims were generally recorded. Writing information on the front of the card would be more likely to come to Gorski's attention because, as he testified, he did not authorize his clerks to insert information on the front of his cards.

III.

For the benefit of the adjudicatory process, we briefly address some of the Division's objections to the ALJ's sharp criticism of its conduct during this proceeding.

The ALJ was straightforward in acknowledging that his analysis of the record in this case did not follow the approach that both the Commission and reviewing courts had employed in previous trade practice cases. *See, e.g., In re Rousso,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,133 (CFTC Aug. 20, 1997), *aff'd sub nom. Rousso v. CFTC,* No. 97-4232 (2d Cir. March 11, 1998); *In re Reddy*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,271 (CFTC Feb. 4, 1998), *aff'd sub nom. Reddy v. CFTC,* 191 F.3d 109 (2d Cir. 1999); *In re Mayer*, CFTC Docket No. 92-21, 1998 WL 80513 (CFTC Feb. 25, 1998), *aff'd sub nom. Reddy v. CFTC*, 191 F.3d 109 (2d Cir. 1999); *In re Elliott*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,243 at 46,007 (CFTC Feb. 3, 1998), *aff'd sub nom. Elliott v. CFTC*, 202 F.3d 926 (7^{th} Cir. 2000).

While criticizing that approach from several perspectives,[55] the ALJ apparently recognized that he was not authorized to disregard Commission or court precedent merely because he disapproved of the underlying reasoning. Consequently, he offered two rationales for adopting a new approach. First, he suggested that the Commission had adopted a new approach to the evaluation of expert testimony in its *Ashman* and *Zuccarelli* decisions. Second, he suggested that the Commission was bound by the principles the Supreme Court enunciated in *Daubert* and *Kumho Tire*.

[55] For example, the ALJ claimed that in *Rousso* and *Reddy*, the Commission "never looked beneath the surface" of the opinions offered by the Division's expert and "never considered the weight of the opinions independently." I.D. at 48,496 n.82. He also suggested that the approach that both the Commission and courts had followed condoned decisionmaking based on relationships that were "asserted" rather than "demonstrated." I.D. at 48,515.

Neither *Ashman* nor *Zuccarelli*, however, purported to establish a new approach to the evaluation of expert testimony. Nor did either suggest that there were any shortcomings in the traditional approach to evaluating evidence relevant to resolving trade practice disputes. Finally, neither case suggested that the Commission was adopting the Federal Rules of Evidence as a guide to determining the admissibility of expert testimony.[56]

Moreover, in a decision rendered after the ALJ issued his initial decision, the United States Court of Appeals for the Seventh Circuit held that administrative agencies are not required to follow the approach to evaluating expert testimony enunciated in *Daubert* and *Kumho Tire*. *See Peabody Coal Co. v. Jane W. McCandless and Director, Office of Workers' Compensation Programs*, 255 F.3d 465 (7th Cir. 2001). The court's opinion did indicate that that the *policies* underlying *Daubert* and *Kumho Tire* played a role in the review of expert agency decisions. It

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[56] The *Ashman* decision made its single reference to *Daubert* in a footnote. In the context of distinguishing the type of character testimony offered by Ashman from the type of character testimony it had analyzed in two earlier decisions, the Commission explained that:

> Ashman's expert witnesses had formal training and professional experience to support a claim of "scientific, technical, or other specialized knowledge" concerning whether Ashman poses a future threat to the markets. *Cf.* Fed. R. Evid. 702. Where such formal training and experience in a field of behavioral study is present, whether as a probation officer, a social worker, a psychologist, or otherwise, a suitably trained and experienced person may qualify as an "expert" with respect to questions of rehabilitation. *See Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 590 (1993) ("[T]he requirement that an expert's testimony pertain to 'scientific knowledge' establishes a standard of evidentiary reliability"). Even where a witness is so qualified, however, the weight to be accorded to such a person's testimony will depend on what the expert says and what basis the expert has for saying it, and not solely on his or her credentials.

Ashman, ¶ 27,336 at 46,549 n.55. Notably, in examining what Ashman's experts said and their bases for saying so, the Commission's Ashman decision did not apply or even refer to the Daubert factors emphasized by the ALJ. Moreover, the Commission issued several decisions involving expert testimony after *Ashman* that did not refer either to a purported "*Ashman* approach" or to the Supreme Court's decisions in *Daubert* or *Kumho Tire*.

specifically held, however, that *Daubert* did not apply directly, "because it is based on Fed. R. Evid. 702 which agencies need not follow." *Id.* at 469.[57]

Finally, we think there is merit in the Division's claim that the ALJ mischaracterized the nature of Kozlowski's testimony in the process of justifying his application of the standards specifically discussed in *Daubert*. *Daubert* involved an analysis of scientific evidence and the Court provided a list of relevant factors that was designed for this special class of evidence. Nevertheless, *Daubert* itself emphasized that the factors it listed were neither exhaustive nor dispositive. *Daubert, supra* at 594.

After *Daubert* was issued, several courts held that its gatekeeper analysis was limited to scientific experts. The Supreme Court rejected this view in *Kumho Tire*, but emphasized that not all of the specific factors identified in *Daubert* are applicable to every kind of expert testimony. *Kumho*, 526 U.S. at 138 ("*Daubert* factors do *not* constitute a definitive checklist or test") (emphasis in original). Courts applying *Daubert* and *Kumho Tire* have consistently

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[57] Even if we had directed the ALJ to apply the policies underlying *Daubert* and *Kumho Tire*, we would have to conclude that his application of those policies was flawed. The central premise of these cases is the importance of the "gatekeeping" role played by the person responsible for ensuring the reliability of the record used to make factual determinations. Consequently, *Daubert* established a test for the *admissibility* of expert testimony. Properly applied, the standards established in *Daubert* and *Kumho Tire* prevent unreliable expert testimony from becoming a part of the factual record in a proceeding.

