UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 85-6152

COMMODITY FUTURES TRADING COMMISSION,

Plaintiff-Appellee,

-against-

BRITISH AMERICAN COMMODITY OPTIONS CORP. and JOHN FORMA,

Defendants,

JOHN FORMA,

Defendant-Appellant.

On Appeal from the United States District
Court for the Southern District of New York

BRIEF FOR PLAINTIFF-APPELLEE

COUNTERSTATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Whether the District Court properly exercised its broad discretion in ordering appellant Forma to disgorge $1,023,375 on the basis of flagrant violations both of registration and antifraud regulations promulgated under the Commodity Exchange Act?

2. Whether the appellant has failed to show that the District Court's finding that Forma's ill-gotten gains amounted to $1,023,375 was clearly erroneous?

PRELIMINARY STATEMENT

Appellant John Forma ("Forma"), defendant below, seeks reversal of a May 8, 1985, judgment ordering him to disgorge $1,023,375, the income he received in 1977 from co-defendant British American Commodity Options Corp. ("BACO"), a corporation then engaged in the marketing and sale of London commodity options ("London options"),[1/] of which Mr. Forma was the sole shareholder and chief operating officer. Forma was ordered to disgorge this income because he and BACO were found to have engaged in a fraudulent business operation from December 9, 1976 through September 7, 1977 in violation of the Commodity Futures Trading Commission's (the "Commission" or "CFTC") antifraud options regulation, 17 C.F.R. § 32.9 (1977). The disgorgement order was also based upon findings that, from January 17, 1977 through September 7, 1977 (when BACO ceased business operations), Forma aided and abetted BACO in acting as an options broker without having been granted registration as a futures commission merchant ("FCM") by the Commission, in violation of the FCM registration requirements of Commission Regulations 32.3(a) and (b), 17 C.F.R.

1/ A commodity option grants the purchaser the right, but not the obligation, during a fixed and specified period of time, to buy ("call") or sell ("put") a specific commodity futures contract or physical commodity. London options of the type solicited and sold by appellant Forma related to futures contracts traded on the London commodity markets. For a thorough description of the characteristics and market mechanics of commodity options, see this Court's opinion in British American Commodity Options Corp. v. Bagley, 552 F.2d 482, 484-85 (2d Cir. 1977), cert. denied, 434 U.S. 398 (1977); see also Commodity Futures Trading Commission v. British American Commodity Options Corp, et al., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,662, at 22,699 (S.D.N.Y. 1978). (Gagliardi, J.)

§§ 32.3(a) and (b) (1977).2/

The evidentiary bases for the District Court's findings of unregistered brokerage activities and pervasive fraudulent conduct may be found in its August 31, 1978 opinion in Commodity Futures Trading Commission v. British American Commodity Options Corp., et al., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,662. In that opinion, the District Court ordered the imposition of a receivership to prevent the waste of any proceeds obtained by BACO and Forma in the course of their unregistered FCM activities and their fraudulent and deceptive options scheme, and to aid in the computation of damages incurred by their unlawful conduct. The Court also provided for specific orders of disgorgement to be made upon particularized applications therefor. Forma has not, in any of the supplementary proceedings before the District Court or in this appeal, challenged the evidentiary bases for the District Court's findings in its 1978 opinion that BACO and Forma flagrantly violated the registration and antifraud regulations promulgated under Section 4c(b) of the Commodity Exchange Act (the "Act"), 7 U.S.C. § 6c(b) (1977).

2/ In Section 2(a)(1) of the Commodity Exchange Act (the "Act"), 7 U.S.C. § 2 (Supp. V, 1976), the term "futures commission merchant" is defined to include

> individuals, partnerships, corporations, and trusts engaged in soliciting or 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 or 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.

For a discussion of this provision's application to option transactions, see British American Commodity Options Corp. v. Bagley, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,245, at 21,334 (S.D.N.Y. Dec. 21, 1976) (Knapp, J.) (sustaining Commission Regulation 32.3 which required persons, like BACO, offering commodity options to the public to be registered as an FCM under the Act after January 17, 1977.)

