

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 87-7469

FRANCES A. DOMENICO,

Petitioner

v.

COMMODITY FUTURES TRADING COMMISSION,

RUFENACHT, BROMAGEN & HERTZ,

-and-

RICHARD ALLISON,

Respondents

On Petition For Review Of An Order
Of The Commodity Futures Trading Commission

BRIEF OF RESPONDENT
COMMODITY FUTURES TRADING COMMISSION

COUNTERSTATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether the weight of the evidence supports an order of the Commodity Futures Trading Commission declining to award reparations because Frances Domenico failed to prove allegations of inadequate risk disclosure.

COUNTERSTATEMENT OF THE CASE

I. MATTERS REQUIRED BY NINTH CIRCUIT RULE 28

A. Basis for jurisdiction in the Commodity Futures Trading Commission.

The Commission had subject matter jurisdiction over petitioner Frances A. Domenico's reparation complaint pursuant to Section 14(a) of the Commodity Exchange Act, 7 U.S.C. §18(a)(1982).

B. Basis for jurisdiction in the Court of Appeals. Section 14(e) of the Commodity Exchange Act, 7 U.S.C. §18(e)(1982), confers jurisdiction to review Commission reparations orders in the Circuit in which a hearing was held. The hearings below were held in San Francisco and Los Angeles, California.

C. Appealability. The Commission's September 30, 1987 order of which petitioner seeks review finally disposes of all claims with respect to all parties.

D. Timeliness. The petition for review was timely filed with this Court on October 20, 1987. See Section 14(e) of the Commodity Exchange Act, 7 U.S.C. §18(e)(1982), incorporating by reference Section 6(b) of the Act, 7 U.S.C. §9 (1982); cf. 17 C.F.R. §12.10(b)(1987).

E. Attorneys fees. The Commission does not intend to seek attorneys fees for this appeal.

II. NATURE OF CASE, COURSE OF PROCEEDINGS, AND DISPOSITION BELOW

This petition for review grows out of an order of the Commodity Futures Trading Commission ("Commission" or "CFTC") issued in a reparation proceeding under section 14 of the Commodity Exchange Act (the "Act"), 7 U.S.C. §18 (1982). Frances A. Domenico v. Rufenacht, Bromagen & Hertz, et al., CFTC Docket

No. R-81-355-81-604. Such proceedings are designed to provide an inexpensive forum for customers to proceed against commodity industry professionals for damages proximately caused by violations of the Act. 7 U.S.C. §18(a); see generally, CFTC v. Schor, 106 S.Ct. 3245, 3250 (1986).

The reparations complaint, filed January 23, 1981, alleged that respondents Richard Allison ("Allison"), Maury Kravitz ("Kravitz"), and Rufenacht Bromagen & Hertz ("RBH"), a futures commission merchant ("FCM"), allowed petitioner Frances A. Domenico ("Domenico") to open futures accounts even though she was not suitable for commodity futures trading.^{1/} The complaint further alleged that Allison, an associated person ("AP") at RBH,^{2/} advised Domenico to purchase as many as twenty-one gold futures contracts which ultimately caused her to lose \$83,850, and that he failed to advise her of the risks involved in commodity trading. It also alleged that Kravitz, another AP at RBH, caused Domenico an additional \$5,000 in losses by trading her account without advising her that she should not trade futures.

^{1/}The term "futures commission merchant" is defined in section 2(a)(1)(A) of the Act to include individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom. 7 U.S.C. §2 (1982).

^{2/}An associated person is generally described in section 4k of the Act as a person associated with, inter alia, an FCM in any capacity that involves the solicitation or acceptance of customers' orders. 7 U.S.C. §6k (1982).

On the eve of the hearings, Domenico voluntarily dismissed with prejudice all claims against Kravitz. Oral evidentiary hearings were held on October 21 and 22, 1982 in San Francisco, and on January 17, 1983 in Los Angeles.^{3/} Subsequently, an Administrative Law Judge ("ALJ") issued an initial decision finding that Allison failed to disclose to Domenico the risks of commodity trading in violation of the antifraud provisions of section 4b of the Act,^{4/} 7 U.S.C. § 6b(A)(1982), and that RBH failed to obtain a signed dated risk disclosure statement from Domenico prior to trading, in violation of section 1.55 of the Commission's regulations, 17 C.F.R § 1.55.^{5/} Based on these findings, the ALJ awarded Domenico damages of \$80,775.^{6/}

Respondents then applied for Commission review of the initial decision. While that application was pending, respondents also moved to supplement the

^{3/}Domenico testified and was subject to cross examination only at the October hearings. Although subpoenaed by respondents to testify at the January hearing, Domenico failed to appear. Thus, respondents urged that they were unable to cross examine her concerning discovery materials (e.g., account materials and trading records pertaining to the 1978 futures account she maintained at Merrill Lynch Futures before she opened her account at RBH) that she had not produced as of the October hearings that could shed light on the level of her sophistication as an investor. See C.R. 90 at 1308-09.

^{4/}In relevant part, section 4b(A) of the Act, 7 U.S.C. §6b(A)(1982), makes it unlawful for any person to cheat or defraud any other person in, or in connection with, orders for commodity futures contracts made for or on behalf of such other person.

^{5/}Section 1.55 of the Commission's regulations prohibits an FCM from opening an account on behalf of a customer unless the FCM first furnishes the customer with a separate written risk disclosure statement containing only the language set forth in regulation 1.55(b) and receives from the customer an acknowledgment signed and dated by the customer that he or she received and understood the risk disclosure statement. The language of regulations 1.55(a) and (b) is set forth at pp. 21-22, infra.

^{6/}The ALJ made no findings with respect to whether Domenico was suitable for commodity trading.

record with a newly discovered risk disclosure statement that was intended to corroborate Allison's testimony that he obtained a signed risk disclosure statement from Domenico when she opened her RBH account in April 1979. After granting respondents' motion to supplement, the Commission remanded the case to the ALJ for further consideration of the risk disclosure issues in light of the newly discovered evidence.

After allowing the parties an additional opportunity to supplement the record, the ALJ issued an initial decision on remand. He again ruled that respondents violated section 4b(A) of the Act and section 1.55 of the Commission's regulations by failing to adequately disclose risks to Domenico. On that basis, the ALJ affirmed his prior award in favor of Domenico.

