UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

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| In the Matter of: | : | CFTC Docket No. 01-08 |
| Michael H. Varner | : | OPINION AND ORDER |

Michael H. Varner ("Varner") seeks dismissal of one of the two theories of liability raised in the June 1, 2001 amended Complaint. He claims that the theory of liability is legally flawed and should be dismissed at this time because its inclusion in the amended Complaint triggered the suspension of his registration as a floor broker. The Division of Enforcement ("Division") argues that all the liability theories raised in the amended Complaint are legally sufficient and consistent with Commission precedent.

As explained below, we find that Varner has not established that there are extraordinary circumstances that warrant immediate consideration of his motion. Consequently, we dismiss it.

**BACKGROUND**

The procedural context of Varner's motion is unusually complex because at least three independent proceedings play a role in the ongoing suspension of his floor broker registration. To identify the roles played by the three proceedings, we must begin with the registration proceeding the Commission brought more than two years prior to the current enforcement proceeding.

I.

In January 1999, the Commission issued a Complaint alleging that Varner was statutorily disqualified from registration pursuant to Section 8a(3)(M) of the Commodity Exchange Act

("Act").[1] The Division relied on Varner's settlement of 35 New York Cotton Exchange ("NYCE") disciplinary actions between 1987 and 1997 as proof that there was "other good cause" for revoking his floor broker registration.[2]

The parties to the January 1999 proceeding settled their dispute in June 1999. The terms of their agreement were documented in the Commission's June 4, 1999 settlement order. *In re Varner*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,673 (CFTC June 4, 1999). The Commission agreed that Varner would retain his floor broker registration and Varner agreed to restrict his activities as a registrant (the "registration restrictions") during a two-year period.[3]

In addition to agreeing to the registration restrictions, Varner consented to the Commission's use of a special enforcement mechanism (the "streamlined enforcement procedures") during the two-year period that the registration restrictions applied. Under the streamlined enforcement procedures, Varner's registration would be "automatically suspended" when a triggering event took place. The parties agreed that this automatic suspension would terminate after six months, unless the Commission commenced a registration proceeding against Varner pursuant to Commission Rule 3.60(a).[4] According to the parties' agreement, the

[1] Section 8a(3)(M) is a catchall provision authorizing the Commission to deny a registration application when there is "other good cause."

[2] According to the January 1999 Complaint, NYCE's charges against Varner included prohibited trading ahead of customer orders, improper trade practices, and a variety of record keeping violations. The Complaint also noted that Varner had agreed to sanctions that included $36,250 in fines, two cease and desist orders, and a 30-day suspension of his membership privileges.

[3] These restrictions included: (1) no direct or indirect trading "on behalf of customers;" (2) no direct or indirect activities as "a principal, partner, officer, or branch office manager" of any entity registered with the Commission; and (3) only using "MGF Clearing Corp." to clear trades.

[4] Commission Rule 3.60(a) governs statutory disqualification proceedings pursuant to Sections 8a(2), (3), and (4) of the Act.

triggering event for the streamlined enforcement procedures was Varner being charged with a "disciplinary offense as defined in [Commission Rule] 1.63(a)(6)."[5]

II.

The current enforcement proceeding commenced on May 31, 2001, when the Commission issued a Complaint alleging that Varner violated three of the six registration restrictions imposed in the June 4, 1999 Settlement order.[6] The May 2001 Complaint directed that an ALJ conduct a hearing on whether Varner had violated the cited restrictions and, if the record showed that he had, decide the appropriate sanctions for the violations demonstrated. It did not allege a violation of the Act or Commission regulations and did not reference the streamlined enforcement procedures set forth in the June 4, 1999 Settlement order.

On June 1, 2001, the Commission amended the May 2001 Complaint to add a second theory of liability. The amended complaint alleged that Varner's failure to comply with the registration restrictions imposed in the June 4, 1999 Settlement order amounted to a violation of Section 6(c) of the Act. It did not raise any new factual allegation or seek additional sanctions or relief. Nor did it reference the streamlined enforcement procedures set forth in the June 4, 1999 settlement order.

On June 4, 2001, the Division issued a press release announcing the Commission's May 2001 Complaint. This press release made a reference to the streamlined enforcement procedures set forth in the June 4, 1999 settlement order, indicating that "the filing of the complaint against Varner triggered an automatic suspension of his registration as a floor broker."

[5] That provision defines "disciplinary offense" to include any violation of the Act or Commission regulations as well as any violation of specified types of self-regulatory organization rules.