Rather, Forma argues here, as he did before the District Court, that the 1978 evidentiary findings, coupled with the supplementary evidence presented by the Commission (through subsequent depositions held to determine the appropriate amount of disgorgement to be made by Forma), are insufficient to sustain an order directing Forma to disgorge $1,023,375, all the income he received from BACO as compensation during 1977.

As will be shown, infra, the record of this proceeding amply demonstrates that disgorgement is both a necessary and appropriate remedy to deprive Forma of unlawful proceeds derived from unregistered FCM activities and fraud, and to deter future such violations by Forma and others. The evidence also clearly shows that the income Forma received from BACO in 1977 is a proper measure of disgorgement in this proceeding. Accordingly, the District Court's May 8, 1985 judgment ordering Forma to disgorge $1,023,375, should be affirmed in all respects.

COUNTERSTATEMENT OF THE CASE

A. The Commission's Authority To Regulate The Marketing And Sale Of Commodity Options And To Seek Equitable Relief For Violations Of Its Regulations

In 1974, Congress substantially revised the Commodity Exchange Act to create the Commission as an independent agency of the United States to administer and enforce the Act's provisions. See Section 2(a)(2) of the Act, 7 U.S.C. § 4a (Supp. V, 1975). The 1974 amendments: (1) expanded the Act's coverage to include previously unregulated commodities;[3/] (2) increased

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3/ From 1936 through 1974, only the specifically enumerated commodities in Section 2(a) of the Act were subject to regulation by the Commodity Exchange Act, as amended. Options on these commodities were banned throughout this (Footnote continued)

substantially the law enforcement powers previously held by the Commission's predecessor agency; and (3) vested the Commission with exclusive regulatory jurisdiction and plenary rulemaking authority over commodity option transactions. Sections 2(a)(1) and 4c(b) of the Act, 7 U.S.C. §§ 2, 6c(b) (Supp. V, 1975).4/ As relevant here, Section 4c(b) of the Act made illegal the offer or sale of any commodity option that is

> contrary to any rule, regulation or order of the Commission prohibiting any such transaction or allowing any such transaction under any such terms and conditions as the Commission shall prescribe . . . .

Pursuant to this statutory grant of authority to regulate all phases of commodity option transactions, the Commission adopted Part 32 of its Regulations, 17 C.F.R. Part 32 (1977). Regulation 32.3 prohibits any firm, such as BACO, on or after January 17, 1977, from acting as a commodity options broker unless registered with the Commission as an FCM. 17 C.F.R. § 32.3 (1977). Regulation 32.9 makes it unlawful for any person in connection with the solicitation or sale of any option transaction, inter alia, to cheat, defraud or deceive any other person by any means whatsoever. 17 C.F.R. § 32.9 (1977).

In addition to this plenary authority to regulate commodity options, Congress in 1974 authorized the Commission to institute actions in U.S.

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period. See Section 4c of the Commodity Exchange Act of 1936, Pub. L. No. 675, 74th Cong. 2d Sess., 49 Stat. 1491 (1936).

4/ The 1974 amendments authorized the Commission to regulate or ban options on previously unregulated commodities, see Section 402 of the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 463, 93d Cong. 2d Sess., 88 Stat. 1389 (1974), but continued the ban on options trading in the commodities listed in Section 2(a) of the Act. See Section 4c(a)(B) of the Act, 7 U.S.C. § 6c(a)(B) (Supp. V, 1975); see also British American Commodity Options v. Bagley, 552 F.2d 482, 486 (2d Cir. 1977), cert. denied, 434 U.S. 938 (1977).

District Courts to enjoin any practice in violation of the Act, or any rule, regulation or order thereunder. Section 6c of the Act, 7 U.S.C. § 13a-1 (1976). This Court has observed that this injunctive authority is in all material respects similar to Section 21(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(e), and Section 20(b) of the Securities Act of 1933, 15 U.S.C. § 77t(b), and that case law developed under those sections of the securities laws is pertinent to cases under Section 6c of the Commodity Exchange Act. CFTC v. British American Commodity Options, 560 F.2d 135, 141 n.11 (2d Cir. 1977). Thus Section 6c of the Act authorizes, in addition to injunctive relief, appropriate ancillary equitable relief, including disgorgement. CFTC v. Hunt, 591 F.2d 1211, 1222-23 (7th Cir. 1979); CFTC v. CoPetro Marketing Group, Inc., 502 F. Supp. 806, 819 (C.D. Cal. 1980), aff'd, 680 F.2d 573 (9th Cir. 1982); CFTC v. U.S. Metals Depository Co., 468 F. Supp. 1149, 1163 (S.D.N.Y. 1979) (Weinfeld, J.).5/

