UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of	CFTC Docket No. 92-4
HOWARD MILLER	OPINION and ORDER

In June 1995, the Commission found that between January 1987 and April 1991, respondent Howard Miller ("Miller") violated Section 4c(b) of the Commodity Exchange Act ("Act") and Commission Rule 33.10 by fraudulently inducing customers to open option accounts with his employer, Siegel Trading Company ("Siegel"). In particular, the Commission concluded that Miller misled customers about the fundamental nature of options trading by minimizing the risk of loss and informing them that they easily could double or triple their money within a short period of time. *In re Miller*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,440 at 42,912-14 (CFTC June 16, 1995) ("*Miller I*").

As for sanctions, the Commission held that the record supported the imposition of a cease and desist order, registration revocation, and permanent trading prohibition. *Miller I* at 42,914 n.9. Because the record had not been sufficiently developed to permit the imposition of a civil money penalty, the Commission remanded the case to the presiding Administrative Law Judge ("ALJ") for additional proceedings. *Id.* at 42,914.

In March 1998, the Commission was once more confronted with a limited record on issues material to the calculation of a civil money penalty. It noted that Miller bore responsibility for the limited record on factors material to his net worth because his response to Division of Enforcement ("Division") subpoenas was substantially incomplete. In these circumstances, the Commission concluded that Miller waived his right to have net worth considered in determining an appropriate civil money penalty. *In re Miller*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,297 at 46,351 (CFTC Mar. 12, 1998) ("*Miller II*").

The Commission also reviewed the record for evidence material to determining the relative gravity of Miller's misconduct. It noted that antifraud prohibitions are at the core of the Act's regulatory purposes. Consequently, the Commission reasoned that Miller's misconduct would be properly characterized as "very grave" even if the record demonstrated some mitigating circumstances. *Id.* at 46,349.[1] In addition, the Commission noted that the record showed that Miller's misconduct was both intentional and repeated,[2] and included egregious practices such as guaranteeing profits and misrepresenting his experience and trading success. *Id.* at 46,350. The Commission also emphasized that, after his misconduct was discovered, Miller neither cooperated with the Division's investigation nor took steps to ameliorate the consequences of his wrongdoing. *Id.*

Finally, the Commission addressed the financial consequences flowing from Miller's misconduct. In this regard, the Commission described the testimony of a Commission investigator who had analyzed trading records pertaining to Miller's customers at Siegel between January 1984 and July 1989. *Id.* at 46,346. In light of this testimony and related exhibits, the Commission found that Miller's customers lost

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[1] In this regard, the Commission noted that customer testimony that Miller relied on in mitigating his wrongdoing did not address his solicitation practices at Siegel during the period at issue in the Complaint. *Id.* at 46,350 n.12.

[2] For example, the Commission cited testimony indicating that Miller called customers repeatedly to encourage them to open Siegel accounts. *Id.* at 46,350.

$1,351,623 between January 1987 and July 1989. *Id.* at 46,350. In light of tax records submitted by Miller, the Commission also found that Siegel paid him $637,519.94 in commissions from 1988 through 1991. *Id.*[3]

The Commission recognized that the record included the testimony of only seven customers who opened accounts after listening to Miller's fraudulent solicitations. *Id.* at 46,345. Nevertheless, it believed that it was "appropriate" to find that Miller's misconduct led to a "substantial portion" of the losses suffered by all his customers during the period covered by the Complaint. *Id.* at 46,350 n.13. In this regard, it noted that Miller's fraudulent solicitation "appeared fairly standard and consistent with regard to each of the testifying customers and clearly played a significant role in convincing his customers to expose themselves to the risks of the commodities markets." *Id.* The Commission also found that Miller's misconduct was "widespread and continuous" and emphasized that there was "no basis to conclude that Miller acted differently with the numerous other customers whom he solicited at Siegel." *Id.*

In light of the factors it found established on the record, the Commission ordered Miller to pay a $600,000 civil money penalty. *Id.* at 46,351.

Miller then filed a petition for review in the United States Court of Appeals for the Ninth Circuit. After a detailed review of the testimony offered by the Division's seven customer witnesses, the court found "no basis" for disturbing the findings and conclusions underlying the Commission's liability analysis,[4] or the imposition of a cease

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[3] The Commission acknowledged that it was relying on estimates to determine both the financial gain that Miller derived from his wrongdoing and the losses suffered by his customers. It characterized these estimates as "conservative" due to the absence of evidence relating to the full period covered by the Complaint. *Id.* at 46,350 n.13.

[4] The court found specifically that the ALJ did not err by crediting the testimony of the Division's seven customer witnesses. *Miller v. CFTC*, 197 F.3d 1227, 1234-1235 (9th Cir. 1999).

and desist order, registration revocation, and permanent trading prohibition. *Miller v. CFTC*, 197 F.3d 1227, 1235 (9th Cir. 1999) ("*Miller III*").

The court held that the Commission had erred as a matter of law, however, by assuming that Miller fraudulently solicited his other customers as he had the Division's seven customer witnesses and that this treatment caused their losses. *Id.* at 1235. In this regard, the court emphasized that the record did not establish that the Division's seven witnesses were representative of Miller's hundreds of customers during the period at issue. According to the court, by relying on assumptions rather than reliable evidence, the Commission had improperly "transferred the burden of proof to Miller so that he had to prove he had not defrauded the other customers and that fraud by him had not caused them substantial loss." *Id.* at 1236.[5]

Having identified the Commission's error, the court remanded for further proceedings. It remarked that the Commission was "free to fashion a monetary penalty appropriate to the gravity of Miller's offenses and sufficient to act as a deterrent," but must arrive at such a penalty through "an act of reason grounded on the record before the agency." *Id.*[6]

[5] As to the necessary link between respondent's wrongdoing and either financial benefit or customer losses, the court observed that:

> In the trading of options on commodit[y] futures, as all agree, there are substantial risks. There are always losers. To attribute all customer losses to the fraud of the broker goes in the face of this fact. Similarly, to attribute all of Miller's income to fraud assumes that he never put a customer in the way of a profit and that never in four years of trading gave one piece of honest advice. The assumption is arbitrary.

