

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

U.S. COMMODITY FUTURES
TRADING COMMISSION :
v. : Civil Action No. DKC 2004-1021
CALVARY CURRENCIES LLC, et al. :
:

MEMORANDUM OPINION

Presently pending and ready for resolution in this commodities regulation case are (1) the motions of Plaintiff for entry of default and default judgment, permanent injunction and ancillary relief against Defendant Calvary Currencies, LLC, pursuant to Fed. R. Civ. P. 55(b)(2); and (2) the motions of Defendants to dismiss for failure to state a claim, pursuant to Fed. R. Civ. P. 12(b)(6).¹ The issues are fully briefed and the court now rules pursuant to Local Rule 105.6, no hearing being deemed necessary. For the reasons that follow, the court denies Plaintiff's motions and both Defendants' motions.

I. Background

On March 29, 2004, Plaintiff, the United States Commodity Futures Trading Commission ("CFTC") filed an action in this

¹ The two Defendants filed separate motions to dismiss, but because the memoranda in support of the two Defendants' motions to dismiss are identical in content, and because Defendants together filed a single reply to Plaintiff's response, the court considers those motions together.

court alleging that Defendant Arthur John Keefe II ("Keefe"), himself and on behalf of his limited liability company, Defendant Calvary Currencies, LLC ("Calvary"), fraudulently solicited customers, inducing them into illegal off-exchange trading of foreign currency futures in violation of Sections 4(a) and 4(b)(a)(i) and (iii) of the Commodity Exchange Act, 7 U.S.C. §§ 6(a), 6(b)(a)(i), (iii) ("The Act") and related CFTC Regulations, 17 C.F.R. § 1.1(b)(1), (3). See paper no. 1, at ¶ 1-2. Plaintiff requested injunctive relief, restitution, civil monetary penalties, and other equitable relief such as this court might find appropriate. See *id.* at ¶ 3.

On June 15, Keefe, proceeding *pro se*, moved to dismiss for failure to state a claim, asserting that the transactions forming the basis of Plaintiff's complaint were not transactions for futures but "spot" transactions, over which the CFTC has no regulatory authority. See paper no. 8. Calvary would eventually move to dismiss on identical grounds. See Paper no. 17.

II. Plaintiff's Motions for Entry of Default and Default Judgment Against Defendant Calvary

Shortly after filing this action, Plaintiff requested waiver of service from both Defendants. Paper nos. 2 and 3. On April 12, Keefe waived service, paper no. 4, but Calvary did not

respond to the request. On May 10, 2004, Plaintiff properly and timely served its Complaint and Summons upon Calvary. See paper no. 7. Keeffe, acting in his *pro se* capacity on behalf of both Defendants, apparently obtained consent for enlargement of time, requesting that both Defendants be allowed until June 15 to file an answer. (No such consent or stipulation appears in the court file or in the docket.) Keeffe responded timely, moving to dismiss on June 15. Paper no. 8. On July 8, however, Calvary still had not responded, so Plaintiff applied for entry of a default by the clerk against Calvary pursuant to Fed. R. Civ. P. 55(a). Paper no. 12. On July 19, when Calvary still had not responded, Plaintiff moved for default judgment, permanent injunction and ancillary relief against Calvary. Paper no. 14. On July 26, Calvary finally responded, moving to dismiss for failure to state a claim in language identical to Keeffe's earlier motion to dismiss. See paper nos. 17 and 8.

Entry of default is left to the discretion of the court. *Dow v. Jones*, 232 F. Supp. 2d 491, 494 (D.Md. 2002). The Fourth Circuit has a "strong policy" that "cases be decided on their merits." *Dow*, 232 F. Supp. at 494-95(citing *United States v. Shaffer Equip. Co.*, 11 F.3d 450, 453 (4th Cir. 1993)).

Entry of default is inappropriate here. CFTC does not suggest that its case has been prejudiced by Calvary's late

response to the complaint. The court is also mindful of Defendant Keeffe's *pro se* status at the time default was sought and the need for counsel to represent the corporation. Considering the Fourth Circuit's strong preference for resolving cases on their merits, the court will exercise its discretion to deny Plaintiff's motions for entry of default and default judgment without prejudice. See *United States v. Mraz*, 274 F.Supp.2d 750, 755-56 (D.Md. 2003); *Dow*, 232 F. Supp. at 494-95.