That is not what occurred here. The ALJ's remarks during the November 1996 prehearing conference made it clear that he had substantial doubts about the reliability of Kozlowski's testimony at that stage of the proceedings. The ALJ did not conduct a hearing in this matter until July 1998. By that time, both the Commission's *Ashman* decision and the Supreme Court's *Daubert* decision had been issued. Nevertheless, neither respondent's counsel nor the ALJ raised a challenge to the *admissibility* of Kozlowski's testimony. Indeed, at no time during this proceeding has any party suggested that Kozlowski's testimony was insufficiently reliable to warrant admission under Commission Rule 10.67. As a consequence, the Division had no occasion to address the admissibility issue.

By delaying his application of the *Daubert* factors until after the hearing was completed, the ALJ essentially denied the Division a fair opportunity to develop the record. Had the Division been aware that the ALJ regarded the testimony of its primary expert as so unreliable that it was inadmissible, it surely would have litigated its case in a different manner. It might have introduced different evidence or sought interlocutory review of that ruling, potentially leading to a quicker resolution of the case. In effect, the ALJ admitted Kozlowski's expert testimony at the hearing and then essentially reversed himself after the record was closed. This is not the process that the Supreme Court contemplated when it emphasized the importance of a gatekeeper in *Daubert*.

recognized that factors applicable to scientific testimony are not appropriate guides to assessing the usefulness of testimony based on expertise developed through direct observation and experience. *See McCullock v. H.B. Fuller Co.*, 61 F.3d 1038, 1042-43 (2d Cir. 1995) (consulting engineer's extensive practical experience established his qualifications to testify as an expert in products liability action against manufacturer of hot-melt glue on the issue of whether plaintiff was within the "breathing zone" of glue fumes in the workplace); *U.S. v. Locascio*, 6 F.3d 924, 937 (2d Cir. 1993) (FBI agent properly qualified as expert on the inner workings of the Gambino crime family); *Betterbox Communications, Ltd. v. BB Technologies, Inc.*, 300 F.3d 325, 327-28 (3d Cir. 2002) (basis of the specialized knowledge of an expert witness can be practical experience).

In *Gorski*, the Division's expert examined the trading cards of Gorski and Bilello and drew conclusions from the trade configurations and audit trail evidence. When asked about the basis for her assessments, Kozlowski did not focus on the statistical summaries that the Division submitted after the November 1996 prehearing conference. Instead, she straightforwardly acknowledged that she relied on:

> [O]bservations, in looking at numerous, numerous trader's activities over the years and looking at trading cards, has been that that pattern does not occur frequently and certainly does not occur frequently involving the same individuals.

(Tr. at 265.) This remark quite clearly suggests that Kozlowski was offering testimony based on her experience and observations rather than the "formal methods" of "empirical social science." I.D. at 48,492 n.55. The kind of expert testimony Kozlowski offered on behalf of the Division has long been treated as admissible expert testimony in Commission trade practice cases. *See Rousso*, ¶ 27,133; *Reddy*, ¶ 27,271. It is also the type of admissible expert testimony that respondents often present in such cases. *See, e.g., In re Buckwalter*, [1990-1992 Transfer

Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,995 (CFTC Jan. 25, 1991). Such testimony remains an admissible form of expert testimony, consistent with Commission and federal court precedent. While we are not adopting Fed. R. Evid. 702 for use in Commission proceedings (*see Peabody Coal*, 255 F.3d at 469), that rule provides guidance and support for the notion that expert testimony of the type Kozlowski offered is admissible expert testimony in Commission proceedings. Fed. R. Evid. 702 explicitly provides that admissible expert testimony may be based upon *"specialized knowledge"* as well as "scientific and technical knowledge." Fed. R. Evid. 702 also makes it clear that a witness may qualify as an expert "by knowledge, skill, experience, training or education." Kozlowski's expert testimony, based upon her specialized knowledge in the field of commodity futures and options trading, and supported by her observations of trading in the commodity pits, clearly falls within the range of expert testimony contemplated by Fed. R. Evid. 702. Accordingly, the ALJ erred by failing to perform the reliability analysis in the context in which the testimony was offered.

IV.

In assessing the significance of factors established on the record, we continue along the "facts and circumstances" path recently endorsed by both the Second and Seventh Circuits. We recognize that this approach draws largely on experience with trading behavior in the context of open outcry exchange systems and principles derived from common sense, and must be applied with an appreciation of its limits. As our precedent acknowledges:

> The real issue before us is the identification of the dividing line between circumstantial evidence that is a reliable basis for the factual inferences necessary to liability and circumstantial evidence that is so ambiguous that no reasonable trier of fact would deem it a reliable basis for such inferences.