Respondents again appealed. The Commission found on review that respondents had in fact adequately disclosed risks to Domenico. It therefore dismissed the complaint.

The petition for review to this court followed.

III. COUNTERSTATEMENT OF THE FACTS

A. Events Leading To The Proceedings Below

The following facts are not in dispute. Frances Domenico, a widow whose husband had died in June 1975,^{7/} became interested in gold and silver that same year when she read an investment book entitled, How To Prosper During the Coming Bad Years, by Howard Ruff ("Ruff"). (Tr. 19)^{8/} She also subscribed

^{7/} Domenico was separated from her husband at the time of his death.

^{8/}The abbreviation "Tr." denotes the reporter's transcript, which may be
(Footnote Continued)

to at least two periodical investment newsletters, one published by Ruff and another by James Sibbet. (Tr. 59) Neither Ruff nor Sibbet had any business affiliation with the respondents in this case. (Tr. 59, 68)

Between 1975 and 1979, Domenico invested the proceeds of her husband's life insurance policy, which belonged to her children, in mutual funds, South African gold mining shares, South African Kruggerands (gold coins), and bags of silver coins. (Tr. 22-23, 28-29) From October through December 1978, she maintained a nondiscretionary commodity futures account at Merrill Lynch Futures, an FCM, where she traded mainly agricultural commodity futures.^{9/} (Tr. 118; C.R. 63, at 1039-41.)

In one of his 1979 newsletters, Ruff recommended gold and silver futures trading at RBH. (Tr. 38.) In April 1979, Domenico, acting upon that recommendation, contacted RBH. After speaking to Allison, she decided to open a futures account with a deposit of \$5,000. (Tr. 36-37) Domenico received a rule 1.55 risk disclosure statement that Allison sent her along with other account papers at that time. (Tr. 43.) During May 1979, Domenico traded one gold contract that resulted in a loss of \$65. She then withdrew her funds from the account, and reinvested in gold and silver coins. (Tr. 60.)

(Footnote Continued)

found in Document Numbers 43, 44 and 60 of the Certified Record. The abbreviation "C.R." denotes the Certified Record. The Certified Record is divided according to Document Number, but is paginated sequentially. Thus, for example, page 2 of respondent's prehearing memorandum would be cited in this brief as (C.R. 42, at 247.) Hearing testimony is cited as "Tr." followed by the actual page number of the transcript where the cited material appears.

^{9/}A nondiscretionary account is one in which the customer retains the authority to make all of the trading decisions for the account. A broker who recommends a trade to such a customer ordinarily must obtain the customer's approval before the trade is executed.

In early 1980, upon advice from Sibbet, Domenico decided to invest in a Swiss commodity investment program.^{10/} (Tr.58) Domenico's decision to participate in this program was motivated by her desire to augment the profit potential of her investment funds through "leveraging." (Tr. 160, 185)

In his June 1980 newsletter, Ruff predicted a significant price rise for gold.^{11/} (Tr. 66.) In early June 1980, after learning from Sibbet that there would be a brief delay in setting up the Swiss escrow account, Domenico wired \$63,240 to RBH to reactivate her account with Allison. (Tr. 65; Exh. C-3). Later that same month, Domenico authorized Allison to purchase one gold futures contract, and two silver contracts for her account. (Exh. C-4; C.R. 45 at 571-73; Tr. 71-72) In early July 1980, when the Swiss silver investment program appeared ready to proceed, Domenico withdrew \$50,000 from her RBH account. (Tr. 73; Exh. C-4 at 10) However, a second delay, which was expected to last throughout the summer, again kept Domenico from establishing the escrow account. (Tr.73)

Domenico then called Sibbet and asked whether he could recommend another investment company through which she could promptly effect leveraging. (Tr. 73, 161) She also inquired whether she could buy gold, instead of silver, on margin through a Swiss bank. Sibbet told her that it would be too expensive to buy gold in that manner and suggested that Domenico buy futures while waiting for

^{10/}Under that program, an investor would establish an escrow account with a Swiss bank to buy silver. Once the silver was purchased, the investor would be permitted to borrow up to 50% of the value of the acquired silver, subject to interest charges, to buy additional silver. (Tr. 58).

^{11/}A July 1980 Ruff newsletter that Domenico also received had further predicted that the price of gold could move as high as \$850/oz. during July. (Tr.160)

the Swiss investment program to proceed. (Tr. 73, 161-162.) Acting upon this advice, Domenico wired \$103,200 to RBH on July 9, 1980, which increased her account equity to \$114,155. Early in the day on July 10, 1980, ten "long" gold contracts were acquired for Domenico's account at a \$670.50 price level.^{12/} When the market price continued to rise during the day, five additional long gold contracts were acquired for Domenico's account at the \$676 price level. The market continue to rise throughout Friday June 11. As a consequence, Domenico had made an (unrealized) profit of approximately \$10,000 in two days. (Tr. 391)

On Monday July 14, the market price of gold began to decline. Three additional long gold contracts were acquired at the \$647 price level in order to "average down" Domenico's overall long position in gold. On Tuesday July 15, the price of gold further declined dramatically. Late that day, Domenico and Allison discussed by telephone the extent of Domenico's unrealized losses and the likelihood that she would need to deposit additional funds to margin her eighteen contracts. The alternative was to sell her positions and realize her losses. Domenico informed Allison that she wanted to consult Sibbet before selling any of her positions. Sibbet, Allison and Domenico then had a three-way conversation in which Sibbet advised Domenico to stay in the market and to liquidate only as many contracts as would allow her to avoid a margin call. (Tr. 163-64) Acting on Sibbet's recommendation, Domenico liquidated all but five contracts, thereby incurring a loss of \$72,675 for the day. The remaining five

^{12/}A "long" futures contract is a contract to buy a standardized quantity of a commodity in a specified future delivery month. A long position in the futures market is taken by a trader who anticipates a price rise in the relevant commodity.

contracts were liquidated the next day when the market price further declined, adding another \$11,175 to her losses.