III. Defendants' Motions to Dismiss

A. Standard of Review

The purpose of a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) is to test the sufficiency of the plaintiff's complaint. See *Edwards v. City of Goldsboro*, 178 F.3d 231, 243 (4th Cir. 1999). Accordingly, a 12(b)(6) motion ought not be granted unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

In its determination, the court must consider all well-pled allegations in a complaint as true, see *Albright v. Oliver*, 510 U.S. 266, 268 (1994), and must construe all factual allegations in the light most favorable to the plaintiff. See *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 783 (4th Cir.

1999) (citing *Mylan Laboratories, Inc. v. Matkari*, 7 F.3d 1130, 1134 (4th Cir. 1993)). The court must disregard the contrary allegations of the opposing party. See *A.S. Abell Co. v. Chell*, 412 F.2d 712, 715 (4th Cir. 1969). The court need not, however, accept unsupported legal allegations, *Revene v. Charles County Comm'rs*, 882 F.2d 870, 873 (4th Cir. 1989), legal conclusions couched as factual allegations, *Papasan v. Allain*, 478 U.S. 265, 286 (1986), or conclusory factual allegations devoid of any reference to actual events, *United Black Firefighters v. Hirst*, 604 F.2d 844, 847 (4th Cir. 1979).

B. Analysis

The Commodity Exchange Act makes unlawful certain activities in connection with the sale of a "commodity for future delivery." Section 4(a) of the Act, 7 U.S.C. § 6(a), requires that futures contracts be sold on a "contract market" designated by the CFTC, and Sections 4b(a)(i) and (iii), 7 U.S.C. § 6b(a)(i),(iii), forbid fraud and willing deception in their sale.

Plaintiff alleges that Defendants marketed and sold foreign currency futures contracts to the general public and did not use a designated contracts market as required by the Act. Plaintiff further alleges that Defendants defrauded their customers by misrepresenting the profit potential of trading foreign currency

futures contracts, as well as failing to inform them of the associated risks and misrepresenting how those risks would be managed.

In their motions to dismiss, Defendants contend that they engaged not in transactions for foreign currency futures, but in "spot" transactions. While foreign currency futures contracts are regulated by the Act, spot transactions -- agreements for the purchase and sale of commodities that anticipate near-term delivery -- are not. See *CFTC v. Noble Wealth Data Info. Svcs., Inc.*, 90 F.Supp.2d 676, 689 (D.Md. 2000), *aff'd in relevant part sub nom. CFTC v. Baragosh*, 278 F.3d 319 (4th Cir. 2002) (citing *Dunn v. CFTC*, 519 U.S. 465, 472 (1997) and *Salomon Forex, Inc. v. Tauber*, 8 F.3d 966, 970 (4th Cir. 1993)). Defendants' motions turn, therefore, on whether, construing all factual allegations in favor of Plaintiff, Defendants' activities constitute futures trading or spot transactions. If the latter, then under the Act, Plaintiff would have no jurisdiction, and the court would be required to grant Defendants' motions to dismiss. The court, however, will conclude otherwise, and deny Defendants' motions.

Differentiating a futures contract from a spot transaction is not always easy; the term "futures contract" is not defined in the Act, and there is no established list of the elements of a futures contract. *Noble Wealth*, 90 F.Supp.2d at 688 (citing

CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573, 577, 581 (9th Cir. 1982)). In *Noble Wealth*, the CFTC successfully claimed that defendants had violated the same provisions of the Act allegedly violated by Defendants in this case.² The *Noble Wealth* court, citing cases that "have fleshed out [the] meaning" of the term "futures contracts," summarized its hallmark characteristics:

[A] "futures contract" has been defined as a contract for the purchase or sale of a commodity for delivery in the future at a price established at the time the contract is initiated. It may be fulfilled through offset, cancellation, cash settlement, or other means to avoid delivery, and is entered into primarily to hedge or speculate upon price changes in the commodity without transferring ownership of the commodity. Other characteristics that facilitate exchange-traded contracts include standardized commodity units and initial deposit and maintenance margin requirements.

