UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

PRECISION RATIOS, INC. and MILLENNIUM TRUST COMPANY f/b/o GEORGE POWELL	CFTC Docket NO. 01-R096
v.	ORDER OF SUMMARY AFFIRMANCE
MAN FINANCIAL, INC.	

Because our review of the record and the parties' appellate submissions establishes that the presiding officer committed no error material to the outcome of the proceeding, and the parties have not raised important questions of law or policy that merit extended discussion, we adopt the result of the Judgment Officer's well-reasoned decision.

IT IS SO ORDERED.[1]

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[1] Under Sections 6(c) and 14(e) of the Commodity Exchange Act (7 U.S.C. §§ 9 and 18(e)(1994)), a party may appeal a reparation order of the Commission to the United States Court of Appeals for only the circuit in which a hearing was held; if no hearing was held, the appeal may be filed in any circuit in which the appellee is located. The statute also states that such an appeal must be filed within 15 days after notice of the order, and that any appeal is not effective unless, within 30 days of the date of the Commission order, the appealing party files with the court a bond equal to double the amount of any reparation award.

A party who receives a reparation award may sue to enforce the award if payment is not made within 15 days of the date the order is served by the Proceedings Clerk. Pursuant to Section 14(d) of the Act, 7 U.S.C. § 18(d) (1994), such an action must be filed in the United States District Court. See also 17 C.F.R. § 12.407 (1997).

Pursuant to Section 14(f) of the Act, 7 U.S.C. § 18(f) (1994), a party against whom a reparation award has been made must provide to the Commission, within 15 days of the expiration of the period for compliance with the award, satisfactory evidence that (1) an appeal has been taken to the United States Court of Appeals pursuant to Sections 6(c) and 14(e) of the Act or (2) payment has been made of the full amount of the award (or any agreed settlement thereof). If the Commission does not receive satisfactory evidence within the appropriate period, such party automatically shall be suspended from registration under the Act and prohibited from trading on all contract markets. Such prohibition and suspension shall remain in effect until such party provides the Commission with satisfactory evidence that payment has been made of the full amount of the award plus interest thereon to the date of payment.

Dissenting Opinion of Commissioner Sharon Brown-Hruska

The issue presented here is whether an FCM's failure to disclose a material fact, standing alone, is actionable in a reparations proceeding. Its resolution is important, because "the Commission can only award damages caused by a violation of one of the provisions of the CEA or one of the Commission's rules and regulations thereunder."[1] Relying upon the Commission's decision in *Lee v. Lind-Waldock*,[2] Judgment Officer Phil McGuire resolved this issue by holding that Man Financial's failure to promptly notify complainant George Powell of a change in the settlement date of his open positions breached duties embedded in Sections 4b and 4d to disclose a material change in the status of a customer's account, and to provide the customer a fair opportunity to protect his financial interests.

This resolution, in my view, represents a fundamental misapplication of both of these statutory provisions.

Section 4b Liability

Even if we assume that Man Financial breached a fiduciary duty here, that would not resolve the issue, for "not all breaches of duties owed to customers constitute fraud."[3] For a

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[1] *Tysdal v. Jack Carl/312 Futures, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,242 at 38,713 (CFTC Feb. 27, 1992) (Albrecht, C., concurring). The Commission's reparations jurisdiction is limited to claims based *only* upon a "violation of this Act or any rule, regulation, or order issued pursuant to this Act." CEA § 14(a), 7 U.S.C. § 18(a). While the CEA can reach the breach of a duty owed to a customer, "the critical element for reparations purposes is a provision of the Act or a Commission requirement which prohibits the conduct constituting the breach." *Wills v. First Financial Corp. of America*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH), ¶ 22,605 at 30,596 (May 31, 1985) (conduct cognizable in reparations not because a duty has been breached, "but because a Commission-imposed requirement has been violated."). *See also, Graves v. Shearson Hayden Stone, Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,301 at 25,521 (CFTC Oct. 14, 1981) ("conduct by a registrant in violation of a [duty] which does not independently violate any provision of the Act, or a Commission rule, regulation or order thereunder is not actionable under Section 14 of the Act.").