B. Other Pertinent Litigation Involving The Commission and BACO

In October, 1975, John Forma, acting through BACO, commenced operations as an options broker, marketing and selling London options to the public. In 1976 and 1977, the Commission and BACO became involved in two other judicial proceedings which, directly or indirectly, affected events in the proceeding below. The matters at issue in these other proceedings are briefly described here:

1. The Commodity Trading Advisor ("CTA") Litigation

5/ Other courts have recognized that the equitable remedy of restitution is also authorized by Section 6c of the Act. See CFTC v. Skorupskas, 605 F. Supp. 923, 943 (E.D. Mich. 1985); CFTC v. Morgan, Harris & Scott, Ltd., 484 F. Supp. 669, 677 (S.D.N.Y. 1979).

On July 22, 1976, the Commission filed a complaint pursuant to Section 6c of the Act seeking a preliminary and permanent injunction against BACO, who at that time was marketing and selling London options, from violating Section 4m of the Act by acting as a commodity trading advisor ("CTA")[6/] without being registered with the Commission.[7/] The District Court in that action (which happened to be the same court whose disgorgement order is at issue in this appeal) found BACO to be a CTA within the meaning of the CTA registration requirement of Section 4m of the Act, 7 U.S.C. § 6m (Supp. V, 1975). Even though the Commission had made a prima facie showing that BACO was rendering trading advice while unregistered, the District Court ruled that it could in its discretion decline to grant an injunction because of concern for BACO's business, which had grown substantially in its first year of operation, because the Commission had not presented any evidence that BACO had committed a wrong connected with fraud or similar misconduct, and because, in its view,

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6/ In Section 2(a)(1) of the Act, 7 U.S.C. § 2 (Supp. V, 1975), "commodity trading advisor" with some exceptions not relevant here, is defined to include any person who, for compensation or profit, engages in the business of advising others, directly or through publications or writings, as to the value of commodities or as to the value of trading in any commodity for future delivery on or subject to the rules of any contract market. Before the Commission's Part 32 regulations became effective, options brokers, like BACO, were required to register as CTAs because they were engaged in the business of advising others as to the value of commodities. See CFTC v. British American Commodity Options Corp., 560 F.2d 135, 141 (2d Cir. 1977). When Regulation 32.3 became effective on January 17, 1977, the requirement that options brokers be registered as FCMs replaced the requirement that they register separately as a CTA. See 41 Fed. Reg. 51808, 51810 (Nov. 24, 1976).

7/ In March, 1976, BACO did apply for registration as a CTA with the Commission. On April 16, 1976, the Commission instituted an administrative proceeding to determine BACO's fitness to do business as a CTA because BACO's principal, president, and sole shareholder, John Forma, had twice been enjoined by the Securities and Exchange Commission ("SEC") from violating the record-keeping and net capital requirements of the Securities Exchange Act of 1934.

mere registration violations alone would not justify an injunction. CFTC v. British American Commodity Options Corp., 422 F. Supp. 662, 667-68 (S.D.N.Y. 1976) (Gagliardi, J.).

On appeal, this Court reversed, holding that once the Commission has made a prima facie showing that a person is violating and is likely to continue violating the registration requirements of the Act, an injunction is mandatory. CFTC v. British American Commodity Options, 560 F.2d 135 (2d Cir. 1977). In so ruling, this Court observed that

> The intent of the congressional design is clear; persons engaged in the defined regulated activities within the commodities business are not to operate as such unless registered, the Commission is charged in the first instance with determining the applicant's qualifications . . ., and the Commission is empowered to seek injunctive prohibitions against violations of . . . registration provisions. Registration is the kingpin in this statutory machinery, giving the Commission the information about participants in commodity trading which it so vitally requires to carry out its other statutory functions of monitoring and enforcing the Act.