90 F.Supp.2d at 688 (citations omitted). Spot transactions, by contrast,

are agreements for the purchase and sale of commodities that anticipate near-term delivery. . . . Spot transactions in foreign currencies call for settlement within two days. Spot contracts are excluded from regulation under the Act because Congress felt that "transactions in the commodity itself which anticipate actual delivery did not present the same opportunities for speculation, manipulation, and outright wagering that trading in

² In *Noble Wealth*, CFTC also claimed the defendants "bucketed" customer orders in violation of § 4(b)(a)(iv) of the Act, 7 U.S.C. § 6b(a)(iv). That allegation is not relevant to this case.

futures and options presented." Congress, however, never intended to exclude from the Commission's jurisdiction transactions which are "sold merely for speculative purposes and which are not predicated upon the expectation that delivery of the actual commodity by the seller to the original contracting buyer will occur in the future."

Id. at 688-89 (citations omitted).

For the purposes of Defendants' motions to dismiss, to determine whether Defendants engaged in spot transactions or the trading of futures, the court takes as true the following facts as pled by Plaintiff:

The contracts entered into between Calvary and its customers were contracts for the purchase and/or sale of standardized lot sizes of foreign currency, for delivery in the future, at a price fixed at the time the contracts were formed. The contracts did not include a provision for customers to make or take delivery, nor did the customers ever intend to take delivery of foreign currency. The contracts were sold primarily for speculative purposes and invariably were closed by offsetting transactions. Moreover, the contracts sold by Defendants required customers to pay a predetermined portion of the total contract price as a "margin" payment when the contract was purchased, and required customers to make additional "margin" payments if adverse changes in the market price of the commodities caused the equity in their respective accounts to fall below a specified percentage. Finally, the contracts had standardized terms and conditions, including the size and margin requirements that were not negotiable by the customers.

Paper no. 22, at 4 (citations omitted). These facts mirror closely *Noble Wealth's* definition of futures contracts: The contracts were "for delivery in the future," of "standardized

commodity units," "at a price established at the time the contract [was] initiated," were "fulfilled through offset . . . to avoid delivery," were "entered into primarily to . . . speculate," and required "initial deposit and maintenance margin requirements." 90 F.Supp.2d at 688.

Defendants nonetheless offer several arguments for classifying their transactions as "spot" transactions rather than futures contracts. None are persuasive.

First, Defendants argue that "in futures trading, the contract sets a price that will govern a sale to occur in the future," while in spot trading, "the purchaser buys or sells at the current price," and that "the trading engaged in by Calvary did not set a price that will apply in the future, but rather the sale occurred immediately" Paper no. 17, at 5-6. Plaintiff, however, disputes that account of the facts, and asserts that Defendants' contracts were "for delivery in the future, at a price fixed at the time the contracts were formed." Paper no. 22, at 4. At this stage, a court "must construe all factual allegations in the light most favorable to the plaintiff," *Harrison*, 176 F.3d at 783, so Defendants' factual assertion cannot be relied upon for dismissal.

Defendants also argue that, because their contracts "rolled-over" their customers' positions each day, rather than holding

those positions open indefinitely, their contracts should not be considered futures contracts. Paper no. 17, at 6. Again, however, because Plaintiff disagrees with Defendants' version of the facts, asserting that "Calvary maintained customer positions in foreign currency over several days with no indication of a rollover," Paper no. 22, at 8, Defendants' assertion cannot support their motions to dismiss.

