UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of:	:	
R&W TECHNICAL SERVICES, LTD., and GREGORY M. REAGAN	:	CFTC Docket No. 96-3
	:	ORDER ON RECONSIDERATION

In August 2003, we issued a decision vacating the civil money penalty previously imposed on respondents R&W Technical Services, Ltd. ("R&W") and Gregory M. Reagan ("Reagan") and remanding for additional proceedings. *In re R&W Technical Services, Ltd.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,556 (CFTC August 6, 2003) ("*R&W III*"). We took these steps in response to a holding of the United States Court of Appeals for the Fifth Circuit in *R&W Technical Services v. CFTC*, 205 F.3d 165 (5th Cir.), *cert denied*, 121 S. Ct. 54 (2000) ("*R&W II*"). Our decision highlighted the Fifth Circuit's instruction that we undertake a new assessment of the level of civil money penalty appropriate to the nature and gravity of respondents' wrongdoing, beginning with:

> [respondents'] net profits, which then should be adjusted lower based upon any mitigating evidence the [respondents] present with regard to customer satisfaction.

R&W III at 55,390, *quoting R&W II* at 178. In addition, we offered brief guidance on practical issues likely to arise in the context of proceedings on remand.

Shortly after our remand, the presiding Administrative Law Judge ("ALJ") issued an order noting potential ambiguities in the guidance that *R&W III* offered about discovery on remand. The order directed the parties to file memoranda addressing three

issues.[1] Rather than file the memoranda specified by the ALJ, respondents submitted a petition for reconsideration that offers their views on the proper resolution of these discovery-related ambiguities. In addition, they seek reconsideration of some of the issues that we addressed in light of our interpretation of the Fifth Circuit's holding in *R&W II*.[2] In its response, the Division of Enforcement ("Division") supports clarification of *R&W III*'s guidance regarding discovery on remand, but argues against reconsideration of the remaining issues raised in respondents' petition.

In order to expedite the proceedings on remand, we grant reconsideration on the discovery issues raised by the ALJ and addressed by the parties. All parties agree that the 1998 amendments to the Commission's Part 10 Rules should not apply on remand and that discovery should be available to both sides.[3] We endorse these conclusions. As to the remaining discovery related issues, we hold that discovery shall be limited to issues

[1] The issues the ALJ specified were: (1) did amendments to the Commission's discovery rules adopted in 1998 govern proceedings on remand; (2) did *R&W III*'s instructions regarding discovery apply to both of the factual determinations specified in the Fifth Circuit's instructions, or only to the determination of respondents' net profit; and (3) did *R&W III*'s instructions regarding discovery prohibit respondents from seeking discovery or prohibit the parties from seeking subpoenas to obtain testimony and documents?

[2] In view of the Fifth Circuit's conclusion that we erred in denying respondents' motion to reopen the evidentiary record, we held that on remand, respondents should be given an opportunity to present testimony regarding customer satisfaction by individuals who purchased the R&W software at issue in this proceeding. *R&W III* at 55,390. In accordance with Commission Rule 10.67(f), we held that the customer affidavits respondents previously submitted would be accepted into the evidentiary record only if respondents obtained the Division's agreement. *Id.* In addition, we held that the written testimony of Steven Corley ("Corley") and James R. Thompson ("Thompson") would not be accepted into the evidentiary record because such testimony did not fall "within the scope of the court's holding." *Id.*

[3] Respondents argue that discovery should not be permitted at all, but if permitted, should be available to both sides. As noted below, we find no basis to reconsider our prior conclusion that limited discovery should be permitted on remand.

relevant to determining net profit and customer satisfaction.[4] The discovery tools available to parties shall include subpoenas pursuant to Commission Rule 10.68.

While the other issues raised by respondents do not warrant reconsideration, a brief clarification is in order. Respondents argue that, contrary to the Fifth Circuit's finding that the Commission should consider evidence of both the efficacy of the trading system and customer satisfaction, our decision in *R&W III* wrongly prohibits them from introducing evidence regarding the efficacy of the system. Petition for Reconsideration at 4. What we stated in *R&W III*, however, was that, on remand, evidence relating to the efficacy of the system should be informed by testimony offered by customers who used the system rather than studies or modeled behavior. *R&W III* at 55,391 n. 13. In other words, evidence of efficacy should center on proof of actual trading success (or failure) with the system, rather than on theoretical or hypothetical evidence as to whether such systems can work to a customer's advantage.[5] We clarify that, aside from customer

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[4] Consistent with its obligations under *In re First Guarantee Metals, Co.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,074 (CFTC July 2, 1980) ("*First Guarantee*"), and *In re First National Monetary Corp.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,853 at 27,582 (CFTC Nov. 13, 1981)("*FNMC*"), the Division shall make available to respondents exculpatory information material to net profits and customer satisfaction. As discussed *infra*, we construe evidence of customer satisfaction to include evidence that use of the software program in actual trading resulted in profits.