On July 25, 1980, Domenico and Kravitz had a telephone conversation, which was tape-recorded, in which she acknowledged that she entered the gold futures market on Ruff's and Sibbet's recommendation. (R. Exh. 20; C.R. 45 at 698-709) Domenico expressed dismay about her losses, and claimed that no one had ever explained the risks involved. In a subsequent tape-recorded conversation with Kravitz on July 28, 1980, Domenico arranged to transfer her account to Kravitz. (R. Exh. 20; C.R. 45 at 710-16) Thereafter, Domenico signed new account papers, including a risk disclosure statement and a discretionary account form authorizing Kravitz to make the trading decisions for the account. From August 5 until October 28, 1980, Kravitz traded the new account with no appreciable gains or losses. (Tr. 109-10)

Beyond the foregoing undisputed facts, the parties gave sharply conflicting accounts about whether Allison adequately disclosed the risks of futures trading, the extent to which Domenico relied on Allison for trading advice, and the extent that Allison was made aware of Domenico's personal and financial circumstances.

In her testimony, Domenico claimed that her account had in actuality been discretionary because Allison had made most of the trading decisions. (Tr. 70) She further stated that before reactivating her account in June 1980 she had described her personal and financial circumstances to Allison. (Tr. 69-70) Domenico testified that she informed Allison that the \$103,200 deposited with RBH in June 1980 was all she had and that it originated from her children's life insurance proceeds received from her deceased husband's policy. (Tr. 66) She

further related that she told Allison that she was living above a garage in a room with no furniture and subsisting on social security payments. (Tr. 80, 82)

Domenico also testified that she did not recall signing a risk disclosure statement when she opened her account with Allison and probably never read any statement she may have received. (Tr. 138) She further contended that the first time she realized she could lose all the money invested with RBH was upon reading the risk disclosure statement she received when Kravitz took over her account in early August 1980. (Tr. 109, 150)

Domenico additionally claimed that she told Allison to trade the account very conservatively. (Tr. 69) Moreover, Domenico testified that she told Allison that she did not want to risk a margin call because she had no more money. (Tr. 69) She stated that Allison told her there is risk in everything, but that risk could be kept at a minimum. (Tr. 138) According to Domenico, Allison made the decision to acquire the eighteen contracts on July 10 and July 14, although she acknowledged that she did not object to them. (Tr. 93-98, 162-63)

For his part, Allison testified that when Domenico opened her account at RBH, she informed him that she was married and a housewife. (Tr. 367, 404) Allison also testified that Domenico's account was nondiscretionary. (Tr. 372) In this regard, he stated that he sent Domenico a power of attorney form that would have authorized him to make the trading decisions for the account, but that Domenico never signed it because it was her stated intent to follow the trading recommendations of Sibbet and Ruff. (Tr. 372) Allison further testified that he sent Domenico a risk disclosure statement, and recalled going over that statement with her "line by line." (Tr. 367-68) According to Allison, Domenico never told him that the \$103,000 she deposited in July 1980 was all the funds she had. (Tr. 391)

Allison next testified that at the time Domenico rewired \$103,200 to RBH in early July, she told him that on Sibbet's recommendation she was going to buy between 25 and 30 gold contracts to obtain the maximum effect of leveraging.^{13/} (Tr. 385-86) Allison testified that he explained to Domenico that she could lose all her money in one day if the market moved against her. (Tr. 385) Although he agreed that Domenico emphasized that she did not want a margin call, Allison stated that Domenico told her she could come up with additional funds if necessary. (Tr. 387)

It was also Allison's testimony that although Domenico wanted to buy 25 contracts on July 10 (near the maximum that her deposit would allow because of a \$4,000-per-contract margin requirement), he ultimately convinced her to buy only ten contracts. (Tr. 389) Allison further testified that later that day, after repeated calls to Allison, Domenico ordered her to purchase another five contracts. (Tr. 390) When the market declined precipitously on July 15, Domenico insisted on staying in the market and did not agree to liquidate any of her positions until her conversation with Sibbet. (Tr. 395-96) Allison again emphasized that Domenico made all the trading decisions for the account (upon advice from Sibbet and Ruff). (Tr. 399) Allison further disputed Domenico's claim that the account had been overleveraged. (Tr. 399) Specifically, he testified that based on the equity in Domenico's account, as well as the market status on July 10 and 14, Domenico's eighteen contracts had not expose her to significant risk of a margin call or otherwise put her in an overleveraged position. Id.

^{13/}Allison also stated that Domenico told her that Sibbet and Ruff predicted that gold would reach an all-time high in July. (Tr. 384, 394)

There was also considerable confusion and dispute at the hearing regarding an unsigned, undated and underscored risk disclosure statement (Exh. C-11) which bore the number "31007" (the number of the Domenico account handled by Allison), as well as a second undated risk disclosure statement (Exh. R-2) signed by Domenico. Domenico first identified Exh. C-11 as the only one she received when she transferred her account to Kravitz^{14/} at the end of July 1980. (Tr. 151) Domenico further claimed that it was Kravitz who put the underlinings on Exh C-11. (Tr. 149-50) However, Domenico also identified a different (signed but undated) risk disclosure statement (Exh. R-2) as the statement she signed when she transferred her RBH account from Allison to Kravitz in late July 1980. (Tr. 151) Allison, on the other hand, testified that the signed, undated risk disclosure statement (Exh. R-2) was the one he sent Domenico before she opened her RBH account with him in April 1979. (Tr. 366)

B. The Proceedings Below

1. The Initial Decisions

On October 31, 1983, after the parties had filed proposed findings of fact and conclusions of law, the ALJ issued an initial decision (C.R. 72). On the risk disclosure issues, the ALJ credited Domenico's testimony concerning her lack of understanding about risk. (C.R. 72 at 1172) The ALJ also relied on the transcript of the July 25 telephone conversation between Domenico and Kravitz (in which Domenico asserted that no one ever explained risks to her) as additional support for her testimony. Id. On these bases, the ALJ concluded that

^{14/}Exh. C-11, the unsigned, underlined risk disclosure statement bearing the Allison account number, apparently was in Domenico's possession from the onset of this proceeding. It originated from Domenico's records, and not from the respondents' files. (Tr. 141-42)

Allison willfully failed to adequately disclose the risks of commodity futures trading in violation of the antifraud provisions of section 4b of the Act, 7 U.S.C. §6b. In addition, the ALJ determined that RBH failed to obtain a signed dated risk disclosure statement from Domenico in violation of Section 1.55 of the Commission's regulations, 17 C.F.R. §1.55. As a result, the ALJ calculated that Domenico lost \$80,775, and awarded her that amount, plus interest.