Id.

[6] The court agreed that Miller waived his right to have net worth considered in determining an appropriate civil money penalty by offering a substantially incomplete response to the Division's subpoena. *Id.* at 1235.

DISCUSSION

I.

In view of the court's remarks, we have re-examined our approach to determining an appropriate civil money penalty under the Act's "$100,000 per violation" alternative.[7] The applicable statutory language imposes two constraints. We must ensure that the amount of the penalty does not exceed the number of proven violations times $100,000. We must also "consider" the appropriateness of the amount of the penalty to the "gravity" of the proven violations.[8]

Because Congress did not provide precise instructions on how the Commission should determine a violation's gravity or what consideration should be given to the degree of gravity once determined, the Commission has exercised discretion in the context of case-by-case determinations. For example, the Commission has consistently held that the penalty appropriate to the gravity of proven violations is not normally equated with the statutory maximum. *See, e.g., In re Incomco*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,198 at 38,535-36 (CFTC Dec. 30, 1991). The Commission has also eschewed any formulaic approach to determining the penalty appropriate to the gravity of proven violations. *In re Grossfeld,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,921 at 44,467 (CFTC Dec. 10, 1996), *aff'd, Grossfeld v. CFTC*, 137 F.3d 1300 (11th Cir. 1998). Rather, it has assessed gravity by

[7] The current version of the Act authorizes the Commission to impose civil money penalties of not more than "$100,000 for each . . . violation" or "triple the monetary gain to [respondent] for each such violation." Prior to 1992, however, the Act simply required that civil money penalties not exceed "$100,000 for each . . . violation." Because Miller's conduct took place prior to the 1992 amendments, we limit our discussion to the $100,000 per violation approach.

[8] The version of the Act applicable in this case would normally also require us to consider whether the amount of the penalty appropriate to the gravity of respondent's wrongdoing was also appropriate to Miller's net worth. As noted above, however, the court affirmed our conclusion that Miller waived his right to consideration of this statutory factor.

examining the relationship of the violations to the regulatory purposes of the Act, respondents' state of mind, the scope and frequency of the wrongdoing, respondents' post-violation conduct, and the financial consequences flowing from respondents' wrongdoing.

While consideration of these factors has generally proved helpful in assessing the overall gravity of respondents' violations, the Commission's ultimate goal has been to assess a specific penalty appropriate to the determined level of gravity and suitable to deter future violations. For many years, the Commission used "comparable cases" as a tool for moving from a gravity determination to a specific penalty. When using this tool, the Commission looked for prior cases where the gravity of the proven violations was roughly comparable to the gravity of the violations committed by the respondent at issue, and used the specific penalty imposed in the prior case as a rough guide to the appropriate penalty in the case at issue. *See, e.g., In re JCC, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,080 at 41,582 (CFTC May 12, 1994).

The Commission also used its analysis of the financial consequences flowing from respondents' wrongdoing as a tool for moving from a gravity determination to a specific penalty. *See, e.g., In re Gordon,* [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,667 at 40,182 (CFTC Mar. 16, 1993) ("*Gordon I*"). In 1992, we offered a simple, straightforward explanation for giving a prominent role to such an analysis:

> Civil monetary penalties cannot be calculated with precision. Even so, such penalties may be rationally devised in accordance with the purposes [of deterrence]. We begin with the proposition that potential violators will be discouraged from illegal conduct if they know that they are unlikely to profit from it. Thus, in any individual case, our focus turns initially to the gain realized by the particular wrongdoers from their conduct.

In re GNP Commodities, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,222-23 (CFTC Aug. 11, 1992) ("*GNP*")), *aff'd in part and modified*, *Monieson v. CFTC*, 996 F.2d 852 (7th Cir. 1993).

Over the years, however, experience proved that neither tool was consistently useful or easy to administer. Consequently, in 1996 the Commission held that it would no longer give significant weight to the specific penalties imposed in prior cases. In explaining this change in precedent, the Commission noted several flaws that affected the usefulness of the comparable case tool, including that: (1) cases are rarely truly comparable; (2) the level of civil money penalties imposed in cases decided prior to 1992 was frequently depressed due to respondents' limited net worth; and (3) over time, the deterrent effect of a particular penalty amount is undermined by inflation. *Grossfeld*, ¶ 26,921 at 44,468 & n.35.

Reliance on an analysis of the financial consequences flowing from respondents' wrongdoing was plagued by different shortcomings, particularly the parties' limited development of the record on factual issues material to the analysis. The Commission took a fairly pragmatic approach to this limitation. For example, in *JCC*, ¶ 26,080 at 41,582, the Commission specifically noted that the parties did not present evidence of either how many customers were harmed by the fraudulent scheme established on the record or the overall loss suffered by affected customers. Based on evidence that the controlling person of the corporate respondent earned a salary of over $1.4 million during one year of the multi-year period covered by the Complaint, the Commission inferred that he "benefited handsomely from the commissions earned as a result of the fraudulent solicitation methods employed at [the company]." *Id.*

While the Commission gave significant weight to its analysis of financial consequences in cases issued after *GNP*, it did not disregard the other factors material to determining gravity. For example, in *In re Gordon,* [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,326 (CFTC March 6, 1995) ("*Gordon II*"), *aff'd*, *Gordon v. CFTC*, 86 F.3d 1169 (11th Cir. 1996) (Table), the Commission addressed general gravity, scienter, and aggravating circumstances, in addition to the financial consequences of the violations. Moreover, the results of Commission decisions suggest that the weight accorded the analysis of financial consequences varied with the precision of the underlying evidence. For example, as noted above, in *JCC*, ¶ 26,080 at 41,582, the record showed that the controlling person earned a salary of $1.4 million in one of the years covered by the Complaint. Nevertheless, the Commission affirmed the ALJ's imposition of a $510,000 civil money penalty on the controlling person.[9] *Id.* at 41,583.