560 F.2d at 140. (Emphasis added.)

This Court also concluded that the District Court accorded undue weight to BACO's business interests, and that, to the extent that BACO's business fluorished through rendering unlawful trading advice in an unregistered capacity, BACO had been acting at its own peril. 560 F.2d at 143. In this regard, this Court stated: "[a] court of equity is under no duty 'to protect illegitimate profits or advance business which is conducted illegally.'" Id. (Citation omitted.) Accordingly, this Court remanded the case to the District Court with a direction to issue a preliminary injunction. On September 7, 1977, the preliminary injunction issued, and BACO shut down all of its business operations permanently.

2. The Bagley Litigation

On November 22, 1976, the Commission adopted specific regulatory registration requirements, minimum financial requirements, and disclosure, record-keeping, and segregation requirements applicable to options brokers. 17 C.F.R. Part 32 (1977). On November 16, 1976, BACO and another plaintiff commenced suit in U.S. District Court for the Southern District of New York seeking to enjoin the Commission from enforcing these new regulations. British American Commodity Options Corp. v. Bagley, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,245 (S.D.N.Y. Dec. 21, 1976) (Knapp, J.). In that action, BACO argued that the Commission's regulation requiring options brokers to segregate 90% of customer funds received in connection with options purchases subjected BACO to undue, severe hardship.[8/] BACO also argued that the Commission's promulgation of the FCM registration regulation was unnecessarily disruptive since the Commission could exclude firms from the options business simply by not acting on their applications.

While upholding the challenge to the 90% segregation rule,[9/] the District Court rejected BACO's challenges to the balance of the Commission's new options rules, including the FCM registration requirement for options brokers. On appeal, this Court reversed the District Court's grant of a preliminary injunction against Commission enforcement of the segregation

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8/ BACO also generally alleged that these rules were adopted arbitrarily and capriciously, and in violation of the procedural requirements of the Administrative Procedure Act ("APA").

9/ The District Court found that the Commission acted with undue haste in imposing the new segregation rule, since it was not part of the Commission's original proposed rules. British American Commodity Options Corp. v. Bagley, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,245 at 21,332. (Knapp, J.)

requirement, and affirmed the lower court's denial of an injunction on all other grounds. British American Commodity Options Corp. v. Bagley, 552 F.2d 482 (2d Cir. 1977). BACO applied for review of this Court's decision in the U.S. Supreme Court.

On June 14, 1977, this Court granted a stay of the issuance of its mandate in Bagley pending BACO's application to the Supreme Court for a writ of certiorari on the condition that BACO post a bond in the amount of $250,000, which BACO then posted with the District Court. (A42-45)[10/] On November 8, 1977, the Supreme Court denied certiorari. British American Commodity Options Corp. v. Bagley, 434 U.S. 938 (1977). The $250,000 bond posted as security in the form of U.S. Treasury notes was ordered to remain with the District Court in the Bagley proceeding until it was determined that all customer claims) against BACO in this proceeding had been satisfied in the proceeding below. (A43-44)

C. The Proceeding Below

1. The Commission's Complaint

On April 15, 1977, the Commission filed its original complaint in this proceeding,[11/] in which the Commission alleged that (i) from and after January 17, 1977, BACO, aided and abetted by Forma, had engaged in the options business as an unregistered FCM, in violation of § 32.3 of the Commission's

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10/ "(A)" indicates the page number in the appendix where the material cited in this brief appears.

11/ In December, 1976, BACO filed an application for registration as an FCM. The administrative proceeding commenced on April 16, 1976, to determine Forma's fitness as a CTA, see note 7, supra, was consolidated with another proceeding, commenced January 14, 1977, to determine Forma's fitness for registration as an FCM. On December 2, 1977, the Commission issued its opinion and order, finding BACO unfit for registration as a CTA or FCM and denying its applications for registration. In the Matter of British American Commodity Options Corp., CFTC Docket Nos. 76-15 and 77-3, slip opinion (CFTC Dec. 2, 1977).