[6] An enforcement proceeding is based on the authority conferred by Section 6(c) of the Act. In contrast to a registration proceeding, an enforcement proceeding may result in the imposition of a cease and desist order, trading ban, or civil money penalty in addition to a registration sanction.

III.

The third proceeding, a registration proceeding before the National Futures Association ("NFA"), was commenced on June 1, 2001, when NFA issued a letter notifying Varner that it was amending his registration record to show that: (1) his registration was suspended as of May 31, 2001 and (2) the Commission had issued a Complaint alleging that he violated registration restrictions imposed in its June 4, 1999 Settlement order.[7] NFA's letter indicated that it would amend Varner's registration record in the manner described above unless Varner filed a written objection by June 11, 2001. In addition, it advised that Varner "[could] not trade on any contract market or act in any capacity that requires registration."

NFA's letter gave two reasons for its decision to amend Varner's registration record. First, it stated that the "Commodity Futures Trading Commission" had notified NFA of its May 2001 Complaint against Varner. Second, the letter stated that the "CFTC" had "directed NFA to implement the automatic suspension provision" included in the June 1999 Settlement order. NFA did not describe either communication in detail.[8] Nothing in the record suggests that Varner filed a written objection with NFA.

IV.

At a telephone conference that he initiated on June 8, 2001, the ALJ presiding over the current enforcement proceeding sharply criticized the suspension of Varner's registration on May 31, 2001. He characterized the suspension as reflecting an unjust "[s]entencing [Varner] first, verdict afterwards," (Tr. at 8) and claimed that it irreparably harmed Varner by denying him

[7] Section 17(o)(1) of the Act authorizes the Commission to delegate its registration functions under the Act to a registered futures association. The Commission has delegated its authority to deny, condition, suspend, modify, restrict, or revoke the registration of a floor broker to NFA. *See* 59 F.R. 38957 (August 1, 1994).

[8] As discussed below, NFA's reference to the "Commodity Futures Trading Commission" or "CFTC" appears to be a type of "shorthand" reference to a communication from one or more members of the Commission's Staff. Varner alleges that a member of the Division contacted NFA with instructions.

"his day in court to defend himself against the underlying charges that he violated the terms of the [June 4, 1999 settlement agreement]." (Tr. at 9.)

The ALJ viewed the suspension as the direct result of an "apparently wrongheaded amendment to the Complaint" in the current enforcement proceeding. He characterized the amended Complaint's allegation that Varner violated Section 6(c) of the Act as "frivolous on its face," and suggested that Section 6(c) was "incapable of being violated by Mr. Varner, or . . . any other respondent." (Tr. at 8.)

The ALJ recognized that the Commission's Part 10 Rules did not authorize him to consider a motion to dismiss the allegation that Varner violated 6(c) of the Act.[9] Nevertheless, he ordered counsel for the Division to file a brief defending the validity of the 6(c) allegation. In this regard, the ALJ emphasized that Division counsel had an "ethical obligation" to confine his arguments to those with a good faith basis, and that he was giving counsel an opportunity to demonstrate that he was acting in good faith. (Tr. at 28.)

The Division filed the required brief on June 12, 2001. Among other things, the brief noted that the Commission had affirmed an ALJ's determination that a respondent's failure to comply with a Commission cease and desist order amounted to a violation of current Section 6(c)'s predecessor, Section 6(b). *In re Grossfeld*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,726 at 40,367 (CFTC May 20, 1993). In his responsive brief, Varner claimed that the Commission's *Grossfeld* decision was distinguishable because, in the current enforcement proceeding "the Commission ha[d] not alleged a violation of any substantive section of the Act or regulation, which, standing alone could serve as the basis for the violation."

[9] The ALJ noted the Commission's decision in *In re Trillion Japan Company, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,082 at 41,589-60 (CFTC May 23, 1994) ("*Trillion*") and advised respondent's counsel that the Commission would only consider such a motion to dismiss in the context of extraordinary circumstances. (Tr. at 27-28.)

Varner's Response at 6-8. After reviewing the briefs, the ALJ issued an order staying all proceedings while Varner sought Commission consideration of a motion to dismiss the allegation that he violated Section 6(c) of the Act.

V.