[5] In its discussion finding that the efficacy of the trading system is relevant in assessing sanctions, the Fifth Circuit criticized our earlier refusal to reopen the record to hear evidence of customer satisfaction, and cited the Commission's decision in *In re Grossfeld*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,9[21] at 44,468 & n.30 (CFTC Dec. 10, 1996) (subsequent history omitted), for the proposition that, in assessing civil money penalties, the loss suffered by customers is one pertinent factor. *See R&W II* at 176-77 & n.59. We interpreted the court's discussion to mean that efficacy should be measured by the success (or failure) of the system as demonstrated by the actual results achieved by customers who used the system. For this reason, we determined that the proffered testimony of Corley and Thompson was not relevant. According to the respondents, Corley would have described how the trading system was developed, and Thompson would have described his research on the trading system and his conclusion that it could produce the results that Respondents advertised. Respondents' Motion to Reopen the Hearing at 1-2.

testimony demonstrating efficacy,[6] respondents should be free to present reliable documentary evidence demonstrating successful customer trading results generated by following the system.[7]

CONCLUSION

Reconsideration is granted, in part, and otherwise denied.

IT IS SO ORDERED.

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

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

Dated: March 4, 2004

[6] We expect that customers might offer fairly precise but frequently differing views about the appropriate standard for gauging efficacy in the circumstances of this case. Some customers might insist that efficacy should be measured strictly against the claims included in respondents' advertising, while others might consider the system valuable, or generally satisfactory, even if it did not work as well as advertised. Still others might be content to measure efficacy in terms of their experience with respondents' trading system compared to their experience with similar trading programs.

[7] Our earlier ruling on the admissibility of customer affidavits needs no clarification.

Concurring Opinion of Commissioner Sharon Brown-Hruska

The issue that we must address on remand concerns the efficacy of respondents' trading system. As with any question of fact, we should aspire to obtain the best evidence that is available. On that score, the majority maintains that we can get there solely by relying upon evidence of customer satisfaction "rather than studies or modeled behavior." It interprets the Fifth Circuit's remand order in this matter as meaning that efficacy can be demonstrated *only* by the "actual results achieved by customers," not by what experts or studies might suggest to be the case based upon "theoretical or hypothetical evidence."

To say that efficacy can be measured only by "actual results achieved by customers" is uncalled for. Recall that in remanding this case back to us, the Fifth Circuit simply said that customer testimony relating to efficacy should not have been excluded. It did not, however, preclude us from *also* considering evidence of a more empirical nature, such as expert testimony or taking official notice of academic findings. Nor did it say that we could take into account only direct evidence of consumer satisfaction. That would make little sense since customer experience does not constitute all or even the most reliable evidence on the issue of efficacy for reasons that I explained in my separate opinion in our previous order in this matter.

In adopting the efficient capital market model, the United States Supreme Court made clear that any theory predicated upon its accuracy merely constituted a rebuttable presumption that could be disproved by the kind of evidence that the Fifth Circuit is requiring us to consider here.[1] But to go further, as the majority does here, and to prohibit the presiding officer from taking it into account at all, misconstrues the important role that such evidence can play in cases of this nature.

Ironically, the theoretical construct that the majority rejects here--the efficient capital market model--is the very theory that underlies a number of our enforcement efforts and constitutes the principal basis for liability against brokers who claim that investors can profit from information that is already reflected in market prices.[2] But while the Commission has accepted the implications of this theory as it relates to whether investors can profitably take advantage of certain publicly available information, it presumably is not prepared to do so as it relates to the matter here.

Commissioner Sharon Brown-Hruska

Date 3/3/2004

[1] *See Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) (adopting a "fraud-on-the market theory" of reliance in SEC Rule 10b-5 fraud cases based on the efficient capital market hypothesis).

[2] *See, e.g., In re Staryk,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,206 (CFTC Dec. 18, 1997) (involving claims that investors can profitably take advantage of historical seasonal pricing trends in gasoline and heating oil).