Buckwalter, ¶ 24,995 at 37,684. When identifying this line in the context of a particular set of facts, we must balance those policies served by sanctioning knowing wrongdoers with "appropriate concern for the effect our linedrawing may have on legitimate trading activity." *Id.*

Our independent review of the record shows that Kozlowski's analysis does not give sufficient weight to the importance of maintaining the appropriate balance. In identifying suspicious trading patterns, Kozlowski primarily focused on the alleged goal of the trade sequence rather than the reason that the trading pattern was suspicious. Commission decisions discussing pattern evidence generally focus on a pattern or configuration that leads to a wash result. *See Reddy*, ¶ 27,271 at 46,211 ("respondents' explanation for the frequent wash results lacks broad applicability and is an inadequate explanation for the pattern of trading and audit trail irregularities observed in this case"); *Rousso,* ¶ 27,133 at 45,308 ("The Division's expert identified repeated instances of trading in which respondents traded opposite each other at about the same price and about the same quantity within a very short period of time"); *Mayer*, ¶ 27,259 at 46,135 ("The NYMEX streetbook indicates that [respondent] repeatedly traded, for the Mayer family accounts, the opposite sides of the same or similar quantity of the same commodity at the same price with the same individuals within very short time intervals. This pattern strongly supports the inference that the trades were noncompetitive.") As these cases indicate, the configuration that leads to a wash result involves: (1) the purchase and sale of (2) the same quantity of (3) the same month of (4) the same futures contract at (5) the same (or a similar) price. Precedent clearly links the suspect pattern to "characteristics unlikely to occur in an open and competitive market." *Rousso*, ¶ 27,133 at 45,308.

Wash results are suspicious and unlikely to occur in an open and competitive market because they are not an economically viable outcome for a trader conducting business in the long run.[58] Decisions recognize, however, that wash results may be the product of a strategy focused on earning small profits while strictly limiting risk. Consequently, precedent has acknowledged that traders who scalp the market are more likely to generate an unusual volume of trades reflecting a pattern leading to a wash result. *See generally, In re Rosenberg*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,992 (CFTC Jan. 25, 1991) (holding that neither the Division's expert nor the ALJ had given proper consideration to respondent's testimony that his status as a market maker explained his frequent involvement in transactions achieving a wash result).

Some of the trade sequences that Kozlowski analyzed reflect this suspicious trading pattern, because, by its nature, an "indirect" bucket includes an accommodating trader who is willing to assist the floor broker initiating the transaction at least partly *because he can negate his risk by achieving a wash result*. The wash result embedded in trade sequences leading to Gorski's taking the other side of his customer's order warrants further investigation because it suggests that the wash result was intentional rather than the best available outcome in unfortunate circumstances.

There is no wash result embedded in the trade sequences that Kozlowski identified as facilitation trades. Gorski's participation in these trade sequences resulted in either an outright position or a spread position. Such a result cannot properly be described as having "characteristics unlikely to occur in an open and competitive market," and Kozlowski's testimony never addressed why she believed that the specified trade sequences had a suspicious trading pattern.

[58] Traders generally incur a per-transaction cost when they trade. Consequently, buying and selling at the same price is generally a losing proposition. The result may be the best available outcome in circumstances where risk of loss is greater than the opportunity to earn a profit.

Gorski's participation in these trade sequences does have some common elements: (1) both a purchase and sale of gold futures contracts (2) within a short period of time (3) with Bilello. These common elements are arguably significant in view of Kozlowski's testimony that she would expect a scalper such as Gorski to trade proportionally with all the traders in his vicinity rather than disproportionately with Bilello. During her cross-examination, however, Kozlowski conceded that she would not be surprised that Gorski traded less with three specified traders who stood in his vicinity.

More importantly, Kozlowski did not offer a reliable basis for concluding that scalpers trade proportionally with the other traders in their vicinity. Our experience with trading behavior in the context of open outcry exchange systems does not support an inference of such proportionality, and it seems somewhat contrary to common sense.[59] We cannot independently determine how Kozlowski's training and experience put her in a position to reliably determine this fact. In these circumstances, the so-called facilitation pattern is not a reliable guide to determining whether Gorski knowingly participated in trade practice violations.[60]

In examining trade sequences with an embedded wash result, we often look for audit trail irregularities that suggest the wash result was intentional rather than the best available outcome in unfortunate circumstances. Irregularities are especially meaningful when the record

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[59] For example, limiting trading to one or two responsible traders in your vicinity would likely limit the likelihood of trading disputes and increase the likelihood that disputes could be resolved amicably.

[60] Similarly, the Division fails to explain why what it identifies as a money pass pattern has "characteristics unlikely to occur in an open and competitive market." Indeed, the trades included in these sequences appear to be typical futures trades where one trader loses money to another. The only circumstances even arguably suspicious about these trades involve (1) both the purchase and sale (2) of the same month (3) of the same futures contract (4) by Bilello and Gorski. Given the fact that Gorski and Bilello stood together in the gold pit, we see no basis for finding that the cited factors are unusual or suspicious.

The Division also claims that some of the challenged trade sequences reflect "a pattern very similar to the pattern which supported the liability findings made by the COMEX hearing and appeal panels" in the proceeding at issue in the Commission's 1998 *Clark* decision. We do not interpret the *Clark* decision as placing significant weight on the alleged pattern of the trades at issue. Certainly that decision does not explain how the alleged pattern includes "characteristics unlikely to occur in an open and competitive market."

establishes a reasonable connection between the irregularity at issue and a plausible arrangement involving the wrongdoing at issue.

The record relating to trade sequences 10, 17, 36, 37, and 52, for example, shows that Gorski achieved a wash result in the context of a significant audit irregularity -- both traders initially recorded information pertinent to the transaction in a consistent manner, but subsequently changed the information, again in a consistent manner. In each instance, both traders changed the quantity of a trade Bilello made for customers and then completed a transaction whereby Bilello traded in the same amount as the increase on the side of the market opposite to his customer's trade. As Kozlowski noted in her written testimony, the combination of an embedded wash result and this type of post-trade alteration is consistent with a scheme whereby the floor broker (Bilello) instructs the opposite trader (Gorski) to "increase the quantity by a certain quantity and 'give him back' the same quantity, either of the same or a different contract month." Kozlowski Written Testimony at 14. Our decision in *Reddy* found this combination of circumstances to be persuasive, explaining that:

> The explanation for the quantity increases in particular is tied integrally to the Division's theory of the case: the quantity changes in the transaction executed for the bucketing broker's customer match the amounts traded between the broker for his own account and the accommodating trader. The broker, having tested the market at his customer's risk in a competitive trade, then exploits it at no risk for his own benefit. The audit trail irregularities, occurring in conjunction with the basic violative trading pattern of indirect bucketing, provide further support for the Division's case.