[2] *Lee v. Lind-Waldock & Co.*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH), ¶ 28,173 (Jun. 29, 2000).

[3] *Graves*, ¶ 21,301 at 25,521. *See Green v. Santa Fe Industries*, 533 F.2d 1283, 1304 (2d Cir. 1976), (Moore, C.J., dissenting) (observing that "breach of fiduciary duty and commission of fraud are wholly different from one another.") *rev'd on other grounds, Santa Fe Industries v. Green*, 430 U.S. 462 (1977) (breach of fiduciary duty without deception does not violate § 10(b) of the Securities Exchange Act of 1934, the securities-law counterpart to CEA Sec. 4b).

Moreover, the extent of any fiduciary duty owed here is attenuated somewhat by the fact that Powell's trading account was self-directed. *See Gordon v. Shearson Hayden Stone, Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,016 at 23,981 (CFTC Apr. 10, 1980) (distinguishing between broker who acts "only as the conduit for orders by transmitting the order to an exchange floor for execution," from one who acts in an "advisory capacity," and noting that in the latter the capacity, the duties owed to the customer "broadens substantially").

breach of a fiduciary or similar duty to be considered fraudulent, and therefore a violation of Section 4b, deception must be integral to the misconduct, since deceit is the "very essence of fraud."[4] But where the breach does not involve deception, the courts have held that no cause of action lies for fraud under the type of statute that we operate under.[5] In fact, the language of Section 4b makes clear that its prohibition applies only to conduct that *defrauds* another person, *i.e.,* that acts "to cheat" or "to deceive," as opposed to conduct merely treats him *unfairly.*[6]

To be sure, an omission is considered to be fraudulent where it occurs "for purposes of deliberate concealment or misrepresentation."[7] Thus, nondisclosure will trigger liability under an antifraud statute where disclosure is "necessary to make other representations not materially misleading,"[8] or where it is affirmatively required by regulation.[9] In either instance, and especially in the latter, disclosure is deemed necessary to prevent deception.[10] But where neither of these conditions applies, mere silence, or the passive failure to disclose facts, cannot serve, as a general rule, as the basis for a cause of action for fraud.[11] Such a "pure omission" is not regarded as deceptive, because, as the Federal Trade Commission points out, it "do[es] not presumptively or generally reflect a deliberate act on the part of the seller."[12]

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[4] *U.S. v. Kreimer,* 609 F.2d 126, 133 (5th Cir. 1980).

[5] *See Santa Fe Industries,* 430 U.S. at 473-74 (only conduct involving manipulation or deception is reached by § 10(b)). *See also, In re Figgie International, Inc.,* 107 F.T.C. 313, 1986 WL 722111 at 63 n.17 (1986) (pure omission "is not deceptive although it may be unfair.").

[6] *See* CEA Sec. 4b(a) (i) and (iii). *See also, Santa Fe Industries,* 430 U.S. at 473-74 (where antifraud statute "speaks so specifically in terms of manipulation and deception," and "gives no indication that Congress meant to prohibit any conduct not involving " those elements, Supreme Court held that it was unwilling to extend its scope to reach mere fiduciary breach).

[7] *Green,* 533 F.2d at 1304 (Moore, C.J., dissenting) ("Non-disclosure for purposes of deliberate concealment or misrepresentation is the essence of fraud, and synonymous with liability under Section 10(b) and Rule 10b-5.").

[8] *Rowe v. Maremont Corporation,* 650 F.Supp. 1091, 1111 (N.D. Ill. 1986).

[9] *See e.g,* Commission Rule 1.55 (mandating disclosure of risks inherent in all futures trading); Commission Rules 4.31 and 4.35 (requiring commodity trading advisors to disclose "actual performance of all accounts"). *Cf. Lehoczky v. Gerald, Inc.,*[1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,441 at 42,923-24 n. 24 (CFTC Jun. 12, 1995) (noting that disclosure of IB's track record is not mandated by Commission's rules).