Varner filed his motion to dismiss the Section 6(c) charge in July 2001. As to the substance, Varner essentially argues that the logic underlying the Commission's *Grossfeld* decision should either be abandoned as flawed or limited to the particular facts in that case. As to the need for immediate review, Varner emphasizes what he regards as the unjustified ongoing suspension of his floor broker registration.[10] He suggests that an immediate decision on the merits will end the irreparable harm arising from the ongoing suspension because it will lead to: (1) a dismissal of the allegation that he violated Section 6(c) of the Act and (2) a determination that the theory of liability raised in the May 2001 Complaint was not sufficient to trigger the streamlined enforcement procedures set forth in the June 4, 1999 settlement order. Varner dismisses NFA's June 1, 2001 determination that his registration was suspended on May 31, 2001 as a product of improper advice from the Division.

The Division opposes Varner's motion on the merits but does not oppose his claim that there are extraordinary circumstances warranting an immediate decision on the motion.

**DISCUSSION**

I.

Because Varner's motion to dismiss is the first filed since we issued our decision in *Trillion*, we take this opportunity to briefly review our holding and amplify on our policy

[10] Because more than six months have passed, any suspension of Varner's registration triggered by the commencement of this proceeding has lapsed. The issue raised by Varner is not moot, however, because registration records maintained by NFA show that he remains suspended pending resolution of a statutory disqualification proceeding commenced in November 2001.

regarding such motions. In *Trillion*, an ALJ ruled that he was authorized to consider motions to dismiss enforcement Complaints pursuant to Commission Rule 10.26.[11] The Commission held that Rule 10.26 did not authorize an ALJ to consider such motions and that Rule 10.3(c)[12] does not amount to a "license for presiding officers to do what they think best in all circumstances." *Id*. at 41,590. We noted that the Division had followed the appropriate procedure by filing the motion directly with the Commission and requesting a waiver of Rule 10.26's requirement that motions filed prior to the issuance of an initial decision be directed to the ALJ. We recognized, however, that considering motions filed directly with the Commission would create incentives for parties to bypass presiding officers, and indicated that we would discourage the practice by requiring "extraordinary circumstances" to justify intervention prior to a final decision. *Id.* at 41,589 n.6.

The requirement of extraordinary circumstances is particularly important in the context of motions to dismiss part or all of an enforcement complaint. Enforcement complaints generally allege specific facts and circumstances that identify the core wrongful conduct at issue in a case. In addition, they frequently raise a variety of overlapping legal theories in support of a request for sanctions. Our precedent recognizes that disputes relating to overlapping legal theories are frequently immaterial to the imposition of sanctions appropriate to the core wrongful conduct established on the record. *See, e.g.*, *In re Incomco*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,198 at 38,535-36 (CFTC Dec. 30, 1991) ("our selection of appropriate sanctions in a particular case turns more on an examination of the overall nature of the wrongful

[11] Rule 10.26 is a catchall provision permitting parties to file motions seeking "a form of relief not otherwise specifically provided" in Part 10. It states that such motions shall be directed to the presiding ALJ "prior to the filing of an initial decision in a proceeding," and to the Commission "after the initial decision has been filed."

[12] Rule 10.3(c) authorizes presiding officers to waive any rule in Subparts A through H of Part 10 in certain limited circumstances.

conduct than a simple enumeration of the number of violations established on the record.") Consequently, prior to the development of the record at a hearing, determining the practical significance of a particular legal theory is often, at best, a matter of speculation.

Given these circumstances, entertaining challenges to the legal theories raised in enforcement complaints generally wastes the resources of both the parties and the forum. Extraordinary circumstances may exist, however, where the record shows that eliminating a particular legal theory will result in a substantial reduction in the scope of the factual disputes considered at a hearing. In such circumstances, the benefits of immediate review will frequently outweigh the costs and disruption attendant on piecemeal litigation.[13]

Varner, however, cannot claim that a dismissal of the amended Complaint's allegation that he violated Section 6(c) of the Act will substantially reduce the scope of the factual disputes considered at the hearing. Under either legal theory included in the amended Complaint, the parties' factual dispute will focus on whether Varner violated the registration restrictions imposed in the Commission's June 4, 1999 settlement order. Consequently, Varner's claim that extraordinary circumstances warrant immediate consideration of his motion must rise or fall with his claim that immediate review on the merits will end the irreparable harm arising from the unjustified, ongoing suspension of his floor broker registration.

The premise underlying this claim, however, is clearly flawed. NFA's June 1, 2001 letter notified Varner that, absent his objection, it was amending his registration record to show that his

[13] In the context of interlocutory review, we have recognized that identifying extraordinary circumstances involves balancing:

> [T]he benefits of immediate intervention against those flowing from our policy of discouraging piecemeal appeals, including conservation of Commission resources and preservation of the orderly conduct of Commission proceedings.