Regulations; (ii) from December 9, 1976, BACO, aided and abetted by Forma, had conducted a fraudulent options sales scheme, in violation of § 32.9 of the Regulations; and (iii) BACO, aided and abetted by Forma, had wrongfully denied the Commission's staff access to the books and records of BACO in violation of § 32.7 of the Regulations. An amended Complaint was filed on June 8, 1977. (A5-20)[12/]

In the prayer for relief, the Commission's Amended Complaint sought preliminary and permanent injunctive relief, restraining the defendants from further participation in these illegal activities, and also sought, among other things, the imposition of a receivership, and

> an order directing all defendants to disgorge to the receiver appointed herein all benefits, including, but not limited to, salaries and commissions, derived directly or indirectly from the violative activities described herein.

(A19) The Commission, in its prayer for relief, also sought:

> an order establishing a trust over all of the assets of the defendant Forma and prohibiting him ... from directly or indirectly ... dissipating, concealing or disposing of in any manner, any assets ... of the defendants herein.

(A19-20) The Amended Complaint also sought "such other and further relief as the Court may determine to be just, equitable and necessary." (A20)

2. The District Court's Findings Of Fraud And Other Violations

The District Court (Gagliardi, J.) conducted hearings in April and May of 1977,[13/] and subsequently, the court considered whether the relief sought by

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12/ The original complaint was amended to add a new paragraph 21(a) which alleged that BACO and Forma, as well as BACO's employees, engaged in unauthorized transactions for customer accounts (A11)

13/ At these hearings, the Commission presented John Forma, and seven witnesses who had purchased options or had received solicitations from (Footnote continued)

the Amended Complaint was moot because of the injunction issued on September 7, 1977 at the direction of this Court in the separate CTA proceeding. At the conclusion of a hearing held on January 23, 1978, the District Court ruled that this case was not moot and that appropriate equitable relief in the form of a permanent injunction and the appointment of a Receiver should be granted. When the parties could not agree on the content and scope of the order, the District Court issued its Opinion of August 31, 1978, CFTC v. British American Commodity Options Corp. and John Forma, [1977-80] Comm. Fut. L. Rep. (CCH) ¶ 20,662 (S.D.N.Y. 1978) (the "1978 Opinion"), which constituted its formal findings of fact and conclusions of law under Fed. R. Civ. P. 52(a). (A73-74)

In its 1978 Opinion, the District Court found "abundant and convincing proof that both BACO and John Forma had committed flagrant violations of the futures commission merchant registration requirements ... and of the general anti-fraud provisions ...." Id. at 22,697. Specifically, the District Court found that BACO, acting through defendant Forma, sold options to the public while unregistered from January 17, 1977, until September 7, 1977, the date of the injunction against BACO entered in the CTA litigation (see page 8, supra). The District Court concluded that BACO and Forma, by selling options without having been registered as an FCM, violated Section 4c(b) of the Act, and Regulation 32.3 (1976). (A74-75)[14/]

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defendants. The Commission also introduced the transcripts of eight former customers of BACO who had testified in administrative hearings before the Commission concerning BACO's fitness to be registered. Defendants also called witnesses, and introduced transcript testimony of unavailable witnesses who had testified in administrative hearings. John Forma also testified on his own behalf.

14/ BACO and Forma continued their unregistered options business after January 17, 1977 despite notification from the CFTC on January 14, 1977 that (Footnote continued)

Entirely apart from BACO's and Forma's registration violations, the District Court found that BACO and Forma had engaged in pervasive fraudulent conduct including "misrepresentations of the risks, guarantees, costs and market mechanics involved in commodity options investing." (A79) In particular, the Court found that BACO and Forma, by engaging in "cold canvassing" telephone solicitations of members of the public who had expressed no prior interest in options investing, had exploited customer ignorance about the market mechanics of commodity options trading, exaggerated the probable returns, understated the general risks involved in options investments, and misrepresented that performance guarantees protected investors.15/ The Court further found that both defendants had falsely stated that: (1) BACO was a "licensed" or "registered" options dealer; (2) BACO had a "research department;" and (3) that BACO was a "long-established Wall Street institution." BACO and Forma were also found to have: (1) failed to disclose markups and misrepresented commission charges; (2) regularly confused customers about options costs; (3) interchanged references to American dollars and British pounds without explaining that fluctuation in either of the currencies could have an effect on profitability; (4) executed options transactions without customer authorization; (5) delayed execution of, or refused to execute, customer-authorized transactions; and (6) held out BACO