Reddy, ¶ 27,271 at 46,212.

Of course, as we acknowledged in *Rousso*, audit trail irregularities have limited evidentiary value when the available analytical tools are unable to reliably distinguish between deliberate obfuscation and random error. *Rousso*, ¶ 27,133 at 45,309. Because both traders allegedly made the same "error" at the same time, however, random error seems an unlikely explanation for these irregularities. Indeed, Gorski offers no credible explanation for the repeated, simultaneous errors. Finally, because the pattern evidence and audit trail evidence complement each other, their combined weight provide a reliable basis for inferring that Gorski knowingly facilitated Bilello's scheme to bucket his customers' orders.

The record relating to trade sequences 16 and 40 shows that Gorski achieved a wash result in the context of audit irregularities clearly suggesting that his trades were not executed by open outcry. In trade sequence 40, Gorski used the COMEX claims procedure to insert matched purchases and sales on his trading cards. In trade sequence 16, matched purchases and sales are recorded in a different manner than the remainder of the information on the trading card and there was a significant discrepancy between the times Gorski and Bilello recorded on their trading cards and that appearing in the price change register.

Clearly, neither use of the claims procedure to execute trades nor apparent post hoc insertion of trading information is invariably a sign that the trade at issue was executed non-competitively. We recognize that trading mistakes occur.[61] The question then, is whether the overall circumstances are more consistent with the existence of a legitimate mistake warranting

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[61] The testimony on the record suggests that COMEX traders handled the claims procedure in a very informal manner. Indeed, Kozlowski testified that:

> Different traders and their clerks have different arrangements. There are some traders who have told their clerks that if you get claims by a specific broker, go ahead and accept the trade. If you get claims and it has no effect on my position, you can accept the trade. If you get a claim and it doesn't affect me financially, you can accept the trade. So it depends on the arrangement that the broker has or the local has with his clerk.

(Tr. at 137.) While acknowledging this informal process, Kozlowski testified that it amounted to knowing participation in non-competitive trading when a local trader acknowledged claims when he did not recall whether the underlying trades were done through open outcry. Commission precedent does not endorse any such hard and fast rule. Kozlowski's evaluation was apparently affected by her perception that during the period at issue the claims process was one of the main ways brokers abused their customer orders on COMEX and other futures exchanges. This "fact," however, has not been established on the record and therefore cannot bolster Kozlowski's analysis.

corrective action or with the existence of a pretended mistake that can be used to disguise improper trading.

In her testimony, Kozlowski noted that at least some of the claims at issue involved both a purchase and a sale and indicated that it would be unusual for a trader to forget both trades. Schneiderman confirmed this testimony. Aside from his incredible story blaming Diaz for accepting Bilello's claims, Gorski did not offer an explanation for such an uncommon type of mistake. Given these circumstances, and Gorski's cooperation with Bilello in the scheme underlying trade sequences 10, 17, 36, 37, and 52, we find that Gorski knowingly facilitated Bilello's scheme to bucket his customers' orders in trade sequences 16 and 40.

Six other trade sequences also show evidence of embedded wash results (15, 18, 42, 45, 51 and 54). In five of these trade sequences (15, 18, 42, 51, and 54) the Division emphasizes that either Gorski, or Bilello and Gorski, were trading a larger position than usual.[62] During her testimony, Kozlowski acknowledged that active markets with more liquidity could influence a trader to establish a position larger than his typical trading size. She also indicated that a local might see an advantage to trading in a "back" month because the bid/ask spread would usually be wider. Schneiderman confirmed that these factors could affect a trader's decision to accumulate a larger than normal position. Nevertheless, the Division chose not to address these factors in its analysis.

In our view, the record is insufficiently developed to determine the significance of Bilello's and Gorski's variations from their normal position size. While we do not doubt that many traders tend to limit the size of their positions in some way, we expect that compliance with the limit is often not very strict. Moreover, exceptions may involve matters of judgment

[62] The other trade sequence allegedly involves a type of quantity change similar to that shown in trade sequences 10, 17, 36, 37, and 52. Our examination of the trading card, however, shows that the evidence of a change is too ambiguous to support a reliable finding.

based on somewhat unpredictable circumstances. We are not convinced that Kozlowski's survey of Bilello's and Gorski's trading gave her sufficient insight to make reliable judgments about the significance of their exceptions to their normal practice.

The remainder of the trade sequences pertinent to the Division's appeal reflects what even the ALJ identified as suspicious circumstances. The Division, however, generally failed to analyze these factors in the context of plausible innocent explanations. For example, the Division makes much of the fact that Gorski sometimes made mistakes in his position count. It argues that such mistakes are significant because it is generally important for a trader to know his current open position. This is particularly true for traders who seek to end trading sessions with no open positions.

