

Current Comment
Litigation Watch

IN THE MATTER OF GARY GLASS & ZOLTAN GUTTMAN

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A recent CFTC decision involving Zoltan Guttman ("Guttman"), the former chairman of the New York Mercantile Exchange (NYMEX), has grabbed the attention of the futures community. On April 27, 1998, the CFTC affirmed the Administrative Law Judge's ("ALJ") findings that respondents had engaged in fictitious wash sales and non-competitive transactions, and that they violated the Commodity Exchange Act's (the "Act") trade practice, recordkeeping, and financial reporting requirements. [FN1]

Most notably, the CFTC reversed the ALJ's determination and held Guttman liable as a "controlling person" under the Act, Section 13(b), [7 U.S.C. § 13\(c\)\(b\)](#) ("Section 13(b)"), with respect to the trading activities of respondent Harold Magid ("Magid").

Background and The Trading Activity

As alleged by the Division of Enforcement, in 1987 Guttman and Magid began a partnership to engage in trading activities in joint accounts. Magid handled the day-to-day management of the accounts, while Guttman managed the financial affairs and maintained the books and records. Magid began to utilize respondent Glass as a counter-party whereby Magid and Glass entered into trades on the last trading day of the month, and then offset those transactions on the first trading day of the following month. The Division alleged that these trades, while giving the appearance of open market transactions, were in reality fictitious or accommodation trades.

On February 17, 1993, a seven-count complaint was issued against Gary Glass, Zoltan Guttman, Harold Magid, and Gerald, Inc. for violations of the Act. Specifically, the complaint alleged that "Magid and Glass entered into wash, fictitious and accommodation trades in violation of Section 4c(a)(A) of the Act; caused non-bona-fide prices to be reported in violation of Section 4c(a)(B) of the Act; and violated Commission Rule 1.38 by engaging in non-competitive trading." [FN2] In addition, the complaint charged Guttman pursuant to Section 13(b) as a controlling person of Magid, and pursuant to Section 2(a)(1)(A) of the Act alleging that Magid was acting as Guttman's agent. Gerald, Inc. and Glass were charged with several other miscellaneous violations.

The Initial Decision

After trial, the ALJ (Painter, J.), issued a decision dated September 11, 1996 which concluded that the trades executed by Magid and Glass were fictitious wash sales because the trading techniques that they employed gave the appearance of open market transactions when in fact risk had been negated; respondents had knowingly intended to avoid bona fide market positions. [FN3]

Finding that Magid acted as Guttman's agent, and that Magid's actions were within the scope of his employment, Guttman was held vicariously liable as a principal for Magid's trades under Section (2)(a)(1)(A) of the Act. [FN4] The ALJ did not impose liability under Section 13(b), control person liability, because the ALJ found that "Magid was the sole decision-maker over all trading - that makes it impossible for Guttman to be the controlling person of Magid regarding these trades." [FN5]

The ALJ imposed the following sanctions:

(i) On Guttman, a cease and desist order, a five-year trading ban, a \$500,000 penalty, and the revocation of his registration; and

(ii) On Glass, a cease and desist order, a permanent trading ban, and a \$150,000 penalty. [FN6]

In sanctioning Guttman, the ALJ stated: "As the Chairman of the NYMEX throughout the relevant time period, Guttman was bound by the highest ethical standards, yet permitted his partner to subvert the free market system through prearranged transactions. Guttman's gross violations of the Act over a period of six months, especially in light of the fact that he was the chairman of the NYMEX, directly taint the integrity of the futures market and warrant serious sanctions." [FN7]

The Appeal

On appeal, the Division sought reversal of the ALJ's finding that Guttman was not liable as a controlling person with regard to Magid's trades. Guttman sought reversal of his liability as a principal under Section (2)(a)(1)(A), and alternatively, sought a reduction of sanctions because the ALJ improperly considered his status as NYMEX chairman. Glass claimed that his due process rights were violated, and requested that the sanctions imposed on him be reduced.