On November 16, 1983, respondents applied for Commission review of the ALJ's liability conclusions. While that application was pending, respondents also filed an application with the Commission to supplement the record to include after-discovered evidence. (C.R. 76) In their application to supplement, respondents stated that they had just discovered a missing risk disclosure statement--i.e., one that had been signed by Domenico and dated July 31, 1980--and urged that the newly discovered risk disclosure statement was the statement Domenico signed when she transferred her RBH account to Kravitz. (C.R. 76 at 1168) Thus, respondents argued in effect that the other signed (but undated) risk disclosure statement (Exh. R-2) must have been signed by Domenico when she opened her account with Allison.^{15/} Respondents also urged that the complaint should be dismissed because the ALJ's determination that Allison failed adequately to disclose risks to Domenico had been based in large part on the ALJ's mistaken view that Domenico signed only one risk disclosure statement.

On review, the Commission concluded that there were reasonable grounds for respondents' failure to produce the missing risk disclosure statement at the

^{15/}Without stating so explicitly, the ALJ had apparently credited Domenico's testimony (Tr. 151) that the signed, but undated risk disclosure statement (Exh. R-2) was the one that she signed when she transferred her account to Kravitz.

hearing and permitted them to supplement the record with this evidence.^{16/} (C.R. 79 at 1176 n.2) The Commission then reviewed the testimony of both Domenico and Allison. Id. at 1178. Specifically, the Commission took note of Allison's testimony that he had gone over the statement "line by line" with Domenico, and his assertion that the signed but undated risk disclosure statement was received from her before she opened her RBH account. Id. at 1178-79. At the same time, the Commission observed that Domenico's testimony did not specifically deny that Allison had reviewed such a document with her. Id. at 1179.

Because in its view the newly discovered evidence, when taken together with the existing evidence, tended to negate Domenico's contention that the undated disclosure statement (Exh. R-2) was signed when she transferred the account to Kravitz, the Commission reasoned as follows:

[T]he record provides no explanation for the existence of the signed but undated statement in respondents' possession other than that offered by respondent Allison. Complainant has never claimed that she signed two statements upon transferring her account to Kravitz. Absent some persuasive evidence, the record as it now stand would not support the [ALJ's] conclusion that a substantive violation of regulation 1.55 is established.

Id. at 1179-80. Therefore, the Commission remanded the case to the ALJ with instructions to consider the issue of whether Allison had obtained a risk disclosure statement prior to Domenico's trading even though that statement might

^{16/}That risk disclosure statement, unbeknownst to counsel for RBH and Allison, had been in the files of Kravitz' attorney, who was unaware of its significance to Allison and RBH. The statement had not been discovered until after the initial decision was entered. (C.R. 76 at 1166-67)

have been undated, and to afford Domenico an opportunity to present rebuttal testimony on that issue.^{17/}

On remand, the ALJ afforded the parties an additional opportunity to supplement the record with evidence relating to Domenico's risk disclosure. (C.R. 80) Respondents filed copies of 3 x 5 computerized account cards taken from RBH files. One was dated "4-30-9" (April 30, 1979), and contained an "X" and "Y" which denoted that both a signature card and a risk disclosure statement were on file for Ms. Domenico's account with Allison. (C.R. 81 at 1190-94) Respondents argued that Allison's uncontroverted testimony that he went over the risk disclosure statement line by line with Domenico, when taken together with the newly found risk disclosure statement, supported a finding that "complainant chose, out of ignorance or faith in her outside source of advice, to ignore the risks." (C.R. 86 at 1187)

For her part, Domenico's did not challenge the respondent's newly discovered evidence or the computerized account cards showing that a risk disclosure statement was on file as of April 30, 1979. (C.R. 86 at 1121-22) Rather, she

^{17/}The Commission also instructed the ALJ that if he were to adhere to his determination that respondents failed to obtain a signed risk disclosure statement from Domenico prior to trading, he should determine whether Domenico's losses were proximately caused by that failure. In this regard, the Commission explained that although there is a presumption of customer reliance on a broker's failure to obtain a risk disclosure statement, that presumption may be rebutted by a showing of either actual disclosure of risks or that Domenico was otherwise aware of the risks. The Commission further instructed that if the ALJ still found inadequate risk disclosure, he was to specify the material facts which he concluded that respondents failed to disclose. Finally, the Commission instructed the ALJ to explain his finding that Domenico was unsophisticated and whether that meant that "Allison did not sufficiently explain the risks of trading to her or whether he disclosed the risks and complainant chose, out of ignorance or faith in her outside source of advice, to ignore the risks." (C.R. 79 at 1180-82)

asserted that even with such additional proof, the record did not necessarily support a finding that Allison obtained a risk statement from her. Id.

Following these post hearing submissions, the ALJ issued a supplemental initial decision in which he again concluded that respondents failed to disclose the risks of futures trading. (C.R. 88) In his view, this newly discovered evidence, coupled with Allison's testimony, did not provide an adequate factual basis for concluding that the undated risk disclosure statement was signed prior to the trading in Domenico's account. Noting Domenico's assertion that she did not sign a risk disclosure statement at the time she opened her account with Allison, the ALJ found that Respondents offered no explanation for the absence of the date on Exh. R-2, the signed, undated risk disclosure statement. (C.R. 88 at 1276) Accordingly, he accepted Domenico's testimony on this issue and went on to conclude that respondents did not comply with regulation 1.55. Id.

The ALJ also concluded that respondents failed to rebut the presumption that Domenico relied on their nondisclosure of risk, i.e., that she would not have traded in the manner she did if respondents had adequately disclosed the risks to her. In this regard, the ALJ found that Domenico was unsophisticated, and unaware of the actual risks involved. Moreover, he found that Domenico had been lulled into a belief that respondents were capable of confining market risks on the basis of Allison's alleged statement that "there is [risk] in anything you do, but we could keep it at a minimum." See Tr. 138. The ALJ believed it "inherently fraudulent" for a broker to state that it can minimize the risk. Thus, the ALJ found that Allison's alleged statement that risks could be kept at a minimum constituted a fraud independent of respondents' inadequate risk disclosures. (C.R. 88 at 1277) Accordingly, the ALJ reinstated the \$80,775 award. The respondents appealed to the Commission.