The general importance of this information, however, is not necessarily a good predictor of the overall reliability of a particular trader's record keeping. As Gorski notes, the reliability of record keeping may vary with many different day-to-day circumstances. On a busy day, a trader may be forced to divide his attention among several types of important information. In rationing a limited supply of attention, traders reasonably may be more indifferent to the precise size of their open position earlier in the trading session because there is plenty of time to detect and correct a mistake. As the trading session moves toward the close, however, we would expect that the relative importance of an accurate position count would rise. Given the Division's limited development of the record, we cannot reliably determine the significance of the cited errors.[63]

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[63] Similarly, with a few exceptions, the Division's arguments relating to inconsistencies in the information recorded on Bilello's and Gorski's trading cards and information recorded on COMEX's price change register do not take into account factors that affect the reliability and precision of information included on the price change register. *Compare Rousso*, ¶ 27,133 at 45,309.

In light of our independent review of the record, we conclude that Gorski violated Sections 4c(a)(A) and (B) of the Act, and Commission Rule 1.38 by his knowing participation in the trades described in trade sequences 10, 16, 17, 36, 37, 40, and 52.[64]

V.

Sanctions in enforcement proceedings are imposed "to further the Act's remedial policies and to deter others in the industry from committing similar violations." *In re Volume Investors Corp., Inc.*, [1990-1992 Transfer Binder] (CCH) ¶ 25,234 at 38,679 (CFTC Feb. 10, 1992). In determining the sanctions appropriate for the violations established in a particular case, the Commission undertakes a *de novo* review of all relevant factors established on the record. *In re Grossfeld,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,921 at 44,467 (CFTC Dec. 10, 1996), *aff'd sub nom. Grossfeld v. CFTC*, 137 F.3d 1300 (11th Cir. 1998).

Determining the gravity of a respondent's violations involves several related inquiries. The first focuses on the underlying conduct's relationship to the regulatory purposes of the Act. *In re Premex*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,165 at 34,890 (CFTC Feb. 17, 1988). Generally, violations of the "core provisions" of the Act, such as defrauding customers, warrant more serious sanctions. *Id.*

The second inquiry focuses on the facts and circumstances of the particular case. In making this inquiry, the Commission often considers whether a respondent's conduct was knowing and whether respondent cooperated with authorities following discovery of his violations or undertook other steps to ameliorate the harm flowing from the violations. *Grossfeld*, ¶ 26,921 at 44,467-68 and nn.29 & 31; *Premex*, ¶ 24,165 at 34,891. In addition, the Commission looks at the negative consequences flowing from the violative conduct, including

[64] As noted above, the Division's brief argued that Gorski aided and abetted Bilello's violations of Section 4b(a) of the Act in one of the instances in the complaint. We find this aspect of the Division's argument unpersuasive, and treat the remainder of the Complaint's aiding and abetting allegations as waived.

the duration of the violative conduct, the financial benefit to respondent, and the extent of financial harm, if any, to customers. *Grossfeld*, ¶ 26,921 at 44,468 and n.30.

Violations of Section 4c(a) are always serious because, by their nature, they undermine confidence in the market mechanism that underlies price discovery. *In re Piasio*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,276 (CFTC Sept. 29, 2000). Indeed, the Commission has emphasized that such violations are grave even in the absence of direct harm to customers or an actual appreciable effect on the underlying market. *Buckwalter*, ¶ 24,995 at 37,688. Moreover, because the record shows that Gorski aided and abetted Bilello's efforts to take advantage of his customers, the seriousness of his violations is especially high.

The record shows that Gorski was a knowing participant in unlawful conduct and there is no evidence that Gorski has cooperated with authorities since the violations were discovered. The record regarding the negative consequences flowing from Gorski's violations, however, is limited. As noted above, the benefit to Gorski was most likely the maintenance of a valuable trading relationship with Bilello. The record is insufficiently developed, however, to permit a reliable estimate of the monetary value of this relationship.

Because Gorski was a knowing participant in a pattern of wrongdoing, a cease and desist order is clearly appropriate. Moreover, because Gorski's violations involved a repeated abuse of his market trading privileges and pose a substantial risk to the public, both a trading prohibition and a registration suspension are also appropriate.

We also believe that the assessment of a substantial civil money penalty would be appropriate. To assess such a penalty in this case, however, would require, among other things, that the record be developed further to determine Gorski's ability to remain in business or his net worth.[65] Because the ALJ dismissed the complaint for a failure of proof, he did not undertake such a development of the record. In similar circumstances, the Commission has foregone the imposition of a monetary penalty in the interest of facilitating the immediate effect of the other sanctions the Commission imposed. *See, e.g., Volume Investors*, ¶ 25,234 at 38,679.

While we are cognizant of the importance of imposing civil money penalties to deter future wrongdoing by the respondents in a given case and others who may contemplate engaging in similar misconduct, in lieu of doing so in this case we will set the terms of the trading prohibition at a level somewhat higher than we would have if a monetary penalty were also imposed. In this way, we ensure that the sanctions, taken as a whole, are sufficient to provide effective deterrence. We stress, however, that we will not hesitate to impose civil money penalties in future cases involving trade practice violations of the sort proven here.

[65] Because Gorski's wrongdoing occurred prior to October 1992, in assessing a civil money penalty, we must consider not only the gravity of his violations but also either his net worth or the size of his business and ability to continue in business. *See In re Nikkhah*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,275 at 50,674 (CFTC Sept. 26, 2000.)

CONCLUSION

We vacate the ALJ's Initial Decision. Based on our independent review of the record, we conclude that Gorski violated Sections 4c(a)(A) and (B) of the Act and Commission Rule 1.38. As sanctions, we impose a cease and desist order, a six-month registration suspension and a nine-month trading prohibition. These sanctions shall become effective on the thirtieth day following the date that this order is served.[66]

IT IS SO ORDERED.

By the Commission (Chairman NEWSOME and Commissioner LUKKEN) (Commissioner BROWN-HRUSKA concurring, in part, and dissenting, in part).