*In re Bilello,* [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,032 at 41,311 (CFTC March 24, 1994).

registration was suspended as of May 31, 2001 - - the date that the Commission issued the May 2001 Complaint. By referring to this date, NFA indicated that it was relying on the May 2001 Complaint rather than the June amended Complaint.[14] Consequently, there is no basis for inferring that the inclusion of a second theory of liability in the June amended Complaint triggered Varner's suspension.

Varner seeks to divert attention from this fundamental flaw by treating NFA's determination as a meaningless technicality tainted by instructions from Division staff. Certainly NFA's acknowledged reliance on advice from Commission Staff raises a question about the validity of the analysis underlying its determination.[15] Varner, however, apparently failed to raise these alleged defects before NFA within the ten days specified in the June 1, 2001 letter. Indeed, in urging us to conclude that the theory of liability raised in the May 2001 Complaint was not sufficient to trigger the streamlined enforcement procedures set forth in the June 4, 1999 settlement order, Varner does not even acknowledge that he is collaterally attacking NFA's determination to the contrary.

In effect, Varner is urging us to bypass the process Congress specifically created so that aggrieved parties could obtain review of NFA registration decisions.[16] He offers no rationale that supports such an exception, however, and we find no basis to infer that review of NFA's

[14] Indeed, there is nothing in the record indicating that NFA was even aware of the amended Complaint when it made its determination.

[15] We have noted that "[i]n delegating registration responsibilities to NFA, we intended that NFA exercise independent judgment based upon its expertise." *In re Horn*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23, 731 at 33,888 (CFTC July 21, 1987). Moreover, we have held that advice offered by Commission staff is "not generally binding on either the Commission or private parties" even when it is "formally publicized." *In re Antonacci*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,835 at 36,932 (CFTC Apr. 18, 1990).

[16] Section 17(o)(2) of the Act grants a right to petition for Commission review of a registered futures association's registration decisions. Such petitions are governed by the Commission's Part 171 Rules. Commission decisions are subject to review in a United States Court of Appeals.

determination pursuant to Part 171 would provide inadequate protection for Varner's interest in continued registration. Consequently, we decline to review NFA's June 1, 2001 determination in the context of this enforcement proceeding.[17]

In view of Varner's failure to establish that a dismissal of the allegation that he violated Section 6(c) will affect the ongoing suspension of his floor broker registration, we find that immediate consideration of his motion to dismiss is not warranted.

II.

Finally, as a matter of future guidance, we note several problems with the ALJ's decision to exercise jurisdiction over issues related to the streamlined enforcement procedures concerning Varner's floor broker registration. For example, it is quite unusual for a presiding officer to convene a telephone conference, *sua sponte*, before a respondent has even had an opportunity to answer a Complaint. It is even more unusual for a presiding officer to conclude that one party is advocating a facially frivolous legal position that irreparably harms the other party prior to hearing any argument from counsel. In some circumstances, such conduct might suggest the type of deep-seated favoritism or antagonism that warrants disqualification. *Compare McDaniel v. Amerivest Brokerage Services*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,264 at 50,591 (CFTC Sept. 26, 2000) (noting that an ALJ's inclusion of factual findings in an initial decision unrelated to allegations in the complaint could, in certain circumstances, suggest deep-seated favoritism or antagonism on the part of the ALJ). While we do not find that to be case in the present matter, the ALJ's judgment was not what it should have been.

[17] Because Varner failed to object within the ten days specified in NFA's letter, NFA's Compliance representative may object if Varner seeks to appeal at this late date. We are confident, however, that in resolving such an objection, NFA will give appropriate consideration to the fact that this matter involves procedural issues of first impression as well as the confusion arising from the ALJ erroneous exercise of jurisdiction.

Our precedent makes it clear that the sources of an ALJ's authority in enforcement cases are limited to the Administrative Procedure Act ("APA") and the Commission's Part 10 Rules. *Trillion*, ¶ 26,082 at 41,589. Moreover, we have also indicated that we do not interpret some of the general grants of authority in the APA and the Part 10 Rules, such as Rule 10.8(a)(6)'s authority to regulate the course of the hearing or Rule 10.3(b)'s authority to waive the rules in Subpart A through G, as a license for presiding officers to "do what they think best in all circumstances." *Id.* at 41,590. ALJ's have a right to expect respect for their authority from counsel and parties. At the same time, however, they have a duty to respect the limits on their own authority.[18]

An ALJ derives his authority over the parties to a particular case through the case assignments he receives from the Director of the Office of Proceedings. The nature of any particular assignment is defined in the Commission's Complaint. An ALJ's jurisdiction does not extend to any pending dispute between the parties to the Complaint; it extends solely to the disputes described within the four corners of the Complaint. The ALJ may only exercise the authority granted by the APA or Part 10 in the context of these disputes.