[10] W. Keeton, D. Dobbs, R. Keeton, & D. Owen, Prosser and Keeton on the Law of Torts § 106 at 738 (5th ed. 1984) ("if the defendant does speak, he must disclose enough to prevent his words from being misleading."). *See also, Lehoczky v.* ¶ 26,441 at 42,924 (omission accompanying half-truth may be misleading).

[11] Prosser and Keeton, § 106 at 737.

[12] *In re International Harvester Co.,* 104 F.T.C. 949, 1059-60 (1984). In *International Harvester,* the FTC articulated the policy reasons for declining to view pure omissions as unlawful:

Prior to *Lind Waldock,* the Commission's precedent was consistent with these principles. Indeed, in circumstances that closely parallel the situation here, the Commission in *Lehoczky v. Gerald, Inc.* held that a broker's failure to disclose that the majority of its customers lost money, "*standing alone*, does not establish a violation of Section 4b of the Act."[13] In my view, we should abandon continued reliance upon *Lind Waldock* in favor of the legally sound principles that the Commission expressed in *Lehoczky*. These principles, after all, are based upon the common sense view that fraud requires deception and that in order for an omission to be unlawfully deceptive, there must be a "deliberate . . . concealment which is calculated to deprive the victim of some right."[14]

> Not all omissions are unlawfully deceptive under Section 5. Such is the case with what is sometimes characterized as a "pure omission." This is a subject upon which the seller has simply said nothing, in circumstances that do not give particular meaning to his silence. Like any other form of omission, pure omissions may lead to erroneous consumer beliefs if the consumer had a false, pre-existing conception which the seller failed to correct.
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> The Commission does not treat pure omissions as deceptive, however. There are two reasons for this. First, we could not declare pure omissions to be deceptive without expanding the concept virtually beyond limits. Individual consumers may have erroneous perceptions about issues as diverse as the entire range of human error, and it would be impractical and very costly to require corrective information on all such points. Second, pure omissions do not presumptively or generally reflect a deliberate act on the part of the seller, and so we have no basis for concluding, without further analysis, that an order requiring corrective disclosure would necessarily engender positive net benefits for consumers or be in the public interest.
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> If we were to ignore this last consideration, and were to proceed under a deception theory without a cost-benefit analysis, it would surely lead to perverse outcomes. The number of facts that may be material to consumers-- and on which they may have prior misconceptions--is literally infinite. Consumers may wish to know about the life expectancy of clothes, or the sodium content of canned beans, or the canner's policy on trade with Chile. Since the seller will have no way of knowing in advance which disclosure is important to any particular consumer, he will have to make complete disclosures to all. A television ad would be completely buried under such disclaimers, and even a full-page newspaper ad would hardly be sufficient for the purpose. . . . The resulting costs and burden on advertising communication would very possible represent a net harm to consumers.

International Harvester Co., 104 F.T.C. at 1059-60.

[13] *Lehoczky*, ¶ 26,441 at 42,923 (emphasis added) (dismissing claim that broker misled customers regarding the likelihood of trading success by failing to disclose that a majority of its customers lost money). In rejecting the claim that the broker's silence misled complainants regarding the likelihood of trading success, the Commission in *Lehoczky* stressed that such information was neither mandated by our rules, nor necessary to correct any affirmative representations of respondents in that case. *Id.* at 42,923-24 n.24

[14] *Green v. Santa Fe Industries,* 533 F.2d at 1301 (Moore, C.J., dissenting).

That, however, is precisely what is missing here, for there is no evidence that Man Financial's omission was part of an effort to cheat or deceive him. Nor did it deliberately set out to conceal pertinent information from Powell or to deprive him of his right to full and complete opportunity to speculate in dollar futures.[15] Indeed, there is nothing in the record to suggest that Man Financial even made an affirmative misrepresentation that would trigger a duty to disclose more information. Finally, there is no Commission rule that compels an FCM to disclose the kind of information that Man Financial withheld here.[16] Thus, under the principles expressed in *Lehoczky*, Man Financial's omission does not rise to the level of fraud.[17]