Jean A Webb

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

Dated: March 24, 2004

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[66] A motion to stay the effect of this decision pending reconsideration by the Commission or a notice of appeal seeking review by the relevant United States Court of Appeals must be filed within 15 days of the date this order is served.

Concurring Opinion of Commissioner Sharon Brown-Hruska

I concur with the majority's liability findings, and in particular, the Commission's credibility assessment of Gorski, which was made in the absence of a finding by the ALJ.[1] Gorski's lack of credibility combined with other evidence suggests that he participated in a number of illegal trades. I would note further, however, that, as a financial market regulator, it is incumbent upon us to utilize *both* common sense principles and, when possible, quantitative methods in the way evidence is selected, analyzed, and presented. In doing so, we demonstrate our institutional knowledge and expertise to be both unbiased and independent, qualities that encourage legitimate trading activity that enhances market liquidity and that enables us to fulfill our mission to ensure fair and efficient markets that inspire investor confidence.

Consideration of this case raises fundamental questions concerning the quality of the evidence that we rely upon to establish that respondents have engaged in noncompetitive trading. In his initial decision, the ALJ makes a compelling case for employing a more rigorous methodology in instances where liability rests on discrepancies in the relative frequency of certain trading and audit trail practices. He argues that in this context, the probative evidence should be grounded on something more than our "untested impressions and subjective judgment," and favors a more quantitative approach for resolving these issues as called for by the logic of the Supreme Court's decision in *Daubert.* In contrast, the Commission--insisting that *Daubert* principles are inapplicable in an administrative context, and further that they apply only for evidentiary "gatekeeping" purposes--maintains that we can rely upon "principles derived from common sense" to resolve trade practice disputes.

From a legal and policy perspective, I believe that the Commission's interpretation of *Daubert* mischaracterizes the appropriateness of applying those principles to the matter at hand. In *Kumho Tire Company,* the Supreme Court made clear that the *Daubert* framework for assessing the reliability of expert testimony is appropriate for *all* kinds of expert testimony, not just for "scientific" testimony.[2] While the measure of intellectual rigor varies by the field of expertise and by the manner in which such expertise is demonstrated,[3] *Daubert* nonetheless does not create separate but unequal standards of reliability for empirically-based testimony and testimony based upon "experience and observations," as the Commission suggests.[4] As the Supreme Court noted in *Kumho Tire*:

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[1] The ALJ declined to do so based upon his finding that the Division had failed to make a *prima facie* case against Gorski. *In re Gorski*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,742 at 48,517-18 & n.300 (ALJ Aug. 23, 1999).

[2] *Kumho Tire Co., Ltd., v. Carmichael,* 526 U.S. 137, 150-51 (1999). *See also, Tyus v. Urban Search Management,* 102 F.3d 256, 263 (7th Cir. 1997) (*Daubert* principles apply to "all kinds of expert testimony").

[3] *Tyus,* 102 F.3d at 263.

[4] *Kumho Tire*, 526 U.S. at 151 (*Daubert* principles can help evaluate the reliability "even of experience-based testimony").

> We must therefore disagree . . . that a trial judge may ask questions of the sort *Daubert* mentioned only where an expert "relies on the application of scientific principles," but not where an expert relies "on skill- or experience-based observation." We do not believe that Rule 702 [which governs expert testimony] creates a schematism that segregates expertise by type while mapping certain kinds of questions to certain kinds of experts. Life and the legal cases that it generates are too complex to warrant so definitive a match.[5]

Daubert does not come into play only when the issue being contested relates to the *admissibility* of expert testimony. As the Seventh Circuit aptly notes, "it makes little sense to use scientific standards in performing the gatekeeping function and then permit the dispute on the merits to be resolved by arbitrary considerations."[6] Indeed, that court in *Elliott v. CFTC* made clear that such principles also have relevance for how much *weight* we accord such testimony: "*Daubert* and *Kumho* were decided in the context of admissibility, but the principle for which they stand--that all expert testimony must be reliable--should apply with equal force to the weight a factfinder accords expert testimony."[7]

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[5] *Id.* This passage from *Kumho Tire* belies the Commission's view that "factors applicable to scientific testimony are not appropriate guides to assessing the usefulness of testimony based on expertise developed through direct observation and experience." It would also appear to undermine the Commission's view that the ALJ should have performed his reliability analysis "in the context of the testimony actually offered," that is based upon the expert witness's "experience and observations."

[6] *Peabody Coal Company v. McCandless*, 255 F.3d 465, 469 (7th Cir. 2001).

[7] *Elliott v. CFTC,* 202 F.3d 926, 934 (7th Cir. 2000). In its decision, the Commission has ruled out liability on various trade sequences, while also characterizing as error the ALJ's failure to give weight to expert testimony based on reliability grounds. Disregarding incongruities in the Commission's discussion, it should be noted that both the ALJ and the Commission have discretion in making such a determination. Indeed, in *Elliott*, neither the ALJ nor the Commission was swayed by the opinion testimony of the Division's expert. As the court in that case observed: "It appears then that both fact-finders discounted [the expert witness's] unreliable opinion testimony. This is an appropriate approach." *Id*, at 934 (footnote omitted). *See also, Kumho Tire*, 526 U.S. at 152 (trial judge must have "considerable leeway" in deciding how to test an expert's reliability).

