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UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

PAUL CONNOLLY, Claimant-Appellee, v. GREGORY COTTER and TRI GLOBAL FX, INC., Respondents-Appellants.	)))))))))))	CFTC Docket No. 09-R027 **OPINION AND ORDER**

Respondents Gregory Cotter ("Cotter") and Tri Global FX, Inc. ("Tri Global") appeal from a Judgment Officer's ("JO") initial decision ("ID") awarding $221,909 in damages to Claimant Paul Connolly ("Connolly"). The JO held that Cotter and Tri Global (collectively, "Respondents") fraudulently induced Connolly to open a managed foreign currency ("forex") trading account. Cotter argues that the JO erred because (1) the contracts at issue were rolling spot contracts, outside the Commission's jurisdiction during the events at issue; (2) Connolly was required to bring his claims in arbitration rather than in CFTC reparations; and (3) Connolly failed to mitigate damages and the JO erred in certain findings of fact. We reject each of these arguments and therefore affirm.

BACKGROUND

Connolly alleges in his complaint that Respondents fraudulently induced him to invest in a managed forex trading account with Tri Global. About a year later, over the course of four days of trading, Respondents lost the entirety of Connolly's investment. Connolly claims that Respondents fraudulently induced him to open a managed foreign currency trading account, then

deviated from the conservative, loss-limiting strategy with trading safeguards in place, causing him to lose the entire value of his account in a four-day period.

The case was originally assigned to a CFTC Administrative Law Judge ("ALJ"). On July 25, 2011, the ALJ issued an order stating that the pleadings and other materials were insufficient to establish the Commission's jurisdiction over futures transactions. He therefore ordered Connolly to brief that issue and supplement the record as necessary to cure that perceived defect. In response, Connolly submitted a memorandum arguing that his forex contracts were in fact futures, because (1) he never intended to take delivery of the traded currencies; (2) his positions were entered at a predetermined price and were offset; and (3) the trading was on margin and exclusively undertaken for the purpose of speculating on currency fluctuations. *Connolly v. Cotter*, [2011-2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 32,021, 67,021, CFTC No. 09-R027, 2011 WL 4000913, at *2 (CFTC ALJ Aug. 31, 2011). For these reasons, Connolly argued that the contracts were futures contracts, citing *Bardman v. Global Futures and Forex, Ltd.*, CFTC No. 05-R37, 2006 WL 3478984, at *5 (CFTC Nov. 30, 2006), *summarily aff'd,* 2010 WL 1888703, at *1 (CFTC Apr. 30, 2010). *Id.* at 67,021 & n.18, *2 & n.18. The ALJ rejected Connolly's argument, holding in reliance on *CFTC v. Zelener*, 373 F.3d 861 (7th Cir. 2004), that Connolly's subjective experience was not relevant. Rather, he explained, the determination of whether the contracts were futures required "an examination of the overall market in which it is traded." *Id.* at 67,021 & n.19, *2 & n.19.

Although the ALJ had invited Connolly to supplement the record with additional facts, Connolly did not do so. The ALJ therefore re-opened discovery and scheduled a hearing for January 17, 2012. Before that date arrived, however, the case was reassigned from the ALJ to the JO. *Sua sponte*, the JO issued an order reversing the ALJ's decision that the record did not

establish futures jurisdiction. The JO agreed with Connolly that the "economic reality test" controls and held that the Commission did have jurisdiction over the transactions at issue. (Tab 107, Order dated Mar. 14, 2012 (citing *Bardman*, 2006 WL 3478984, at *6).) The JO therefore vacated the ALJ's hearing order and set the case for a hearing on the merits. *Id.*

At the hearing, Connolly testified that in 2007, Tri Global gave him materials including a chart of purported client returns. (Tab 123, Transcript of Telephonic Recording ("Hearing Tr.") at 108:13-109:2.) The chart indicated that no clients lost more than 25 percent. *Id.* According to the marketing materials, Tri Global utilized stop-losses and risk management software for trading, had audited funds, and produced returns in previous years that were consistently high. (Tab 118, Ex. 5 at 1; Tab 120, Ex. 22; Hearing Tr. at 44:8-11, 54:9-23, 56:7-57:5.) The promotional materials also stated that the "goal is to minimize return volatility." (Tab 120, Ex. 22; Hearing Tr. at 109:9-14.) The materials referred to an account called "Metro," which the materials described as "one of our retail managed accounts." (Tab 118, Ex. 5 at 1; Hearing Tr. at 151:10-15.) Respondents made retail forex trades on Connolly's behalf using a Swiss forex dealer called Dukascopy. (Tab 128, Exs. D, N.) Despite Respondents' assurances of measures to reduce the trading risk, Connolly's account lost the entirety of its value in a four-day period. (Tab 128, Ex. P.)