2. The Commission's Final Opinion and Order

On review, the Commission found no record support for the ALJ's credibility finding, based on Domenico's testimony, that respondents did not obtain a signed risk disclosure statement from Domenico prior to opening her account with Allison. The Commission focused on the fact that, contrary to the finding of the ALJ, Domenico never unequivocally testified that she did not sign a risk disclosure statement at the time she opened her account with Allison. For this reason, the Commission declined to adopt credibility findings based on "testimony that does not exist." (C.R. 92 at 1340)

The Commission next determined that Domenico had failed to rebut either Allison's testimony that he went over the risk statement with her line by line, or the proof that a signed but undated risk disclosure statement from Domenico was on file at RBH as of April 30, 1979. In this connection, the Commission relied on Exh. R-2, as well as the newly discovered evidence and the computerized account card. Accordingly, it vacated the ALJ's findings that respondents did not obtain a signed risk disclosure statement from Domenico prior to trading, as well as his conclusions that respondents violated section 4b(A) of the Act, and section 1.55 of the Commission's regulations. (C.R. 92 at 1340)

The Commission then reviewed the ALJ's conclusion that respondents "lulled" Domenico into a belief that they were capable of confining market risk. The Commission observed that lulling occurs only in furtherance of a preexisting fraud. Because it had found that Domenico had signed a risk disclosure statement (Exh. R-2) before she commenced trading with Allison, there was no preexisting fraud. In the circumstances, the Commission further found that Allison's alleged statement that he could keep risk at a minimum was, at best, ambiguous, and did not rise to the level of a fraudulent misrepresentation. (C.R. 92 at

1341) The Commission deduced no basis for deferring to the ALJ's conclusion that the alleged statement was fraudulent where the ALJ had not based any liability conclusion on that statement in the first initial decision, where none of the evidence submitted on remand touched on this issue, and where the ALJ had provided no explanation for his change of view. Id. at n.2. For all these reasons, the Commission vacated the ALJ's conclusion that respondents misrepresented the risks of commodity trading and dismissed the complaint.

This appeal followed.

SUMMARY OF ARGUMENT

By statute, this Court's review of Commission orders in reparation cases is limited in scope. "The findings of the Commission, as to the facts, if supported by the weight of the evidence, shall. . . be conclusive." 7 U.S.C. § 18(e) (1982), incorporating by reference 7 U.S.C. § 9 (1982). As this Court has interpreted that provision:

Our role in reviewing CFTC reparation orders is extremely narrow. . . . The function of this court is something other than that of mechanically reweighing the evidence to ascertain in which direction it "preponderates"; it is rather to review the record with the purpose of determining whether the finder of fact . . . was justified.

Dohmen-Ramirez v. CFTC, 837 F.2d 847, 856 (9th Cir. 1988); accord, Chapman v. CFTC, 788 F.2d 408, 410 (7th Cir. 1986); Haltmier v. CFTC, 554 F.2d 556, 560 (2d Cir. 1977); see also Lawrence v. CFTC, 759 F.2d 767, 773 (9th Cir. 1985); Premex, Inc. v. CFTC, 785 F.2d 1403, 1407 (9th Cir. 1986).

This case involves the resolution by the Commission of widely conflicting testimony surrounding the opening of Domenico's account at RBH, Domenico's trading losses, and, in particular, whether those losses resulted from broker fraud. The dispositive issue is whether the weight of the evidence supports the Commission's factual determinations that respondents complied with their duties to disclose to Domenico the risks of commodity futures trading.

As will be shown, the record clearly supports the Commission's determination that Domenico signed a risk disclosure statement (Exh. R-2) before she opened her RBH account with Allison in April 1979. The Commission was well within its discretion to find that the missing risk disclosure statement signed by Domenico and dated "July 31, 1980" (C.R. 76 at 1168), submitted as newly discovered evidence after the hearing, negated Domenico's testimony that Exh. R-2, the undated, risk disclosure statement already in the record, was not signed until she transferred her account to Kravitz at the end of July 1980. Moreover, the Commission was entitled to find that the existence of two risk disclosure statements corroborated Allison's testimony that he obtained the signed, but undated risk disclosure statement (Exh. R-2) from Domenico before she opened her account with him.

The Commission's determination that respondents' risk disclosure pursuant to regulation 1.55 satisfied their duties to Domenico in this case was also sound. Beyond determining whether the notice requirements of regulation 1.55 have been met, the Commission reviews the nature of the relationship between the particular customer and the broker to ascertain the relative degree of reliance on the broker for trading advice. Here, the Commission correctly found a minimal degree of reliance. The record establishes that respondents did not solicit Domenico's account or otherwise play any role in her determination to trade

futures through RBH. Moreover, Domenico principally relied on outside advice and exercised independent judgment as to the type of trading and the timing of her investments in gold futures. Further, where, as here, petitioner also apparently concealed her true personal and financial circumstances from respondents, the Commission was surely justified in rejecting a claim that respondents owed Domenico a fiduciary duty to provide her any greater disclosure of risk than the detailed disclosures required by regulation 1.55.

Finally, the record supports the Commission's determination that Allison did not lull Domenico into believing that the risks of futures trading were less serious than characterized in the risk disclosure statement. Although no trading strategy is free of risk, the Commission's regulations recognize that there are some trading strategies that, relative to others, may be utilized to reduce risk under normal market circumstances. For this reason, the broker's alleged statement that risks could be kept at a minimum was not fraudulent per se.

Absent a showing of per se fraud, Domenico was required to show that Allison's alleged statement about keeping risk at a minimum was made in a specific context which was materially misleading. Here, Domenico has failed to show that Allison's alleged statements about minimizing market risks were made in a specific context that would reasonably operate to nullify the salutary effect of the risk disclosure statement (Exh. R-2) which Domenico had signed. Accordingly, in these circumstances, it was proper for the Commission to vacate the ALJ's findings of lulling activities.