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registration would be withheld pending the outcome of an administrative fitness proceeding, and despite knowledge that their prior judicial challenge to the validity of Regulation 32.3's registration requirement in the Bagley litigation discussed at pages 9-10, supra, had failed. See British American Commodity Options Corp. v. Bagley, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,245 (Dec. 21, 1976).

15/ In this regard, the Court found: "Nearly every material element of an options transaction . . . appears to have been regularly misrepresented or left undisclosed by defendants . . . . [D]efendants did much to obscure and exploit." Comm. Fut. L. Rep. (CCH) ¶ 20,662 at 22,699.

employees with little or no training as options specialists. (A76-79)

With regard to these unlawful activities, the court stated:

> Defendants' violations have been extremely serious, often brazen, and constitute precisely the sort of outrageous abuse of commodity options trading from which the Act seeks to protect investors. . . . The violations occurred in a regular, organized manner as part of a professionally structured system of business, and cannot be characterized as random or isolated incidents. (A80)

With respect to Forma personally, the District Court found that, as chief officer and sole owner of BACO, Forma: (1) maintained close personal supervision over the daily operations of his business and all financial details; (2) specifically oversaw the conduct of his telephone salesmen through a surveillance monitoring system and through immediate supervisors who reported directly to him; (3) failed to take corrective action or to discipline sales employees who were the subject of numerous customer complaints; (4) drafted or personally authorized all promotional literature; and (5) approved the issuance of all recommendations from the single employee responsible for market research. (A80) On these bases, the Court concluded that

> Forma was fully aware of the nature of his business, that he sometimes knew and at other times had reason to know of the specific frauds being committed in the name, and to the profit, of British American, and that he himself acted deliberately and actively, with knowledge of or reckless disregard for the truth.

(A81) The Court also found that Forma "continued his very profitable options trading until enjoined" in the CTA litigation. (A83) (See pages 7-8, supra.)

3. The District Court's Orders For Injunctive, Restitutionary, And Disgorgement Relief

Based on all of the foregoing, the Court ordered an injunction against

future violations of the Commission's options regulations requiring FCM registration and proscribing fraudulent conduct, and imposed a receivership to prevent the waste of proceeds obtained by both BACO and Forma "in the course of their unregistered and deceptive options practice." (A83)16/ The Court recognized that "[t]he injunctive relief already found appropriate can only act as a partial enforcement of the Commodities Exchange Act, since it does not remedy the present financial consequences of past fraud and misconduct." Id. Accordingly, the District Court ruled that "[s]pecific orders to disgorge profit may be made upon particularized application to this Court." Id.

On December 21, 1978, the District Court appointed Thomas F. Egan, Esq., as temporary receiver, authorizing him, inter alia, to send claim forms to former BACO customers and creditors, and to file a report with the Court setting forth all claims filed by customers and creditors with a determination as to which claims were deemed to be valid, due and owing. In 1979, appellant Forma, on behalf of BACO, and the Commission stipulated to the release of $250,000 in Treasury notes, posted in the Bagley litigation, to the care of the Receiver appointed in this proceeding, who redeemed the notes and deposited them in interest bearing accounts. (A44)

On July 29, 1980, the District Court appointed Mr. Egan permanent receiver for BACO, authorizing him, among other things, to protect the interests of, and to seek restitution for, customers and creditors of BACO,

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16/ Although the District Court found that the Commission did establish a violation of its books and records inspection regulation, 17 C.F.R. § 32.7 (1977), the Court declined to issue an injunction against future violations of this regulation because of the unlikelihood that they would recur, given the Court's determination to appoint a receiver who would take control over BACO's books and records. (A82) CFTC v. British American Commodity Options Corp., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,662 at 22,697, 22,704-05 (S.D.N.Y. 1978) (Gagliardi, J.).