Respondent Cotter's own testimony was full of damaging admissions that demonstrated he did not describe Tri Global accurately and that Respondents did not follow the volatility-minimizing practices they advertised. First, while Tri Global's marketing materials claimed that the "results [were] reviewed by two forex auditing firms," Cotter admitted that he used only one accounting firm, and in the audit report the firm explicitly denied having audited or reviewed the performance tables. (Hearing Tr. at 168:5-169:19, 171; Tab 118, Ex. 5 at 1.) Second, though Tri

Global claimed to have risk-management software with stop-loss protections (Tab 120, Ex. 22; Hearing Tr. 178:5-20), Cotter admitted that the protections were at Dukascopy or another brokerage firm, and that his own firm did not have independent risk management software (Hearing Tr. at 178:24-180:6). Although the marketing materials described Metro as "one of our retail managed accounts," Cotter admitted that Metro was their only retail managed account. (Tab 118, Ex. 5 at 1; Hearing Tr. at 151:10-152:2.) Cotter at first testified that an entity called TGFX, Inc., which he claimed was a separate company from Tri Global, was actually the one responsible for the trades on behalf of Connolly, and Respondents were not. (Tab 128, Ex. A at 2; Hearing Tr. 131:15-19.) Cotter later admitted, however, that there was no difference between TGFX and Tri Global, damaging his credibility. (Hearing Tr. 139:9-24.)

Based on the record, the JO held that Cotter and Tri Global "recklessly deviated from the promised strategy" in violation of section 4*o*(1)(B) of the Commodity Exchange Act ("CEA"), 7 U.S.C. § 6*o*(1)(B), and by that conduct "proximately caused damages totaling $221,909." *Connolly v. Cotter*, [2012-2013 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 32,567, 72,296, CFTC No. 09-R27, 2013 WL 1345412, at *1 (CFTC JO Mar. 29, 2013). He found that Connolly's testimony "was plausible . . . internally consistent, and . . . notably more credible and convincing than Cotter's testimony." *Id.* By contrast, "Cotter produced testimony that was opaque, evasive and largely unsubstantiated by any reliable documentary evidence." *Id.* The finding of damages was based on the determination that Connolly's account was worth £140,036.11 the day before the precipitous losses. On October 20, 2008, the account suffered a loss of £10,914.08, bringing its value to £129,122.03. The JO determined that this loss, which was significant relative to previous losses, "should have signaled caution," yet Cotter did nothing to minimize further losses. *Id.* at 72,301, *9. Accordingly, the account continued its

catastrophic losses for the next 3 days, ultimately resulting in a value of -£245.58.[1] The JO determined that the loss over the course of the last 3 days -- £129,122.03 -- was attributable to the fraud, and based on a historical exchange rate of 1.7186, was equivalent to a loss of $221,909. *Id.* at 72,302, *10.

STANDARD OF REVIEW

In a reparations case, we review findings of fact and conclusions of law *de novo*, giving due deference to the JO's credibility determinations. *Ahlstedt v. Capitol Commodity Servs., Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,131, 45,290 n.12, CFTC No. 96-R050,1997 WL 458096, at *3 n.12 (CFTC Aug. 12, 1997).

DISCUSSION

I. The Commission has jurisdiction over Connolly's claims.

Respondents raise two threshold issues. First, they argue that this case must be dismissed because it is subject to mandatory arbitration. Second, they argue that the CEA as it existed at the relevant time did not apply to the trades at issue, because they were in spot contracts and not futures. We reject both assertions.

a. Connolly is not bound to Cotter by an arbitration clause.

Respondents' claim that this case is subject to mandatory arbitration is meritless because it is based on a "Marketplace Trading Agreement" between Connolly and *Dukascopy*. (Tab 128, Ex. C.) Neither Respondent is a party to the agreement, and there is no other indication that Connolly agreed to arbitrate disputes that may arise with either of them. Accordingly, Respondents cannot invoke the agreement. *See EEOC v. Waffle House, Inc.*, 534 U.S. 279, 289, 294 (2002) (a contract to arbitrate cannot bind a nonparty or an issue not covered in the

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[1] There is no evidence in the record before us that the -£245.58 that was due on the account on October 24, 2008 was collected. Accordingly, this amount is not part of the damages calculation.

agreement); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) (an arbitration contract only governs the disputes that the parties have agreed to submit to arbitration); *Granite Rock Co. v. Int'l Bhd. of Teamsters*, 130 S. Ct. 2847, 2862 (2010) (an agreement to arbitrate disputes arising out of one issue does not compel arbitration of a different issue).

b. The CEA covers these transactions because they involved futures contracts.

Respondents contend that the trading at issue fell outside the Commission's jurisdiction over futures contracts because they fell within a then-existing exclusion for any "agreement, contract, or transaction in . . . foreign currency," 7 U.S.C. § 2(c)(1) (2006), and no exception applied. That claim is without merit.