The Commission criticizes the ALJ for denying the Division a "fair opportunity" to develop the record on the application of *Daubert* factors to the testimony of its expert witness. Upon closer inspection, however, the record reveals that he clearly invited the Division's attorneys to address his reservations concerning the methodology employed by the witness:

> The expert testimony from the Division . . . doesn't satisfactorily address the methodological concerns that I have raised in this case.
>
> In order to allow the Division to address these concerns, I will permit the Division on redirect to reasonably stray beyond the scope of cross-examination. I expect the Division to use this opportunity to provide the Court with a better assessment of its evidence, clarify my concerns, and frankly to confess error, which is their obligation if there's a problem with their methodology.

The Commission reasons that because we are not bound by the Federal Rules of Evidence, we are not legally compelled to apply *Daubert*. I would note, however, that the Seventh Circuit in *Elliott* strongly suggested that such an application, properly submitted, would warrant consideration.[8] Characterizing the Division's case as "a numbers case without meaningful numbers," the court opined, "had the respondents objected to the admission of [the expert witness's] opinion testimony, we think that *Kumho* might well have compelled the ALJ to sustain the objection."[9]

Even if we were not bound by *Daubert,* we still have an obligation to ensure that our evidence is reliable, that it is based upon something more than intuition or informed speculation.[10] For example, sampling techniques can help dispel concerns about an expert's choice of trade sequences for further examination, ameliorating claims that the expert himself was biased and prejudicially went looking for trades that would provide evidence of presupposed wrongdoing. Using statistical techniques in sample selection and data analysis, or even providing or possessing insight into why such techniques are inapplicable, increases our confidence not only that the expert is unbiased, and therefore, objective in his analysis, but also increases our confidence in the credibility of his analysis and testimony. In short, agencies endowed with the skill to handle expert testimony, "have a corresponding obligation to *use* that skill when evaluating technical evidence."[11]

A trade practice case such as this is often "essentially a 'numbers' case,"[12] requiring us to wrestle with whether a trading practice is "statistically improbable" or occurs "repeatedly," or whether an audit trail characteristic or trading pattern is "significant" or "significantly different" from what we observe under normal market conditions.[13] As technology has lowered the cost of

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Prehearing Conference Transcript at 64 (Nov. 20, 1996).

[8] The majority in *Elliott* noted that had the respondents properly objected to the admissibility of the opinion testimony of the Division's expert witness on *Daubert* grounds and had they preserved such a challenge for appeal, "we *might* have been inclined to agree with them." *Elliott,* 202 F.3d at 933 (citing *Daubert*).

[9] *Id.* at 934.

[10] *Compare In re Fisher,* CFTC Docket No. 93-2 (Jan. 2004), *slip op.* at 41 (noting that the "social-science based expertise" of respondent's expert witness "brought a useful new perspective to the proceeding").

[11] *Peabody Coal*, 255 F.3d at 469 (observing that neither the ALJ nor the administrative agency on review did this).

[12] *Elliott,* 202 F.3d at 934.

[13] The typical trade practice case, after all, usually involves "a pattern [of trading and audit trail conduct] marked by characteristics unlikely to occur in an open and competitive market." *In re Rousso*, [1996-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,133 at 45,308 (CFTC Aug. 20, 1997). But this begs the question of how "unlikely" such conduct must be before we can conclude with any degree of confidence that it is noncompetitive.

collecting and evaluating market information, we find that we are afforded a wealth of data that would enable the kind of empirical inquiry and analysis necessary to support the factual propositions essential to our decisions.[14] Accordingly, we should strive to complement our institutional knowledge of trading practices with empirical techniques for evaluating and interpreting market information.[15]

While it is desirable to use statistically valid methods in our cases, I am also aware that it is not always feasible, due, for example, to difficulties associated with collecting statistically unbiased information or in measuring meaningful baselines in the context of the trading markets. There may not always be reliable data available for determining how a suspicious trading pattern, for example, relates to the overall level of trading. But while statistically valid evidence cannot always be attained, that does not mean, on the other hand, that that we should eschew analytical approaches and simply rely upon "common sense." As Judge Easterbrook reminds us, "[a]n agency must *act* like an expert if it expects the judiciary to treat it as one."[16]

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[14] *Elliott* illustrates the problems associated with attempting to establish liability in the absence of empirically meaningful evidence:

> The Division, through [its expert witness] Rooney, presented what was essentially a "numbers" case: the circumstances surrounding the charged trades, it alleged, were statistically improbable. But it provided no reliable statistics to support this charge (and, indeed, could not even produce for the petitioners some of the raw numbers upon which it allegedly relied). It conducted no analysis of the liquidity of the market or of the usual number of traders swapping spreads during wheat delivery cycles; no analysis of the likelihood that delivery cycle freshening trades would result in no profit for the traders; and no analysis of the likelihood of making mistakes on trading cards or other audit trail irregularities--that is, it failed to justify Rooney's assertion that the "significant characteristics" were at all significant. It was a numbers case without meaningful numbers, and, had the respondents objected to the admission of Rooney's opinion testimony, we think that *Kumho* might well have compelled the ALJ to sustain the objection.

202 F.3d at 934.

[15] As an example, the Supreme Court requires that such techniques be employed to establish a *pattern or practice* of racial discrimination. *See Watson v. Fort Worth Bank and Trust,* 487 U.S. 977, 994-95 (1988) (party alleging "pattern or practice" of discrimination must offer statistical evidence of a kind and degree sufficient to show that the practice in question has caused the exclusion of . . . members[] in a protected group . . . [and] that [such] statistical disparities must be sufficiently substantial that they raise such an inference of causation."). The evidence required to establish *prima facie* proof of an illegal pattern or practice "usually focuses on statistical disparities, rather than specific incidents, and on competing explanations for those disparities." *Id.* at 987. To measure the significance of any statistical disparity, the Court requires the employment of a standard deviation measure to calculate the "expected number" of protected members and compare that with the actual number of such members. *Hazelwood School District v. U.S.*, 433 U.S. 299, 308 n.14 (1977).