and to make application for disgorgement of unlawful proceeds realized by BACO and Forma from their violative activities. (A67-68) On August 6, 1982, Receiver Egan filed a proposed Final Report seeking distribution to former BACO customers on a pro rata basis of $256,594.30 of proceeds attributable to the Treasury notes, plus accrued interest, BACO had posted as security in the Bagley litigation, which then amounted to $387,211.60.[17/] This report did not indicate that any inquiry had been conducted into the monetary gain Forma had derived from his unlawful activities as found by the District Court. Nor did this Report recommend disgorgement from either BACO or Forma, as the District Court's August 31, 1978 Order clearly specified.

4. Proceedings Concerning Disgorgement From Forma

On October 22, 1982, the Commission filed a Memorandum with the District Court objecting in part to the Receiver's proposed Final Report insofar as it did not seek disgorgement of Forma personally.[18/] (A97-114) Forma, on behalf of BACO, objected to the proposed distribution of receivership assets solely on the ground that the Receiver's verified claims procedure was not reliable proof that each of the customers had been defrauded. (A85-89) Forma made no objection to the distribution on the grounds that there was insufficient evidence that these funds derived from unlawful conduct committed between

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17/ The $256,594.30 ultimately distributed after December 15, 1982 represented a 70% distribution of $345,074.40 available for customer distribution. The remainder of the $387,211.60 was either paid, or earmarked for payment, as legal and administrative expenses of the receivership. (A45-47) Since 1982, the proceeds of the $250,000 bond posted in the Bagley litigation, with accrued interest, have increased to approximately $414,000 (including amounts already distributed to former BACO customers in December, 1982).

18/ The Commission did not object to the portion of the proposed report of the Receiver that recommended a 70% distribution of BACO assets to former BACO customers. (A-111)

December 9, 1976 and September 7, 1977. (A85-89)[19/] On December 9, 1982, the District Court held a conference to consider the Receiver's proposed Final Report, and objections filed by the parties. On December 15, 1982, both Forma and the Commission consented to a distribution of the $256,594.30, to the receivership's verified claimants. (A122-123)

At the District Court's suggestion,[20/] the Commission deposed Forma on January 14, 1983, and April 13, 1983. At the January 14, 1983, deposition, the Commission inquired into the compensation of Forma, as sole shareholder, chief operating officer, salesman, and employee, of BACO from December 9, 1976 through December 31, 1978. At this deposition, Mr. Forma testified that he received compensation from BACO in the form of commissions, salaries and management fees. (A131) He further testified that he received no dividends from BACO. (A130) At the April 13, 1983, deposition, Forma produced his 1977 individual IRS tax return, (A193-249). This return reflected as income the $1,023,375 Forma received as compensation from BACO in 1977.[21/] The Commission also inquired into Forma's extant financial circumstances for the

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19/ The Receiver reported that 199 former customers of BACO had filed valid verified proof of claims with the receivership. (A40) These claims, which totaled $1,476,484.10, reflected the out-of-pocket losses attributable to trades (including commission charges) executed by BACO on behalf of the claimants. (A41)

20/ At the December 9, 1982, conference, counsel for the Receiver expressed concern that proceedings to calculate, and thereafter to collect, a specific order of disgorgement against Forma might prove costly to the receivership. Addressing this concern, the Court inquired whether the Commission would be willing to depose Forma relative to the proper amount of disgorgement and Forma's financial circumstances. (A295-298)

21/ At the April 13 deposition, Forma also produced a 1977 Wage and Tax Statement from BACO (A162), and his 1978 individual IRS return (A250-269) which reflected the $175,995 in compensation he received from BACO in that year. (A250)

purposes of determining the collectibility of a specific order of disgorgement, a concern previously expressed by the Receiver. See note 20, supra. Mr. Forma testified during this deposition that he did not recall having any formal contract or agreement with BACO (A139-140).