Similarly, the Commission has also declined to treat evidence of specific financial consequences as a necessary element of the Division's burden of proof in support of the imposition of a civil money penalty. For example, when the record was essentially bare of evidence material to an analysis of the wrongdoing's direct financial consequences, the Commission did not hesitate to impose civil money penalties based solely on more general factors. *See, e.g.*, *In re Elliott*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep.

[9] This apparent anomaly -- imposition of a civil money penalty less than a respondent's apparent gain -- is not an infrequent result when the Commission applies the $100,000 per violation approach to calculating civil money penalties. *See, e.g., In re Ferragamo*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,982 (CFTC Jan. 14, 1991) (affirming an ALJ's imposition of a $100,000 civil money penalty against a respondent who earned $400,000 during the period covered by the Complaint); *In re Shelton*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,332 (CFTC July 14, 1992) (rejecting the Division's request for a $280,000 civil money penalty and affirming an ALJ's imposition of a $2,500 civil money penalty on a respondent who earned $120,000 during the period covered by the Complaint but had a net worth of $10,000); *In re Commodities International Corp.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,943 (CFTC Jan. 14, 1997) (affirming an ALJ's imposition of a $208,000 civil money penalty on a respondent who earned at least $1.2 million during the period at issue in the Complaint).

(CCH) ¶ 27,243 at 46,007-08 (CFTC Feb. 3, 1998), *aff'd, Elliott v. CFTC*, 202 F.3d 926 (7th Cir. 2000).

Despite its pragmatic approach to the analysis of financial consequences, the Commission did recognize that proof problems could be sufficiently substantial to undermine reliance on financial consequences as a basis for determining a specific penalty. For example, in *Grossfeld, supra*, the presiding ALJ imposed a $2.7 million civil money penalty on respondent Grossfeld based primarily on a finding that Grossfeld had gained $2 million as a result of his wrongdoing. On appeal, the Commission concluded there was insufficient probative evidence to permit a reliable estimate of the financial benefit flowing from Grossfeld's wrongdoing and held that the ALJ had improperly relied on a "chain of inferences" beginning with a representation about what an entirely different officer was paid. ¶ 26,921 at 44,470 and n.39. Similarly, the Commission found that the ALJ's estimate of the losses suffered by Grossfeld's customers was fatally unreliable. *Id.* at n. 40. Based on more general factors established on the record and its own "very conservative estimate" of customer losses, the Commission concluded that a $1.8 million civil money penalty was appropriate to the gravity of Grossfeld's violations. *Id.* at 44,471.

The court's opinion in this case makes it clear that we have a duty to assess the reliability of the factual inferences underlying any analysis of financial consequences used in calculating civil money penalties. The burden of establishing the reliability of a financial consequences analysis lies with the Division, and cannot be shifted to respondent merely because it might result in greater decisional efficiency. As our *Grossfeld* decision illustrates, our precedent recognizes the importance of such a reliability check and the nature of the Division's burden. In this regard, compliance with the court's mandate requires a more diligent and careful application of our existing precedent rather than a fundamental change in that precedent.

The court's opinion also emphasizes our duty to ensure that the calculation of civil money penalties reflects "an act of reason grounded on the record." In this context, we have considered whether we may continue to use reliable estimates of the financial consequences flowing from respondents' wrongdoing or whether we are obliged to require more precise proof. Under our precedent, an analysis of financial consequences is an important factor among other, more general factors. The weight we accord such an analysis can and should be varied with the precision of the underlying evidence. In our view, estimates must pass a reliability check and be given only weight proportionate to the precision of the underlying evidence before they can play a role in a calculation process properly characterized as reflecting an "act of reason grounded on the record."

The court also expressed concern about the causal link between Miller's fraud and losses suffered by his customers. In this regard, the court emphasized that options trading is inherently risky and often results in losses and observed that: "[t]o attribute all customer losses to the fraud of the broker goes in the face of this fact." *Miller III*, 197 F.3d at 1236.

In our view, the nature of Miller's fraudulent solicitation explains the apparent anomaly underlying the court's concern. As noted above, Miller misled customers about the fundamental nature of options trading by minimizing the risk of loss and informing them that they easily could double or triple their money within a short period of time. When misrepresentations go more to the nature of the market than the nature of a particular instrument, it is generally reasonable to infer that customers would never have opened an account or entered the market had they been aware of the true relationship between risk and reward. Indeed, this is why a return of the complaining customer's total out-of-pocket loss is the most common result in successful Commission reparations cases alleging fraudulent inducement. *See, e.g., Knight v. First Commercial Financial Group, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,942 (CFTC Jan. 14, 1997).

Similarly, the court's focus on the possibility that Miller offered his customers good trading advice is misplaced in the context of the type of fraudulent inducement established on this record. Given the inherent risk of commodity trading, successful trading results are at least as likely to be the product of good luck as of good advice. A broker who has tricked his customer into undertaking the significant inherent risk of commodity trading cannot legitimize commissions paid under false pretenses by trying his best to recommend successful trades rather than unsuccessful trades. Consequently, as a general matter, a broker's net income from trading in an account arising out of a fraudulent solicitation going to the fundamental nature of the underlying market is properly viewed as part of the ill-gotten gains flowing from the fraud. Commissions may not be viewed as ill-gotten gains, however, if the record lacks a reliable basis for identifying the class of accounts opened due to a respondent's fraudulent solicitation.