ARGUMENT

THE WEIGHT OF EVIDENCE SUPPORTS THE COMMISSION'S FINDING THAT RESPONDENTS ADEQUATELY DISCLOSED THE RISKS OF COMMODITY FUTURES TRADING TO DOMENICO.

A. The Commission Properly Found That Respondents Complied With Section 1.55 of the Commission's Regulations.

Section 1.55 of the Commission's regulations prohibits an FCM from opening a commodity futures account unless it first "furnishes the customer with a separate written disclosure statement containing only the language set forth in paragraph (b) of this section . . . and receives from the customer an acknowledgment signed and dated by the customer that he received and understood the disclosure statement." 17 C.F.R. 1.55(a). It is beyond dispute that Domenico signed two separate risk disclosure statements, which both tracked the language of regulation 1.55(b), providing as follows:

RISK DISCLOSURE STATEMENT

This statement is furnished to you because rule 1.55 of the Commodity Futures Trading Commission requires it.

The risk of loss in trading commodity futures contracts can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. In considering whether to trade, you should be aware of the following:

(1) You may sustain a total loss of the initial margin funds and any addition [sic] funds that you deposit with your broker to establish or maintain a position in the commodity futures market. If the market moves against your position, you may be called upon by your broker to deposit a substantial amount of additional margin funds, on short notice, in order to maintain your position. If you do not provide the required funds within the prescribed time, your position may be liquidated at a loss, and you will be liable for any resulting deficit in your account.

(2) Under certain market conditions, you may find it difficult or impossible to liquidate a position. This can occur, for example, when the market makes a "limit move."

(3) Placing contingent orders, such as a "stop-loss" or "stop-limit" order, will not necessarily limit your losses to the intended amounts, since market conditions may make it impossible to execute such orders.

(4) A "spread" position may not be less risky than a simple "long" or "short" position.

(5) The high degree of leverage that is often obtainable in futures trading because of the small margin requirements can work against you as well as for you. The use of leverage can lead to large losses as well as gains.

This brief statement cannot, of course, disclose all the risks and other significant aspect of the commodity markets. You should therefore carefully study futures trading before you trade.

Rufenacht, Bromagen & Hertz, Inc.
222 South Riverside Plaza
Chicago, IL 60600

Gentlemen:

I have received a copy of the "Risk Disclosure Statement" required by Rule 1.55 of the Commodity Futures Trading Commission.

I have examined this document and understand fully the advice contained therein.

The initial question is whether the Commission properly concluded, based on the weight of the evidence, that Domenico had signed such a statement prior to opening the Allison account. As will now be explained, the record clearly supports this conclusion.

The first risk disclosure statement (Exh. R-2), which was introduced into evidence at the hearing, was signed by "Frances A. Domenico" but not dated. Domenico testified that the first statement was signed when she transferred her account from Allison to Kravitz at the end of July 1980 (Tr. 151), and the ALJ

apparently credited this testimony. The matter did not end there, however. While on appeal, respondents discovered the existence of important new evidence, a second risk disclosure statement signed "Frances Domenico" and dated "July 31, 1980." (C.R. 76 at 1168) As this newly discovered documentary evidence was plainly at odds with Domenico's testimony that the first undated, risk disclosure statement (Exh. R-2) was signed when she transferred her account to Kravitz at the end of July 1980,^{18/} the Commission was justified in setting aside the initial decision to explore the matter further on remand.

Equally significant, in ordering a remand, the Commission gave Domenico the opportunity to rebut the inference that the first, undated risk disclosure statement (Exh. R-2) was signed before she began trading with Allison. Despite this opportunity, Domenico made no serious attempt to rebut respondents' showing that the signed, undated risk disclosure statement (Exh. R-2) was obtained by Allison prior to opening her account.^{19/} For example, Domenico never asserted that she signed two risk disclosure statements upon transferring her account to

^{18/}Domenico had already testified at the hearing that she signed only one risk disclosure statement upon transferring her account to Kravitz. (Tr. 151)

^{19/}In her brief (Pet. Br. 13), Domenico attempts to find probative value in an undated exhibit (Exh. C-17; C.R. 45 at 627), an RBH compliance record which indicates that a "risk disclosure statement has not been signed." Domenico's argument there appears to be that this evidence undercuts the newly discovered evidence. The argument is groundless. That exhibit, Exh. C-17, in fact bears the account number "35221," which was clearly Kravitz' account number, not Allison's. See Tr. 142, 145, 433-34. Thus, Exh. C-17 was initially prepared around the time Domenico transferred her account to Kravitz (late July 1980), *i.e.*, before Kravitz had received the signed risk disclosure statement dated July 31, 1980 (*i.e.*, the statement admitted as newly discovered evidence). See Tr. 433-34. Accordingly, Exh. C-17 has no bearing on whether Domenico previously had signed a different risk disclosure statement (Exh. R-2) in connection with opening an account with Allison.

Kravitz.^{20/} Nor, in her supplemental response, did Domenico challenge the authenticity or the trustworthiness of either Exh. R-2, or the newly discovered risk disclosure statement, or the computerized account card. Rather, she resorted to ad hominem attack:

The writer of the [Commission's remand order] seems so impressed with the newly discovered evidence that we do not see any point in the case depending on this issue.

(C.R. 86 at 1-2).

In these circumstances, the Commission was also well within its discretion to find that respondents obtained a signed risk disclosure statement (Exh. R-2) from Domenico before she opened an account with Allison, and that respondent's supplemental evidence, unrebutted by Domenico, corroborated Allison's hearing testimony that he went over the risk disclosure statement "line by line" with her. (Tr. 367-68) The Commission's determination that the requirements of rule 1.55 were met is therefore entitled to stand.