If these trades occurred today, we would not need to determine if they involved futures or spots, because the applicable statute would be CEA section 2(c)(2)(C), concerning leveraged, margined, or financed retail foreign currency transactions. 7 U.S.C. § 2(c)(2)(C). For contracts like Connolly's entered before the enactment of that statute, however, the futures contract versus spot contract determination was necessary, and two competing legal theories developed.[2] The first was a multi-factor test designed to capture the economic reality of the transaction, articulated in *Bardman v. Global Futures and Forex, Ltd.*, CFTC No. 05-R37, 2006 WL 3478984 (CFTC Nov. 30, 2006), *summarily aff'd*, 2010 WL 1888703, at *1 (CFTC Apr. 30, 2010). The second, set forth in *CFTC v. Zelener*, 373 F.3d 861 (7th Cir. 2004), focused almost exclusively on the formal contract terms. We conclude that the choice of tests does not matter here because these contracts were futures under either test.

[2] Accordingly, our discussion here applies only to transactions prior to May 22, 2008, the effective date of 7 U.S.C. § 2(c)(2)(C).

Under *Bardman*, purported spot forex contracts are actually futures if they have the "essential characteristics of futures contracts," specifically that (1) the contracts involved the purchase and sale of foreign currency for future delivery; (2) the prices were determined at the time that the parties entered into the contract; (3) the customer primarily used the forex contracts to speculate on fluctuations in the value of currency; and (4) the forex contracts permitted customers to roll-over trades, to close positions through offset, and to trade on margin, and the delivery of the underlying currencies was not anticipated. 2006 WL 3478984, at *5. Here, each factor is present: (1) the contracts involved the purchase and sale of foreign currency for future delivery (Tab 94 at 4); (2) prices were determined when parties entered into each foreign currency contract (*id.*); (3) the customer here used the forex contracts primarily to speculate on fluctuations in the value of currency (*id.*); and (4) the forex contracts permitted customers to roll over trades, to close positions through offset, and to trade on margin, and the delivery of the underlying currencies was not anticipated. (*Id.*; Tab 97 at pdf p. 23.) Indeed, the account documents provided that "no delivery" would ever occur. (Tab 97 at pdf p. 23.) Thus, as the JO concluded, these contracts were futures under *Bardman*.

The result would be the same under *Zelener*. In that case, the Seventh Circuit held that purported spot contracts are not futures if the terms of such contracts contemplate actual delivery. 373 F.3d at 869. Here, the contracts contemplated "no delivery." (Tab 97 at pdf p. 23.) 373 F.3d at 866-67, 869. The court in *Zelener* also stated that a transaction may be in a futures contract if "the seller of the contract promises to sell another contract against which the buyer can offset the first contract." 373 F.3d at 868 (citing *In re Bybee*, 945 F.2d 309, 313 (9th Cir. 1991) and *CFTC v. Co Petro Mktg. Grp., Inc.*, 680 F.2d 573, 580 (9th Cir. 1982)). That is the case here because delivery was actually precluded in the account documents and Dukascopy,

the dealer (*i.e.* the seller), promised to create offsets in lieu of delivery. (Tab 97 at pdf p. 23.) Thus, even under *Zelener*, the CEA applies.

II. The JO correctly held that Respondents violated CEA section 4*o*.

A claimant under CEA section 4*o*(1)(B) must prove that a Commodity Pool Operator or Commodity Trading Advisor ("CTA") or Associated Person thereof made a misrepresentation or omission, that was material, and that proximately caused damages. *CFTC v. Heffernan*, 245 F. Supp. 2d 1276, 1292 (S.D. Ga. 2003); *Ho v. Dohmen-Ramirez*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,221, 32,606-07, CFTC No. R80-1155-81-186, 1986 WL 66148, at *4 (CFTC Aug. 19, 1986); CEA section 14(a)(1)(A), 7 U.S.C. § 18(a)(1)(A). A misrepresentation or omission is "material" if a reasonable investor would consider it important in deciding whether to make an investment. *CFTC v. R.J. Fitzgerald & Co.*, 310 F.3d 1321, 1328-29 (11th Cir. 2002) (citations omitted). To assess proximate cause, "the Commission looks to whether respondents' violative conduct was a substantial factor in bringing about complainants' loss and whether the loss was a reasonably probable consequence of respondents' conduct." *Muniz v. Lassila*, [1990-1992 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 25,225, 38,650, CFTC No. 87-R395, 1992 WL 10629, at *7 (CFTC Jan. 17, 1992) (internal quotation marks and citation omitted). The claimant need not prove that the respondent acted with *scienter*. *Messer v. E.F. Hutton & Co.*, 847 F.2d 673, 677 (11th Cir. 1988); *Heffernan*, 245 F. Supp. 2d at 1292.