While our reassessment of prior precedent convinces us that our approach remains fundamentally sound, we have concluded that our 1996 abandonment of "comparable cases" as a tool for moving from a gravity determination to a specific penalty warrants revisiting. We believe that this tool must be used carefully, with due regard for the circumstances that may justify giving its guidance lesser weight. With these caveats, it may be employed usefully in ensuring that our civil money penalties reflect an "act of reason grounded on the record."

II.

With these principles to guide us, we turn to an assessment of the civil money penalty appropriate to respondent's proven violations. As we discussed in *Miller I*, antifraud prohibitions are at the core of the Act's regulatory purposes. Consequently, Miller's misconduct would be properly characterized as "very grave" even if the record demonstrated some mitigating circumstances. The record shows that Miller's misconduct was both intentional and repeated, and included egregious practices such as guaranteeing profits and misrepresenting his experience and trading success. After his misconduct was discovered, Miller neither cooperated with the Division's investigation nor took steps to ameliorate the consequences of his wrongdoing.

As the court highlighted, only seven of Miller's hundreds of customers described his fraudulent solicitation. The time periods that these solicitations were given (July, October and December 1987; May and September 1988; June 1990 and January 1991) tend to negate an inference that Miller's misconduct was isolated in a manner suggesting inexperience or inadvertence. Indeed, the court's review of the testimony of the Division's customer witnesses indicates that both in July 1987 and January 1991 Miller was using a similar "triple your money" pitch to lure customers. *See Miller III*, 197 F.3d at 1229 (Barnes's testimony), 1231 (Scully's testimony).

As the court emphasized, however, there is an important distinction between a bare suspicion that Miller led most or all of his customers to believe that he could triple their money and a reliable basis for drawing such an inference. In this instance, the Division failed to develop the record on circumstances that might support such an inference – a written script with the offending language or other evidence that Siegel had a policy of encouraging its account executives to use certain fraudulent pitches. *Compare JCC*, ¶ 26,080 at 41,576 (use of fraudulent scripts); *In re First National Trading Corp.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,142 at 41,783 (CFTC July 20, 1994) (testimony that account executives were taught to use a "standard line" with prospective customers). Nor did the Division elicit an admission from Miller that he used a certain type of sales pitch all or most of the time. *Compare In re Staryk*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,206 at 45,811 (CFTC Dec. 18, 1997) (respondent acknowledged that during a typical initial solicitation, he mostly discussed seasonal moves in markets). Finally, as the court noted, the Division did not take any steps to show that the experiences of its seven customer witnesses were representative of the experiences of Miller's other customers.

Because we lack a sufficient basis for reliably estimating the number of customers exposed to Miller's wrongful solicitation, we must base our analysis of the financial consequences of Miller's wrongdoing on the limited amount of reliable evidence available to us. In essence, this limits our analysis of the financial consequences to the seven customers who testified for the Division.

The record admittedly does not establish the precise loss each of the seven customers suffered as a result of Miller's fraud. Barnes, for example, testified that he lost "[a]bout $35,000," and Black testified that he lost "[a]round $12,000." TR1 at 96, 247.[10]

[10] References to "TR1 at ____" are to pages of the transcripts of the first hearing held in this proceeding.

The record permits us to reliably estimate the loss suffered by the seven testifying customers, however, as in excess of $100,000. The record regarding the commissions that the seven customers paid to Miller is insufficient to permit a reliable estimate.

Finally, the $200,000 civil money penalty we imposed in *Gordon II*, ¶ 26,326 at 42,592, is pertinent to our analysis. Like this case, *Gordon II* involved an account executive's fraudulent solicitation of customers. The period at issue in that Complaint was 20 months and the Division presented only five customers who testified about Gordon's deceptive solicitation. Like the misconduct at issue here, Gordon's wrongdoing was "serious" and "wholly unmitigated." *Id.*

Gordon II did present a better record on the financial consequences of the wrongdoing. The Commission estimated customer losses at $1 million and Gordon's gain at $200,000 to $260,000. On the other hand, the Commission had to consider Gordon's limited net worth of $220,000 in assessing his civil money penalty. *Id.* This suggests that it would have imposed a higher civil money penalty based solely on its assessment of the gravity of Gordon's misconduct.

Inflation since 1995 has somewhat undermined the deterrent effect a $200,000 penalty would have on Miller.[11] Moreover, the time period at issue in the Complaint in this case (50 months) is substantially longer than the time period at issue in *Gordon II*. In view of these factors, and the others established on the record, we believe that a civil money penalty of $350,000 is appropriate to the gravity of Miller's violations and necessary to our goal of deterrence.

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[11] We estimate the inflation-adjusted amount to be approximately $242,000.

III.

Finally, we note that a recent decision of the United States Court of Appeals for the Seventh Circuit emphasized the importance of determining whether our civil money penalties fall within the maximum permitted by the Act. *See Slusser v. CFTC*, 210 F.3d 783, 786 (7th Cir. 2000). In our recent decision on remand, we reiterated that we would follow a "broad but common sense approach" to determine the number of "violations" at issue for purposes of the $100,000 per violation approach to civil money penalties. *In re Slusser*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,411 (CFTC Feb. 28, 2003). Here, for example, the record establishes that Miller fraudulently solicited seven customers. If we treat the deception of each customer as one violation, the maximum civil money penalty would be $700,000. Since this limit far exceeds the amount of the penalty we are imposing, we need not specifically determine whether the Complaint in this proceeding reasonably could be interpreted as alleging more than seven violations.[12]

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[12] As we noted in *Slusser*, *supra*, the violation count in most Commission cases could range from dozens to hundreds of violations. Here for example, the record establishes that Miller called some customers repeatedly to encourage them to open accounts. In these circumstances, each phone call could be viewed as a separate fraudulent solicitation, increasing the violation count several fold.