Several amicus briefs were filed in support of Guttman's appeal. Briefs were filed by the Chicago Mercantile Exchange ("CME"), the Chicago Board of Trade ("CBOT"), the Coffee, Sugar and Cocoa Exchange, Inc. ("CSCE"), the Commodity Floor Brokers and Traders Association ("CFBTA"), the New York Cotton Exchange ("NYCE"), and the New York Mercantile Exchange ("NYMEX"). The amici expressed much concern that the ALJ improperly had increased the sanctions levied upon Guttman because of Guttman's position as chairman of the NYMEX. As the NYMEX stated: "Such an increase of the penalty based upon one's Board Service on an exchange could chill the willingness of members to serve in official capacities for exchanges." [FN8]

In addition, the amici expressed concern that finding Guttman vicariously liable for violations of his partner in a trading account without Guttman having known of, or participated in, illegal activity is fundamentally wrong under the Act's provisions relating to secondary liability.

The Decision

The Commission upheld the ALJ's imposition of liability upon Glass and Guttman. However, the Commission reversed the ALJ's decision on the issue of control person liability, and held Guttman liable under Section 13(b) as a controlling person with respect to Magid's trading activity. In addition, the Commission increased the penalty assessed against Glass to \$300,000.

Control Person Liability

In imposing control person liability upon Guttman, the Commission noted that "a fundamental purpose of Section 13(b) is to allow the Commission to reach behind the business entity to its controlling individual and to impose liability for violations of the Act directly on such individual as well as on the entity itself." [FN9] Although the ALJ found that: (a) Guttman (1) did not "control" Magid's trading, (2) did not trade for the accounts and (3) did not interfere with Magid's trading strategy, and (b) Magid was the sole decision maker for all trading, the Commission

nevertheless found that the relevant inquiry was whether Guttman "had the power to control" the activity in question. As the Commission stated:

Thus, if Guttman had sufficient control either to direct or to interfere with the partnership's unlawful trading activity, it is not necessary that Guttman actually dictate the specifics of the trading in order for him to have been a controlling person of the partnership. [FN10]

The Commission confirmed the standard to be applied for control person liability -- that there must be culpability. Guttman must be proven to have either knowingly induced the violation of the Act, directly or indirectly, or to have failed to act in good faith. [FN11] Applying this standard, the Commission found that Guttman had agreed to pursue the prearranged strategy, and that he had failed to stop the prearranged wash transactions. Furthermore, the Commission found that Guttman's continual involvement and participation in the joint account constituted a knowing inducement of unlawful trading activities. Consequently, the Commission imposed control person liability because Guttman had "knowledge" of the unlawful activities and allowed them to continue.

While upholding the sanctions imposed upon Guttman, the Commission did not directly address the concerns expressed by Guttman and the amici that the sanctions were unduly harsh because of Guttman's status as the chairman of NYMEX.

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FN1. In re Glass and Guttman, CFTC Docket No. 93-4, 1998 CFTC LEXIS 95 (April 27, 1998).

FN2. In re Glass and Guttman, 1998 CFTC LEXIS 95 at *4.

FN3. In re Glass and Guttman, CFTC Docket No. 93-4, COMM. FUT. L. REP (CCH) ¶ 26,787, 1996 CFTC LEXIS 175.

FN4. In re Glass and Guttman, 1996 CFTC LEXIS 175, at *28; COMM. FUT. L. REP (CCH) ¶ 26,787.

FN5. Id. at *24.

FN6. Gerald, Inc. and Magid both settled and paid civil monetary fines.

FN7. In re Glass and Guttman, 1996 CFTC LEXIS 175, at *29-30.

FN8. (Brief of NYMEX, Pg. 1.)

FN9. In re Glass and Guttman, 1998 CFTC LEXIS 95 at *55 (citations omitted).

FN10. Id. at *56.

FN11. Id. at *61.