As noted above, both the May 2001 Complaint and the June 2001 amended Complaint mentioned the registration restrictions imposed by the Commission's June 1999 settlement order, but neither mentioned the streamlined enforcement procedures set forth in the settlement order.[19] On their face, both the May 2001 Complaint and the June 2001 amended Complaint focused the ALJ on whether Varner had violated the registration restrictions in the settlement order and, if

[18] For example, as we noted in *Trillion*, " 'Musty' or not, presiding officers are bound by Commission decisions until they are reversed or otherwise refined by the Commission." *Id*. at 41,589.

[19] The Division's June 4, 2001 press release did mention the streamlined enforcement procedures. Such press releases, however, are not part of the Commission's Complaint. Nor do they represent the position of the Commission in its adjudicatory capacity.

the record showed that he had, what the appropriate sanctions were for the violations demonstrated. Nothing in the May 2001 Complaint or the June 2001 amended Complaint suggested that the ALJ had the authority to consider disputes about Varner's registration status during the pendency of this enforcement proceeding. Consequently, the ALJ had no basis for assuming jurisdiction over issues related to that dispute.

Even apart from this error, we are puzzled by the ALJ's orders requiring counsel to participate in a telephone conference and file briefs on an issue the ALJ acknowledged he was not authorized to decide. Parties to Commission enforcement proceedings rightfully expect that their resources will not be diverted to irrelevant exercises.

Nor can the ALJ justify his orders by citing his concern over counsels' compliance with ethical obligations. As we noted in *In re Global Minerals & Metals Corp,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,189 at 50,233 (CFTC July 13, 2000), Part 14 of the Commission's Rules establishes a formal process for sanctioning attorneys who appear before the Commission. Rule 14.8 contemplates the imposition of sanctions on representatives found to lack "character or integrity" or to have "engaged in unethical or improper unprofessional conduct either in the course of an adjudicatory, investigative, rulemaking or other proceeding before the Commission or otherwise." Because the Part 14 Rules provide a more than adequate tool for deterring unethical or unprofessional conduct in Commission proceedings, and reserve the initial prosecutorial determination to the Commission, there is no rationale for a presiding officer to divert his focus from the issues raised in the Complaint by taking on the roles of either investigator or prosecutor of alleged professional lapses. Unlike judges appointed under Article III of the United States Constitution, Commission presiding officers simply do not have inherent

authority to supervise the ethics of attorneys who appear before them.[20]

Finally, we are concerned about the apparently unintended consequences of the ALJ's misjudgments. Varner's ten-day period for objecting to NFA's June 1, 2001 determination ran while Varner's counsel waited for the Division's brief responding to the ALJ's June 6, 2001 order. While counsel must accept substantial responsibility for this result, the ALJ's outspoken support for Varner's position was undoubtedly an influence on counsel's apparent strategy of ignoring NFA's ongoing proceeding. Moreover, by staying all proceedings so that Varner could file a motion with the Commission, the ALJ unnecessarily delayed the resolution of the factual dispute central to Varner's continued registration – whether Varner violated the registration restrictions he agreed to as part of his settlement of the Commission's January 1999 enforcement proceeding. Indeed, a swift hearing on the merits would have been the most efficient tool for addressing the irreparable harm Varner allegedly suffers due to the ongoing suspension of his floor broker registration.

**CONCLUSION**

In light of our analysis, we dismiss Varner's motion to dismiss, vacate the ALJ's stay of the proceedings before him, and order the ALJ to conduct a hearing on the issues raised in the

[20] *In re Sealed Appellant,* 194 F.3d 666, 671 (5th Cir. 1999) (holding that Article III courts have the inherent authority to control the conduct of attorneys appearing before them by imposing a variety of sanctions, including disbarment). Of course, Commission Rule 10.11(b) specifically authorizes presiding officers to debar counsel from enforcement cases for contemptuous conduct committed in the their presence when the presiding officer actually sees or hears the offending conduct. *In re Global Minerals,* ¶ 28,189 at 50,233. Presiding officers may report allegedly unethical conduct that does not meet this standard to the Office of General Counsel, which prosecutes cases brought under the Commission's Part 14 Rules.

amended Complaint on an expedited basis.

IT IS SO ORDERED.

By the Commission (Chairman NEWSOME and Commissioners HOLUM and ERICKSON).

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

Dated: April 29, 2002