Section 4d Liability

If Man Financial's conduct does not serve as a foundation for an action under Section 4b, the case for liability under Section 4d fares no better. That is because Section 4d is a customer segregation rule that prohibits FCMs from commingling customer funds, mandating that they be "separately accounted for." While it obliges FCMs to "treat and deal" with such funds "as belonging to such customer," that stricture is intended primarily to prevent FCMs from using such funds for their own use.[18] Under the Judgment Officer's reasoning, however, anytime an FCM mishandles a customer's transaction, it will risk liability under this section no matter how far removed the broker's conduct is from its intended purpose. But the evil that Section 4d addresses is not involved here as nothing that Man Financial did entails the misuse of Powell's funds.

Conclusion

I do not condone the conduct of Man Financial here, which fell far short of should be expected from a registered FCM when dealing with a customer. We should recognize, however, that our Act does not remedy every instance of undesirable conduct by an FCM.[19] While that

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[15] *Cf. Green v. Santa Fe Industries,* 533 F.2d at 1304 ("Non-disclosure for purposes of deliberate concealment or mispresentation is the essence of fraud, and synonymous with liability under Section 10(b) and Rule 10b-5.").

[16] Nor for that matter, is there any provision in the customer agreement requiring Man Financial to notify its customer of such a change.

[17] *Cf. Green v. Santa Fe Industries,* 533 F.2d at 1304 ("Non-disclosure for purposes of deliberate concealment or mispresentation is the essence of fraud, and synonymous with liability under Section 10(b) and Rule 10b-5.").

[18] *In re Clancy,* [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,126 at 24,563 n.9 (CFTC Nov. 25, 1980) (personal use of the customer's funds once obtained is proscribed by Sections 4d). *See also, Hunter v. Madda Trading Co.,* [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,242 at 25,204 n.11 (CFTC Sep. 2, 1981) (purpose of Section 4d is to prevent brokers from treating customer funds "as belonging to any person other than the customer").

[19] As former Commissioner William Albrecht observed in *Tysdal,* a case involving an FCM's breach of an obligation to orally confirm a customer's order:

may be of little comfort to Mr. Powell, that does not mean that he is left out in the cold. For as the Commission has pointed out in similar circumstances, other legal avenues may be available to address this type of situation.[20] It does mean, however, that unless an FCM's conduct independently violates our Act, we do not have jurisdiction. As Judge Frank Easterbrook observed in another context, "Why stretch the Commodity Futures Act . . . when other remedies are ready to hand?"[21]

Commissioner Sharon Brown-Hruska

7/22/2004
Date

This case serves as a reminder of the limitations imposed by the CEA on the Commission's ability to help customers whose accounts have been mishandled by their brokers. The record establishes that his broker mishandled Mr. Tysdal's account. Nevertheless, the Commission cannot award Mr. Tysdal damages because the broker's misconduct does not amount to the type of fraud prohibited by Section 4b of the CEA. Regrettably, Mr. Tysdal expended significant resources pursuing his claim before the Commission when it will now be clear to him that he should have pursued his claim elsewhere.

¶ 25,242 at 38,712-13 (Albrecht, C., concurring) (mere breach of agreement, absent showing of fraudulent intent on the part of the breaching party, does not constitute violation of Section 4b). *Cf. Moss v. Morgan Stanley,* 719 F.2d 5, 16 (2d Cir. 1983) (noting that § 10(b) and rule 10b-5 "protect investors against *fraud;* they do not remedy every instance of undesirable conduct involving securities.").

[20] Commissioner Albrecht addressed this concern in a concurring opinion in *Tysdal,* noting that the customer could pursue his claim before another dispute resolution forums, such as before an arbitration panel or a state courts. *See also, Graves,* ¶ 21,301 at 25,522 n.15 (noting that complainants may have "an *ex contractu* remedy in another judicial forum").

[21] *CFTC v. Zelener,* No. 03-4245, slip op. at 9-10 (7th Cir. 2004) (observing that gap in CFTC's enforcement jurisdiction may be filled by other legal remedies including invoking state consumer-protection laws).