[16] *Peabody Coal*, 255 F.3d at 469.

Merely finding an unusual trading pattern, even one shown to be statistically significant using formal scientific methods, does not, in and of itself, constitute a *prima facie* case for a violation. In cases that allege non-competitive trading, as in this case, additional evidence, such as audit trail irregularities or incredibility of respondents, can provide necessary corroboration to prove that a trade practice is violative. In my view, subjective evidence using so called common sense principles and more objective approaches derived from scientific methods are both crucial to establishing wrongdoing in trade practice cases.[17]

Sanctions

Finally, I believe that our decision to refrain from imposing any civil monetary penalty in this case will send the wrong kind of signal to potential wrongdoers, especially in light of the fact that significant penalties up to $200,000 were imposed on three of Gorski's confederates, all of whom *settled*. As the court in *Reddy v. CFTC* explained:

> while artificial trading can over time be profitable, it is also difficult to detect. Because the gains available from artificial trading can be great and the danger of detection may seem low, the temptation to engage in such practices may be great. If deterrence is to be achieved, substantial penalties may be necessary.[18]

Failing to impose any monetary penalty in such circumstances will do little to encourage future wrongdoers from coming to the table to settle with the Division. And it will do little to deter them from engaging in such misconduct in the first place.

I hesitate to endorse the view that effective deterrence can be attained by relying solely upon nonmonetary sanctions. While all sanctions have a deterrent effect, it is well recognized that monetary penalties serve this goal in a more optimal manner than do non-monetary sanctions. Posner, for example, argues that from an economic perspective, white-collar crime "should be punished only by monetary penalties."[19] Similarly, Professor Steven Shavell, one of the leading theorists on deterrence, argues that nonmonetary sanctions should be employed "only where monetary sanctions cannot adequately deter undesirable acts," and that social costs can be minimized "by simultaneously reducing the nonmonetary sanction and increasing the monetary sanction."[20] In a similar vein, Congress has recognized that monetary penalties provide both the

[17] Common sense and scientific methods are not mutually exclusive, but rather each employ analytical constructs that are common to both.

[18] *Reddy v. CFTC*, 191 F.3d 109, 125 (2d Cir. 1999).

[19] Richard A. Posner, *Optimal Sentences for White-Collar Criminals*, 17 Am. Crim. L. Rev. 409, 410 (1980).

[20] Steven Shavell, *Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent*, 85 Colum. L. Rev. 1232, 1236 (1985) (arguing that social welfare is enhanced if only monetary sanctions are used to deter undesirable acts).

courts and administrative agencies "with greater flexibility to tailor a remedy to the seriousness of the violation."[21]

Monetary penalties are more closely associated with deterrence than nonmonetary sanctions precisely because they remove the economic benefit of wrongful activity. Congress, for example, enacted the Securities Enforcement Remedies Act of 1990 granting the SEC authority to impose substantial civil monetary penalties because it believed that such authority was "needed to provide *financial disincentives* to securities law violations . . . by increasing the costs associated with repeated securities law violations"[22] Likewise, our case law recognizes the intrinsic link between deterrence and monetary sanctions. As we declared in the *Sigler* case: "Our focus is on deterrence of the individual respondent and those who will find themselves in similar positions in the future. One well-recognized method of deterrence is depriving the wrongdoer of the *fruits* of his violative conduct."[23]

Given the modest nature of the nonmonetary sanctions that are being imposed here,[24] I believe that a monetary penalty is warranted.

Commissioner Sharon Brown-Hruska

3/16/2004
Date

[21] *See* Securities Enforcement Remedies Act of 1990, H.R. Rep. No. 101-616, 101st Cong., 2d Sess., *reprinted in* 1990 U.S. Code Cong. & Admin. News 1379, 1385.

[22] *Id.* at 1384-85 (emphasis added).

[23] *In re Sigler,* [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,978 at 37,579 (CFTC Jan. 8, 1991) (emphasis added).

[24] The nonmonetary sanctions assessed against Gorski pale in comparison to the severity of such sanctions imposed in prior trade practice cases. Indeed, while the length of Gorski's sanctions can be measured in months, the sanctions that are normally imposed in such matters can be measured in years. *See e.g., In re Reddy*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,271 (CFTC Feb. 4, 1998) (five and ten-year prohibitions, registration revocations, and civil penalties of $150,000 and $300,000 imposed on respondents, who were involved in a pattern of noncompetitive trading over a period of months); *In re Glass*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,337 (CFTC April 27, 1998) (permanent trading prohibitions, registration revocations, and monetary penalties of $300,000 and $500,000 imposed on respondents who engaged in 12 noncompetitive trades over a five month period); *In re Mayer*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,259 (CFTC Feb. 3, 1998) (permanent trading prohibitions for some respondents and ten-year bans for others, depending on the level of involvement, registration revocations, and monetary penalties of $250,000 and $500,000 for individuals involved in prearranged and wash trading and bucketing over the course of 26 months); *In re Rousso*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,133 (CFTC Aug. 20, 1997) (ten-year trading prohibitions, registration revocations, and civil penalties ranging from $50,000 to $200,000 imposed on respondents for noncompetitive trading during a five-month period). Moreover, from the perspective of promoting deterrence, Gorski's sanctions are not commensurate with the registration revocation, three-year trading prohibition, and $200,000 monetary penalty imposed on Bilello, the *settling* respondent that he was found to have "knowingly facilitated."