In her opening brief, Domenico initially argues that it was "unreasonable" for the Commission not to adopt the ALJ's credibility findings that she did not sign a risk disclosure statement at the time she opened her account with Allison. (Pet. Br. at 8) While credibility findings by an ALJ are ordinarily entitled to deference by an administrative agency, as this Court has recognized they may be set aside if "inherently incredible" or "patently unreasonable," Dohmen-Ramirez v. CFTC, supra, 837 F.2d at 856. As already explained, the "patent unreasonableness" standard is met here because the newly discovered evidence

^{20/}The presence of Domenico's middle initial in her signature on Exh. R-2, and the absence of that initial on the newly discovered risk disclosure statement (C.R. 76 at 1168) establishes that Domenico did in fact sign two different statements.

eviscerated Domenico's testimony on this question. Moreover, close examination of the testimony reveals not a single instance in which Domenico unequivocally contradicted Allison's testimony that she signed a risk disclosure statement prior to trading. See, e.g., Tr. 138.

Domenico also criticizes the Commission for not giving decisional weight to her statements made in a tape-recorded telephone conversation on July 25, 1980 with Kravitz to the effect that no one ever explained to her how much risk there was. Domenico asserts that this testimony must be considered more persuasive than Allison's because it was "spontaneous" and made "without knowing the legal significance of what she was saying." (Pet. Br. 10-11)

Leaving aside the fact that this is nothing more than a quibble with the Commission's weighing of the evidence, the contention is not supported by the record. Domenico admitted that she had consulted an attorney about bringing suit against Allison shortly after her July 15 losses, but before she began trading with Kravitz. (Tr. 178) Standing alone, this lays to rest the self-serving assertion that her July 25 conversation with Kravitz was "spontaneous" or made "without knowing the legal significance of what she was saying."

B. The Record Supports The Finding That Respondents' Risk Disclosures Satisfied Their Fiduciary Obligation To Disclose Material Facts.

Mere compliance with the risk disclosure requirement of regulation 1.55 does not necessarily relieve a broker from potential liability arising from allegations of inadequate risk disclosure. See 17 C.F.R. § 1.55(d). Rather, whether a broker has a fiduciary obligation to disclose any additional information about risk in a specific context depends on the nature of the relationship between the customer and broker. See Romano v. Merrill Lynch, Pierce, Fenner &

Smith, 834 F.2d 523, 530 (5th Cir. 1987); Clayton Brokerage Co. v. CFTC, 794 F.2d 573, 582 (11th Cir. 1986). For example, if the broker is acting as a mere agent for execution of the customer's orders, compliance with regulation 1.55 normally fulfills the broker's duty to provide adequate risk disclosure. If, on the other hand, the broker has reason to know that a customer is relying upon him for advice, and has reposed trust and confidence in his handling of the account, this relationship may give rise to a fiduciary obligation under section 4b of the Act to provide additional material information concerning the risks inherent in specific transactions. See, e.g., Avis v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,379 at p. 25,832 n.9.

The record demonstrates that respondents initially did not induce Domenico or otherwise play any role in her determination to open an account with RBH in April 1979, or to reactivate that account in June 1980. As her own testimony shows, Domenico determined to open her RBH account in April 1979 on the basis of Ruff's recommendation that a portion of an investor's portfolio should be placed in the futures market, as well as his recommendation of that specific FCM. (Tr. 19, 35) Moreover, even Domenico's decision to reactivate that account in June and July of 1980 was based not on any solicitation by Allison or RBH, but on delays in the Swiss investment program and upon Sibbet's advice that she should invest her money in futures until the Swiss program was ready to proceed. (Tr. 161)

The record also supports the Commission's finding that Domenico's account was "nondiscretionary," i.e., that Domenico did not vest Allison with authority to make trading decisions for the account. Allison testified that he sent her forms which would have vested him with a power-of-attorney, but that Domenico

declined to sign them because of her stated intent to follow the trading recommendations of Sibbet and Ruff. (Tr. 372) Domenico also conceded on cross-examination to making all of the decisions on the gold and silver trades for her RBH account in April 1979 and June 1980. (Tr. 161)^{21/} And, Domenico admitted that, prior to the execution of her eighteen contracts, she told Allison to buy as many contracts as he felt she could safely afford. (Tr. 90) Indeed, on July 15, 1980, she did not allow Allison to liquidate any of her positions without first seeking instruction from Sibbet, and ultimately followed that instruction. (Tr. 163, 396, 437, 451)

The record further establishes that Domenico relied principally on outside sources of advice in making the trades that ultimately caused her losses. Domenico testified that her decision to buy gold was based on predictions in a Ruff newsletter that the price of gold would rise to \$850/oz. in July 1980. (Tr. 160) Her decision to rewire \$103,200 to her RBH account in early July was based on Sibbet's advice to buy futures while she was waiting for the Swiss silver program to proceed. (Tr. 161) As already noted, Domenico would not liquidate any of her eighteen gold positions on July 15, 1980 without consulting Sibbet. Moreover, sometime after her losses on July 15 and 16, Domenico wrote a letter to Ruff and blamed him for the "mess" she was in. (Exh. R-14; C.R. 45 at 650-52)

^{21/}Domenico also conceded that she controlled all the decisions for the 1978 trades in her Merrill Lynch account. (Tr. 114-115) Although Domenico testified that she traded only two (gold) futures contracts with Merrill Lynch Futures in 1978 before closing that account (Tr. 114), the record establishes that she traded substantially more futures contracts through Merrill Lynch. See C.R. 63 at 1039-41.

Thus, it is abundantly clear that Domenico did not rely primarily on any advice she may have obtained from the respondents.^{22/}

Finally, the record demonstrates that Allison had no reason to believe that Domenico was relying upon him to provide risk disclosures that went beyond the requirements of regulation 1.55. Allison testified that when she opened the account in 1979, Domenico told him that she was married and a housewife. (Tr. 367, 371, 404) This is corroborated by an April 1979 RBH customer agreement (Exh. R-1; C.R. 61 at 950) in which she listed her occupation as "housewife." Moreover, when Domenico made a \$5,000 initial deposit in April 1979, she told Allison that she had substantially more assets. (Tr.365-66) Later, when making the \$103,200 deposit in July 1980, Domenico told Allison that she did not want a margin call but could satisfy a call if one occurred.^{23/} (Tr. 387)

^{22/}What advice Allison did give was hardly damaging. As noted, Allison testified that Domenico wanted to place an order for 25 gold contracts, close to the maximum number that her deposit would allow, but he ultimately persuaded her not to take such a large position. (Tr. 389) He further testified she initiated the orders for all of the trades in her account. (Tr. 399)