CONCLUSION

In light of the foregoing, we impose a $350,000 civil money penalty on Miller.

IT IS SO ORDERED.[13]

By the Commission (Chairman NEWSOME; Commissioner LUKKEN, joining the majority and also concurring separately; Commissioner BROWN-HRUSKA, concurring in part and dissenting in part).

Catherine D. Dixon

Catherine D. Dixon
Assistant Secretary of the Commission
Commodity Futures Trading Commission

Dated: July 23, 2004

[13] Respondent's sanction shall become effective 30 days after the date this order is served on the party. A motion to stay any portion of this order pending reconsideration by the Commission or judicial review shall be filed and served within 15 days of the date this order is served. *See* Commission Rule 10.106, 17 C.F.R. § 10.106.

Opinion of Commissioner Sharon Brown-Hruska, Concurring in Part and Dissenting in Part

To determine the scope of a respondent's wrongdoing in a customer solicitation case, the Commission generally relies upon the testimony of a handful of the broker's customers and the results derived from a financial audit of his customers' performance.[1] Where such testimony reveals that the broker consistently employs a standard and misleading sales pitch, the Commission infers that he used it to induce his other customers to open trading accounts with him.[2] In such circumstances, the Commission reasons that it is appropriate to attribute most of the broker's financial gains, and correspondingly most of the losses suffered by his customers to his misconduct.[3] Finally, to estimate the respondent's ill-gotten gains, the Commission generally looks to the gross revenues or commissions that the respondent generates from his customers.[4]

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[1] *See e.g., In re JCC, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,080 (CFTC, May 12, 1994), *aff'd JCC, Inc. v. CFTC,* 63 F.3d 1557 (11th Cir. 1995) (imposing $510,000 penalty on individual based upon testimony of "several dissatisfied customers" out of 446 accounts); *In re Grossfeld,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,921 (CFTC, Dec. 10, 1996), *aff'd Grossfeld v. CFTC,* 137 F.3d 1300 (11th Cir. 1998) (imposing penalties of $1.8 million and $500,000 on two individuals based on testimony of 17 customer witnesses and an audit of 257 customer accounts revealing losses); *In re Gordon*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,326 (CFTC, Mar. 6, 1995) ("*Gordon II*"), *aff'd without opinion sub nom. Gordon v. CFTC,* 86 F.3d 1169 (11th Cir. 1996) (imposing $200,000 penalty upon AP based on testimony of five customers and audit of 134 customer accounts).

[2] Or as the Commission put it here, that Miller's fraud "clearly played a significant role in convincing his customers to expose themselves to the risks of commodities markets."). ¶27,297 at 46,350 n.13. *See Gordon II,* ¶ 26,326 at 45,592 (respondent's solicitation fraud "played a significant role in convincing his customers to expose themselves to the risk of the futures markets."). *See also, In re R&W Technical Services, Ltd.,* [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,582 at 47,748 n.60 (CFTC, Mar. 16, 1999) ("Because . . . nearly 100% of [R&W's] customers during the relevant time period learned about the company through the[ir] advertis[ing], it is reasonable to conclude that all of R&W's customers relied on the advertised claims in making their purchase decisions.").

[3] *See Grossfeld,* ¶ 26,921 44,469 n.37 ("Given the pervasive and ongoing nature of the fraud, we may also infer that virtually all the money CCC paid to Stein was a product of his wrongdoing."); *JCC,* ¶ 26,080 at 41,582) ("We can reasonably infer, however, that [respondent] benefited handsomely from the commissions earned as a result of the fraudulent solicitation methods employed at JCC"); *Gordon II,* ¶ 26,326 at 45,592 ("The Division's evidence establishes that the losses suffered by Gordon's customer's exceeded $1 million. While Gordon's fraudulent activities were not the sole cause of these losses, they played a significant role in convincing his customers to expose themselves to the risk of the futures markets.").

[4] *See e.g., In re Gordon*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,667 at 40,182 (CFTC, Mar. 16, 1993) ("*Gordon I*") (interpreting "financial benefit" accruing to a broker for civil penalty purposes as "his commissions"); *R&W,* ¶ 27,582 at 47,748-49 & n.62 (basing financial benefit to respondents in a penalty calculation on "gross sales estimates").

Until recently, these simplifying assumptions met with the approval of most courts when passing on the appropriateness of our penalties.[5]

Here, however, the Ninth Circuit has told us that we can no longer indulge in such assumptions--that in this instance, we cannot assume that Miller solicited all his customers in the same manner as he had with the seven who testified against him, notwithstanding our finding that his fraud was "widespread and continuous." Nor can we attribute the losses suffered by Miller's customers along with the income he derived from them to his fraud without direct proof of causation. In short, the court held that the causal link between a respondent's wrongdoing and the consequences flowing from it could no longer be based upon such "arbitrary" assumptions. Combined with the Fifth Circuit's rejection of our use of gross revenues for measuring a respondent's wrongful gains in the *R&W* case,[6] virtually all of the simplifying assumptions that we had regularly relied upon in the past--and that until now had regularly survived judicial scrutiny--have come under attack.

In response, the Commission, carefully confining itself to the record developed from seven witnesses who testified against Miller, has concluded that a penalty of $350,000 is appropriate for a broker. Although this represents a substantial reduction from the original penalty of $600,000 assessed against Miller in 1998, it still constitutes a significant penalty, albeit one that nevertheless still provides the respondent with a decent return on his investment in wrongdoing. So what's wrong with this picture?