In their reply, Defendants strain to distinguish the instant case from *Noble Wealth*, apparently in an attempt to persuade this court not to rely upon that decision's distinctions between futures trading and spot transactions. Defendants first note that, unlike here, in *Noble Wealth*, "CFTC obtained a default judgment against the Defendants," "[t]he Defendants in that case were accused of 'bucketing' trades," "[t]here was no evidence that the Defendants actually purchased any foreign currency that corresponded to customer orders," and "Defendants lured customers to their location where they purported to operate a 'board of trade.'" Paper no. 19, at 3. None of those distinctions, however, bear on the definitional differences between futures contracts and spot transactions, nor were any of them of relied upon in the *Noble Wealth* court's conclusion that "the *Noble Wealth* contracts do not fall within the spot contract exception to the Commission's jurisdiction." 90 F.Supp.2d at

689. Defendants also note that *Noble Wealth* predates the Commodity Futures Modernizations Act of 2000 ("Modernizations Act"), Pub.L. 106-554, 114 Stat. 2763, but do not -- and cannot -- assert that the new law in any way disturbs the ruling in *Noble Wealth*. Finally, Defendants assert that, on appeal, *Noble Wealth* "in its entirety was never reviewed. Specifically, [sic] the issue of what is a futures contract and what is a spot transaction," an assertion sharply at odds with the conclusion of the appellate court's opinion, which stated plainly: "Baragosh additionally challenges the Commission's jurisdiction on the ground that *Noble Wealth* transactions were spot contracts and the CEA governs only futures contracts. We reject this argument for the reasons ably set forth by the district court." *Baragosh*, 278 F.3d at 329 n.3.

The balance of Defendants' arguments rely principally on holdings in, and analogies to, *Bank Brussels Lambert, S.A. v. Intermetals Corp.*, 779 F.Supp. 741, 748 (S.D.N.Y. 1991) and *Commodity Futures Trading Com'n v. Zelener*, 2003 WL 22284295, 2003 U.S. Dist. LEXIS 17660 (N.D.Ill. Oct. 3, 2003), *aff'd* 373 F.3d 861 (7th Cir. 2004), regarding the differences between futures transactions and spot transactions. See paper no. 17, at 8-10; paper no. 19, at 3-5. The holdings in those cases differ from those of *Noble Wealth*, but decisions of the Southern

District of New York and the Seventh Circuit do not bind this court. Furthermore, to the extent that Defendants seeks merely to analogize this case to those cases, rather than borrow their holdings, the analogies are inapt, because significant facts in those cases are substantially different than in this one. In *Zelener*, the contracts in question differed from futures contracts in that they were not standardized, 373 F.3d at 867, and called for settlement within forty-eight hours, *id* at 863. Plaintiff alleges that Calvary's contracts, on the other hand, bore signature traits of futures contracts: They were standardized and, because they made no mention of settlement within forty-eight hours, could be held open indefinitely. See Paper no. 21, at 21-23; *supra* at 6-7. Defendants' analogy to *Bank Brussels* is likewise flawed; if anything, a New York case more similar to the instant case is *CFTC v. Int'l Fin. Servs.*, 323 F. Supp. 2d 482 (S.D.N.Y. 2004). In that case, the court found that IFS had engaged in futures trading, not spot transactions. That court distinguished its facts from *Bank Brussels*:

The CFTC's undisputed evidence confirms that "the contracts offered by IFS Inc. to customers concerned the purchase or sale of commodities for future delivery at prices or using pricing formulas that were established at the time the contracts were initiated," and specified "no delivery dates." Spot contracts, by contrast, do specify a delivery date -- within two

days. [779 F. Supp. at 742] at 748 & n.5. Second, in *Bank Brussels*, the bank held an account for its client specifically for the purpose of speculating in the "spot market" and thus presumably had the capacity to take or make delivery of the actual foreign currencies, even if, in practice, it did not do so. See *id.* at 742-43. Here, IFS Inc.'s clients neither expected nor had the capacity to take or make delivery of foreign currencies.

323 F. Supp. 2d at 497 (citations to court papers omitted). Just as in *IFS*, Plaintiff alleges that Calvary "specified no delivery dates" and its clients "neither expected nor had the capacity to take or make delivery of foreign currencies." *Id.* Accepting Plaintiff's factual allegations as true for the purposes of these motions, it is clear that the *Bank Brussels* analogy is inappropriate.

Because the facts as pled by Plaintiff support Plaintiff's contention that Defendants engaged in futures trading, not spot transactions, the court finds that the contracts fall within the Commission's jurisdiction. The motions to dismiss are therefore denied. A separate Order will follow.

/s/
DEBORAH K. CHASANOW
United States District Judge

October 15, 2004