^{23/}Furthermore, the record shows that Domenico apparently concealed her personal circumstances from Allison. Illustratively, Allison testified that Domenico never informed him that she was a widow. (Tr. 403)

Although Domenico claimed that she informed Allison that she was living on social security payments and was investing her children's funds that were proceeds from her husband's life insurance policy, her testimony is called into question by the July 25, 1980 telephone conversation with Maury Kravitz. According to the transcript of that telephone conversation, Domenico told Kravitz that she was a widow whose husband passed away "three or four months ago." (Exh. R-20; C.R. at 698) Yet, Domenico has consistently maintained in her testimony, in her pleadings before the Commission, and in her opening brief to this Court, that her husband passed away five years earlier, in 1975. Domenico's July 25, 1980 statement that her husband passed away "three or four months ago" thus corroborates Allison's testimony that Domenico told him that she was married and a housewife when she opened her account with him, and that he did not know that she was a widow.

(Footnote Continued)

C. The Commission Properly Concluded That Respondents Did Not Mislead Domenico As To The Risks Of Futures Trading.

Petitioner asserts that the Commission unreasonably ignored Domenico's testimony that Allison misrepresented that he could keep risk to a minimum. (Pet. Br. 14) The claim is without substance.

In concluding that this alleged statement was not inherently fraudulent, the Commission did not disturb the ALJ's finding that such a statement was made. Rather, it disagreed with the ALJ's legal conclusion that that statement, standing alone, was sufficient to establish liability for fraud.

Although no trading strategy is free of risk, section 1.55(b) of the Commission's regulations implicitly acknowledges that there are some trading approaches (for example, those that utilize spreads or stop loss orders) which, relatively speaking, may be used to reduce risk under normal market circumstances. For this reason, a broker's statement about keeping risk at a minimum is not per se false or fraudulent, and does not in and of itself eviscerate a risk disclosure given pursuant to regulation 1.55(b). Absent a showing of per se fraud, petitioner was required to show that Allison's alleged statement was made in a specific context which was materially misleading. This she failed to do.

(Footnote Continued)

Another instance in which Domenico misrepresented her personal circumstances occurred when Ms. Domenico opened a future trading account at another FCM, Becker-Kipnis, after she closed her account at RBH. Domenico stated on her application form for the BK account that her annual income was \$15,000 at a time when she testified that she was only receiving \$95 a month in social security payments. Domenico admitted deliberately misstating her income in order to be permitted to trade with BK. (Tr. 126-29) Regardless of what her motives were in each of the foregoing instances, it is clear that Domenico was prone to misrepresent her personal background. In turn, this calls into question her testimony about what Allison knew of her background.

Although Domenico frequently repeated her testimony about Allison's alleged statement (see Tr. 41, 81, 89, 138, 207), she never once demonstrated that it was made in a context which materially misled her. For example, Domenico did not claim that Allison told her to ignore the warnings on the risk disclosure statement she had signed, nor did she testify that Allison guaranteed that she would make money (or not lose money), or that her losses would be limited to any specific amount of money. Accordingly, the Commission was within its discretion to vacate the ALJ's finding of lulling activities.

Finally, Domenico argues (Pet. Br. 15) that the Commission misapplied its own case law in this proceeding by holding that there can be no liability for lulling activities absent a preexisting fraud. However, the authority relied on by Domenico bears no factual similarity to this case.^{24/}

In Machinski v. FCCB, an individual with no prior futures trading experience was induced to open a discretionary futures account on the basis of his broker's representations that risks would be minimized because the broker had an excellent track record; that the broker had the ability to assess future market trends; and that the broker would personally select the trade for Machinski's account. All of these representations were false. Machinski continued to trade on a nondiscretionary basis with FCCB even after he found out that his broker was not personally selecting the trades because the broker continued to falsely assure him of his tremendous track record of securing substantial profits for

^{24/}Domenico relies on Machinski v. FCCB, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,342 (1986) ("Machinski"); O'Hey v. Drexel Burnham Lambert, [1984-1986] Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,754 (1985) ("O'Hey"); and Undsdorfer v. Murlas Commodities, [Current Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,911 (1987) ("Undsdorfer").

customers, further inducing Machinski to trade according to the broker's recommendations. The Commission's found that the latter were "lulling activities" that further perpetuated the broker's preexisting fraud.

Similarly, in O'Hey v. Drexel Burnham Lambert, the customers were induced to open a commodity account on the basis of fraudulent misrepresentations that their risk of loss from a commodity tax straddle (involving both long and a short position in gold in different delivery months) would be limited to \$1,600. The customers ultimately lost in excess of \$200,000. Although the customers were aware that their losses exceeded \$1,600 well before they reached \$200,000, they were reassured by the broker that the profits to be generated from the long side of the straddle would eventually offset the losses from the short side of the straddle. The Commission found that these were lulling activities which caused the customers to remain in the market and incur substantial losses. Thus, contrary to petitioner's assertion, both Machinski and O'Hey support the Commission's statement in its final opinion here that "lulling behavior occurs in furtherance of preexisting fraud." (C.R. 92 at 1341).

The Commission's opinion in Undsdorfer also provides direct support for the decision under review here. In Undsdorfer, the customer, as in this case, was not induced to trade futures on the basis of any promotional activity or "high pressure" on the part of the broker. Moreover, no testimony in the record indicated that the broker had misled the customer as to the likelihood of profit. In short, there was no fraud committed by the broker. Accordingly, as in this case, the Commission vacated the liability conclusions based on what the ALJ perceived as "lulling activities," because it could find no "preexisting fraud." Undsdorfer at p.34,227.

CONCLUSION

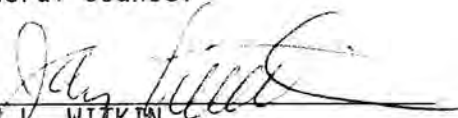
The petition for review should be denied.

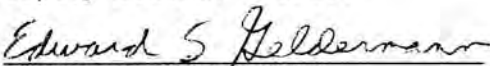
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Statement of Related Cases

The Commission knows of no related cases, as defined by Ninth Circuit Rule 28-2.6, presently pending in this Court.


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April 18, 1988