The problem is that in complying with the Ninth Circuit's mandate, the Commission has implemented a change in policy that undermines the goal it seeks to advance--deterring future wrongdoing of the kind witnessed here. The Commission does this by overturning its carefully reasoned decision in *Grossfeld*--reached only seven years ago--to abandon giving significant weight to the penalty levels imposed in prior "comparable cases." Instead, the Commission reverts back to the pre-*Grossfeld* era of looking to the past as guide for calculating penalties. This change, in my view, only compounds the problem that the Commission initially created in the *R&W* decision of last year, when it acquiesced to the mandate of the *Fifth* Circuit that gains-based monetary penalties be drawn from the respondent's *net*--rather than upon gross--wrongful gains, and furthermore, incorporated it as a permanent feature of our standard.[7]

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[5] *See JCC, Inc. v. CFTC,* 63 F.3d 1557 (affirming imposition of penalties ranging from $50,000 to $510,000 against three individuals based upon gross commission charges they generated for FCM); *Grossfeld v. CFTC,* 137 F.3d 1300; *Gordon v. CFTC,* 86 F.3d 1169.

[6] *R&W Technical Services, Inc. v. CFTC,* 205 F.3d 165, 178 (5^{th} Cir. 2000).

[7] *In re R&W Technical Services, Inc.,* [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,556 at 55.391-92 & n.15 (CFTC Aug. 6, 2000) (interpreting Division's burden of proof under Section 6(c)'s treble monetary gain approach to determining maximum allowable civil money penalties as requiring it "to establish net profits with reasonable precision based on actual revenues and actual expenses").

Taken together, these two actions make it more difficult to deter future wrongdoing. Resorting to penalties imposed in prior cases--even if they are used only as a rough guide--sets a bad precedent. Recall we abandoned using that tool for guidance in 1996 for a good reason--after concluding that it "*undermined*" the deterrent effect of our penalties.[8] Our decision in *Grossfeld* unchained us from a legacy of haphazard and negligible penalty levels imposed on numerous respondents whose conduct was in many cases egregious. Guidance from the past might make sense if we possessed a reservoir of comparable cases where the sanctions imposed were carefully based upon economic deterrent principles. Unfortunately, we do not possess such a foundation to build upon. Rather, we have a body of precedent that with few exceptions levies fines that pale in comparison to the gains or losses flowing from the respondent's conduct. This is illustrated by the cases that the Commission cites in footnote nine of its opinion--all of which involve imposition of penalties that are significantly *less* than the respondent's wrongful gains.[9] Despite acknowledging that this outcome "is not an infrequent result," the Commission, without explanation, asserts that basing our penalties upon such case law is now called for.

Reliance upon such deterrence-deprived precedent, however, undermines our effectiveness as an enforcement agency. Although the court found fault with the manner by which we calculated the penalty here, it expressed no misgivings concerning our efforts to fashion a monetary penalty that would promote deterrence. In remanding this matter to the Commission four years ago, the Ninth Circuit explicitly gave us a green light to promote this important value.[10] Indeed, the court observed: "The Commission can set a penalty as a deterrent. *See Lawrence v. CFTC*, 759 F.2d 767, 776 (9th Cir. 1985). Doing so, the Commission is exercising the important and delicate governmental function of punishing illegal conduct."[11]

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[8] *See Grossfeld*, ¶ 26,921 at 44,468 & n.35.

[9] *See e.g.*, *In re Nikkhah*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,129 (CFTC May 12, 2000) (assessing a $200,000 penalty for fraudulent allocation scheme that resulted in customer losses greater than $550,000); *In re Commodities International Corp.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,943 (CFTC Jan. 14, 1997) (levying fines of $208,000 to $212,000 each against a commodity pool operator and two individuals involved in fraudulent scheme that generated fees of almost $3 million and that led to even greater losses for their customers).

[10] The court stated: "On remand, the Commission is free to fashion a monetary penalty appropriate to the gravity of Miller's offenses and sufficient to act as a deterrent." *Miller v. CFTC*, 197 F.3d 1227, 1236 (9th Cir. 1999).

[11] *Miller v. CFTC*, 197 F.3d at 1236. The inclusion of this passage in the court's opinion apparently was in response to the following exchange between the three judge panel and the Commission attorney that occurred at the appellate oral argument:

> CFTC Attorney: these figures [pertaining to the penalty chosen by the Commission] also reflect another value that I've mentioned before, and that is deterrence.
>
> Judge John T. Noonan: And where does the Commission get the power to do that?

(footnote continued)

The court's difficulty with our penalty applied solely to how we calculated the wrongful gains and the customer losses, not to our goal of deterring such conduct.

Extrapolating from penalty levels imposed in analogous cases does not address this concern. Nor does it shield us from the kind of problems that we encountered in this case, because our past cases share the very shortcomings that the Ninth Circuit found in *Miller*. Indeed, the *Gordon* case--the case that the Commission uses for comparison purposes--suffers from reliance upon the very same assumptions that so troubled the Ninth Circuit in *Miller*.[12] In short, if the Ninth Circuit will not allow the Commission to indulge in such inferences directly, it seems unlikely it will allow us to do so indirectly--by bootstrapping the penalty from an equally flawed analogous case.

Nor does basing a penalty upon the respondent's "net" financial benefit help us.[13] Simply put, deterrence requires that a penalty be based upon a multiple of the revenues that the respondent expects to obtain from his prospective victims, not on the accounting profit that he actually realizes. Moreover, we should consider what kind of signal we are sending to the marketplace when we allow a person whose profession is fraud to deduct all of his "business expenses" so that he can "legitimately claim [such expenses] to reduce his net financial benefit." Leaving aside the wisdom of reducing a respondent's wrongful gains by the amount he incurs in planning his crime, defrauding his customers, and evading detection, it seems an unproductive

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> CFTC Attorney: This Court in the *Lawrence* case said that deterrence is a principal function of the Commission. And the Commission case law has--although the emphasis has been more so in recent years--has repeatedly said that deterrence is an important value in assessing the penalty calculation . . . When you are dealing with deterrence, you are trying to avoid two problems: underdeterrence and overdeterrence. If you set a penalty that underdeters, you are only going to encourage future misconduct.
>
> . . . .
>
> CFTC Attorney: And again . . . the Commission's emphasis in all these cases is more and more on deterring future misconduct, and it places a value on that here. It also places a value on, in this case in regards to the penalty, in depriving Mr. Miller of the bulk of his earnings, which the Commission believes is based on fraudulent conduct.