The evidence of fraud or other actionable misrepresentation in this case is straightforward. Tri Global was a CTA[3] and Cotter was an Associated Person.[4] Respondents

[3] Query for Tri Global FX, *Broker/Firm Information (BASIC)*, National Futures Association, https://www.nfa.futures.org/BasicNet/Details.aspx?entityid=M3VzuJvpHqw%3d (last visited Oct. 24, 2016).

made the misrepresentations described above. *See supra* at 3-4.[5] Some of the misrepresentations were material, because, among other reasons, they concerned trading risk, and therefore "go to the heart of a customer's investment decision and are therefore material as a matter of law." *CFTC v. Noble Wealth Data Info. Servs., Inc.*, 90 F.Supp.2d 676, 686 (D. Md. 2000), *aff'd in part and vacated in part by CFTC v. Baragosh*, 278 F.3d 319, 323 (4th Cir. 2002). The record shows that these misrepresentations proximately caused Connolly's losses, because Respondents did not have in place the claimed stop-loss protections or risk-management software, without which Connolly's account lost almost one hundred percent of its value in just four days. Other misrepresentations went to the sophistication of the firm itself. (*See, e.g.*, Hearing Tr. at 168:5-169:23, 171; Tab 118, Ex. 5 at 1 (misrepresentation about audits); Tab 118, Ex. 5 at 1; Hearing Tr. at 151:10-152:2 (misrepresentation about number of managed accounts).) It is inferable that Connolly would have been less likely to trade through Respondents had he not been misled about those facts as well. Individually and in combination, these misrepresentations proximately caused Connolly's damages. While Respondents allege that the JO made certain erroneous findings of fact (Tab 128 at 5), the facts described above establish all of the necessary elements. We also see no basis in the record to disturb the JO's credibility determinations. Accordingly, we affirm his holding that Cotter violated CEA section 4*o*.[6]

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[4] Query for Gregory Cotter, *Broker/Firm Information (BASIC)*, National Futures Association, https://www.nfa.futures.org/basicnet/Details.aspx?entityid=%2fuQsecf8onI%3d&rn=Y (last visited Oct. 24, 2016).

[5] On appeal, Respondents make no argument that Tri Global lacks responsibility for Cotter's actions.

[6] Cotter also alleges error because "Connolly failed to produce his trading records prior to this period." (Tab 128 at 8). According to Cotter, this prior period of trading could show Connolly's appetite for risk. But Connolly's general "appetite" for risk has no relevance to any element of section 4*o* because Cotter made specific misrepresentations that prevented Connolly from properly evaluating the risk he was taking.

III. Cotter has not demonstrated that Connolly ratified the trades or failed to mitigate losses.

Cotter raises two defenses, ratification and mitigation. (Tab 128 at 5-18.) Both are based on the same contentions: that Connolly did not ask that his "trading be suspended or halted" and never explained why he did not revoke the power of attorney that allowed Cotter to trade on his behalf. (Tab 128 at 6, 14.) Neither defense has any basis.

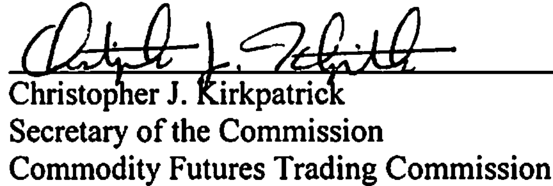
A defense of ratification requires the respondent to show that the complainant permitted the wrongdoing to recur by allowing subsequent trading. *Levine v. Refco, Inc.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,488, 36,116, CFTC No. 86-R225, 1989 WL 242009, at *5 (CFTC July 11, 1989). However, the doctrine "has no practical application in the context of fraudulent inducement." *Id.* (citing *O'Hey v. Drexel Burnham, Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,754, 31,142, CFTC Nos. R80-1080-81-358, 81-R52-81-359, 1985 WL 55284, at *3-4 (CFTC Sept. 23, 1985). Moreover, there is no evidence that Connolly knew during the four-day period during which he suffered the losses that Cotter's representations were false. As to mitigation, we have explained that the duty "does not even arise in the context of fraudulent inducement unless the record establishes that the defrauded individual has become aware of the material facts about which he was initially misled." *Id.* Again, there is no evidence in this case that Connolly became aware in time to act.

CONCLUSION

For these reasons, the decision of the Judgment Officer is affirmed.

IT IS SO ORDERED.[7]

By the Commission (Chairman MASSAD and Commissioners BOWEN and GIANCARLO).



Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: December 12, 2016

[7] Under the Commodity Exchange Act, 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. 7 U.S.C. §§ 9(11)(B), 18(e) (2012). Such an appeal must be filed within 15 days after notice of the order and 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. *Id.* § 18(e).