Miller v. CFTC, No. 98-70360, Oral Argument (9th Cir. Nov. 4, 1999).

[12] As it did here, the Commission in *Gordon* relied upon the testimony of only a handful of customers (five) to estimate the gains derived from and the losses suffered by a much greater pool of customers (134). In addition, the Commission in *Gordon* engaged in the kind of factual inference that the Ninth Circuit in *Miller* held was arbitrary--that Gordon's fraud was largely responsible for his customers' out-of-pocket losses exceeding $1 million. *Gordon II*, ¶ 26,326 at 45,592. Although *Gordon* was summarily affirmed by the Eleventh Circuit, it seems doubtful that the Ninth Circuit would take the same view in light of the inferences relied upon in that matter.

[13] Equating a broker's ill-gotten gains with his net profits has little to do with promoting rational penalty policy for reasons that I explained in my dissenting opinion in the *R&W* case. *See* ¶ 29,556 at 55,394-96.

use of our resources for us to take on the kind of forensic accounting that is necessary to develop the record on this score with "reasonable precision." It also seems highly unlikely that the Division of Enforcement will be too keen on accepting this burden if the *Walters* case is any indication.[14]

If the Commission were merely undertaking "a more diligent and careful application of our existing precedent rather than a fundamental change in that precedent" as it professes to be doing, I would have no problem with the action. But the changes adopted in both this matter and *R&W* represent a radical departure from the procedures that the Commission embraced in recent times in *GNP Commodities*, *Grossfeld*, and *Gordon* to more closely align our sanctions with the principles of deterrence. On that score, they undercut *GNP's* admonition that while "[c]ivil monetary penalties cannot be calculated with precision . . . such penalties may be rationally devised in accordance with the purposes [of deterrence]."[15]

While it may be too costly to calculate gains and losses with precision, as the Division's experience in the *Walters* matter suggests, I am confident that with a little effort our penalties can be devised to comply with the Ninth Circuit's mandate without resorting to either of the blunt tools that the Commission is adopting here. We can do so by ensuring that the customers who testify for the Division in such cases are representative of the respondent's entire pool of customers. The proper way of doing this, in my view, is by conducting a statistically valid sample of the respondent's customers. That is what other agencies do in similar circumstances,[16]

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[14] *See In re Walters*, [2000-2002 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶28,686 (ALJ Nov. 29, 2001). In *Walters,* Administrative Law Judge George H. Painter imposed a $2.4 million monetary penalty upon respondent Walters based upon the his finding that Walter's wrongdoing resulted in a monetary gain to him of $800,000. *In re Walters*, [2000-2002 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶28,459 (ALJ Feb. 9, 2001). On appeal, the Commission's remanded the matter to the ALJ to develop the record to permit a reliable calculation of Walter's *net* financial benefit based upon *R&W* principles. *In re Walters*, [2000-2002 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶28,657 at 52,572 (CFTC Oct. 3, 2001). Rather than undergo this burden, the Division on remand filed a motion to withdraw its request to impose a $2.4 million penalty upon him based on its view that such an undertaking did "not seem to be a worthwhile use of resources." Although Judge Painter's order attributed this request to the Division's view that it was "unlikely" that the penalty could be collected, ¶28,686 at 52,673, "[t]here is reason to believe that the Division's decision not to pursue a civil monetary penalty stemmed from a recognition that *Walters'* synthesis of *Miller* and *R&W* demands too much effort." *In re First Financial Trading, Inc.,* [2002-2003 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 29,089 at 53,705 & n.202 (ALJ Jul. 8, 2002).

[15] In re GNP Commodities, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,222 (CFTC Aug. 11, 1992).

[16] The Federal Trade Commission, for example, uses survey methodology to obtain valid samples from the appropriate population when seeking to determine how consumers as a whole interpret an advertisement. *See In re Thompson Medical Research Co., Inc.*, 104 F.T.C. 648, 789-90 (1984), *aff'd Thompson Medical Co. v. FTC,* 791 F.2d 189 (D.C. Cir. 1986), *cert. denied,* 479 U.S. 1086 (1987).

and that is precisely what the court had in mind when it insisted that our witnesses be part of "a statistically significant group."[17]

Taking on this task no doubt will impose costs upon the Division and upon us, but in the long run it will turn out to be far less burdensome than requiring the Division to undertake what the Commission contemplated in its ill-fated *Walters* decision. In addition, it will provide the added benefit of allowing the other shortcomings mentioned by the court to fall by the wayside. For if we can satisfy the court that our customer witnesses are representative then we will have a

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[17] *Miller v. CFTC,* 197 F.3d at 1236. At oral argument, two members of the panel echoed this view. In response to the CFTC's representation that taking testimony from all of Miller's 347 customers was not feasible, the court observed:

> Judge Harry Pregerson: Maybe you take a random sampling and you learn from a statistician or whomever that out of three hundred so and so, if you got five percent, there's a plus or minus factor . . .
>
> CFTC Attorney: All I can say is that the Division of Enforcement approaches this type of case very similar to that here. It goes over the entire sample of customers and it chooses what it believes to be representative.
>
> Judge Noonan: I would have thought that they would have chosen the worst cases to prosecute. You get the ones who are really angry and . . .
>
> . . . .
>
> Judge Noonan: It seems to me that if you are going to impose a legal penalty, you've got to have some real evidence to say this is what the fellow did.
>
> CFTC Attorney: The evidence that the Commission has is that the aggregate losses of 347 customers was $1.3 million.
>
> Judge Noonan: That's right, that's fine. But how do we know that it was caused by his misconduct?
>
> CFTC Attorney: It's based on the premise that these people would not have incurred these losses had they not been fraudulently induced. That fraud played a significant portion of their investments . . .
>
> Judge Noonan: But we don't know that. That's just a guess.
>
> CFTC Attorney: Right. If you're asking for a mathematical formula . . .
>
> Judge Noonan: No, I'm just asking for evidence, the usual way we get evidence. As Judge Pregerson said, you could have taken a representative standard, say how many, what percentage . . . There are ways of statistically making the determination. But it is not by taking seven people are cooperating with you and say they're representative.

reliable basis upon which to draw inferences regarding the extent to which a respondent's employed a misleading sales pitch, the financial benefit he derived from his misconduct, and the harm suffered by his customers.

Commissioner Sharon Brown-Hruska

3/16/2004
Date

Opinion of Commissioner Walter L. Lukken, Concurring

I write separately today to reiterate my support for the Majority opinion and to respectfully address some of the points raised by my colleague in the dissenting portions of her opinion. Both Commissioners in the Majority strongly favor deterrence as a policy goal in imposing adjudicatory sanctions, and believe that the $350,000 penalty imposed by the Commission today achieves that end. In my view, deterrence can only be realized through the imposition of soundly reasoned penalties that are supported by the factual record of a particular case. Indeed, the Commission is instructed on appeal by the Ninth Circuit to calculate an appropriate penalty that, while serving as a deterrent, is "grounded on the record before the agency." *Miller v. CFTC*, 197 F.3d 1227, 1236 (9th Cir. 1999).

The dissent contends that a deterrence-based penalty should be based on the revenues that a respondent expected to obtain from his victims. I fear that such a 'state of mind' determination could prove inconsistent with the judicial standards espoused by the Ninth Circuit, and would present intractable proof problems in future cases. Defining and proving expected gains would be significantly more difficult and subjective than our agency's recent struggles with the *R&W* decision and the more exact statutory term of "gain." *R&W Technical Services v. CFTC*, 205 F.3d 165, 178 (5th Cir. 2000). While I appreciate the economic theory behind such a proposal, its application in a court of law would appear problematic. Deterrence would not be achieved by imposing penalties that are likely to be rejected for a lack of proof or overturned on appeal.

I also would like to discuss my colleague's description of the Majority's use of comparable cases. The dissent contends that the opinion's use of comparable cases is a "radical departure" that overturns the Commission's 1996 decision in *In re Grossfeld* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,921 (CFTC Dec. 10, 1996). However, I believe this to be a mischaracterization of the Majority opinion. The *Grossfeld* case stated that the Commission would no longer accord "substantial weight" to comparable case analysis.[1] *Id.* at 44,468. Since *Grossfeld*, the Commission has utilized comparable case analysis on some occasions and dispensed with it on other occasions.[2] The Majority is simply clarifying that the consideration of comparable cases

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[1] In *Grossfeld*, the Commission stated:

> [W]e agree with the ALJ that effective deterrence can be undermined by an undue focus on the levels of civil money penalties that we have imposed in prior cases. Indeed, in our experience, it is rare that we find cases to be truly analogous on the factors material to the selection of an appropriate civil money penalty. Moreover, a policy of giving *substantial weight* to civil money penalties imposed in prior cases fails to account for either changes in the regulatory environment and sanctioning policy of the Commission or the role inflation plays in undermining the deterrent effect of a money penalty over time.

Id. at 44,468 (emphasis added).

[2] For example, in *In re Mayer*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 at 46,141 (CFTC Feb. 3, 1998), decided after *Grossfeld*, the Commission made reference to its practice of looking at sanctions in previous comparable cases. Similarly, in *In re Glass and Guttman* [1996-1998 Transfer Binder] Comm. Fut. L Rep. (CCH) ¶27,337 at 46,561-9 (CFTC April 27, 1998), the Commission

is one of the tools that may be used to arrive at a specific penalty once a general gravity determination has been made. In so doing, the majority has forthrightly cautioned that it intends to give due regard, on a case-by-case basis, to those circumstances that may justify giving comparable cases less weight. Slip. Op. at 11-12.

In my view, this position is well balanced and consistent with *Grossfeld*. Indeed, the foundation of our common law system is based on the consideration of past precedent in order to keep the law's application consistent, transparent and predictable. When reaching a decision on penalties, the Commission should not be denied outright the ability to properly weigh the similarities and differences of past cases and to apply them to the specific facts of a case before it. Such a denial would have the unfortunate effect of taking away one of our tools of reasoned thought in an area where the Commission needs such decisional equipment in its toolbox. I believe that justice would not be served by such a Commission position.

Walter L. Lukken — 7-22-04

Commissioner Walter L. Lukken — Date

acknowledged giving weight to comparable cases in assessing the civil penalty. Only in *In re Slusser* [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,701 (CFTC July 19, 1999) did the Commission uphold an Administrative Law Judge's assessment of a civil penalty where comparable cases were not considered. In this regard, the Commission stated in a footnote "in deciding *Grossfeld,* the Commission directly rejected its earlier approach to evaluating sanctions and announced that comparability with sanctions imposed in prior cases is no longer an element of its sanctions analysis." *Id.* at 48,319, n.33. However, this seems to go beyond the holding in *Grossfeld*, which only found that the Commission would no longer give substantial weight to comparable case analysis.