On May 26, 1983, the Commission filed a Report Concerning Entry of a Specific Order of Disgorgement Against Defendant John Forma, in which it made an application for disgorgement from Mr. Forma in the amount of $1,211,840, the entire amount he received as compensation from BACO since December, 1976. Oral argument was held on the Commission's disgorgement application on March 7, 1984. At the request of the parties, the Court deferred ruling on the Commission's disgorgement motion to afford the opportunity to pursue settlement efforts. After these efforts proved unsuccessful, the District Court authorized the Commission to take a third deposition of Mr. Forma, which occurred on November 11, 1984.

At the November 11 deposition, the Commission inquired specifically into the amount of income Forma derived from BACO's illegal options sales activity in 1977. During this deposition, Forma testified that: (1) BACO owned no other businesses that generated revenues, and that all revenues generated by BACO derived from options sales (A340-342); (2) Forma received compensation from BACO in 1977 in the amount of $1,023,375 as "wages, salaries, tips and other employee compensation," as shown on his IRS Form 1040 for 1977 (A358,366-367); (3) Forma did not receive periodic compensation from BACO, of any set amount (A388), nor did he keep track of income he received in 1977 (A390-391); rather he took income from BACO on an "as needed" basis (A359,A391); (4) BACO did not change its business procedures between 1976 and September 7, 1977, the date of the District Court's injunction arising out of the related CTA litigation as well

as the date BACO closed its business operations (A343); (5) all cash on hand in September, 1977 derived from BACO's options business (A342,A362); (6) Forma received compensation for liquidating BACO after the September 7 injunction (A343-344,A349-350,A353); (7) any cash Forma took out of BACO in 1977 would have been declared on his 1977 IRS individual tax return (A358).

On December 11, 1984, the Commission filed with the District Court a Supplemental Memorandum in support of Entry of a Specific Order of Disgorgement Against Defendant John Forma, again seeking disgorgement of $1,211,840, the amount of compensation he received from BACO from December, 1976 through December, 1978. (A324) On April 17, 1985, Judge Gagliardi issued a memorandum decision (A405), ordering defendant Forma to disgorge $1,023,375, or all the income he received from BACO in 1977, as evidenced by his 1977 IRS 1040 return. Commodity Futures Trading Commission v. British American Commodity Options Corp., 77 Civ. 1822 (LPG) (S.D.N.Y. Apr. 17, 1985) (A410) In this opinion, the Court found that because "all of Forma's compensation from British American can be attributable to illegal conduct, including pervasive fraud and unregistered trading," the Commission did not have a burden to isolate portions of Forma's income attributable to illegal activities from income generated from other lawful activities. (A408) The District Court further found that disgorgement is an appropriate remedy for illegal, although non-fraudulent, activity, such as the registration violations in this case. (A408) The Court also found that even if Forma had not been found to have engaged in unregistered FCM activities, the fraud he perpetrated "was so thorough and widespread as to taint the entire enterprise and all proceeds flowing therefrom." (A408) The Court reiterated that "[t]he violations occurred in a regular, organized manner as part of a profes-

sionally structured system of business, and cannot be characterized as random or isolated incidents." (A408)

Finding that Forma's unregistered FCM activities and fraudulent conduct, considered independently, each constituted a separate basis for disgorgement, the Court concluded that

> [t]he only real issue is the proper time period for which benefits should be disgorged. It is clear that all income Forma received from British American in 1977, as disclosed on Forma's W-2 and income tax forms [$1,023,375] should be disgorged. The evidentiary hearings held in April and May, 1977, revealed extensive regulatory violations and fraud, and Forma does not allege that between May and September, 1977 (when it ceased doing business) British American ever registered or otherwise conformed to CFTC regulations.

(A409) The Court declined, however, to order disgorgement of the income Forma received in December, 1976, or in 1978, because the Commission had not adequately shown what portion Forma's total proceeds for December, 1976, were received between December 9 and 31, 1976, and because the liquidation by Forma of BACO's assets in the course of winding down the company in 1978 could have produced proceeds to Forma that related to a sale of assets that dated from August, 1975. (A410)

ARGUMENT

I. THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN FINDING DISGORGEMENT TO BE AN APPROPRIATE REMEDY FOR FORMA'S REGISTRATION AND FRAUD VIOLATIONS.

Forma argues that the District Court erred when it ordered disgorgement based on Forma's unregistered options brokerage activities because, Forma contends, disgorgement is not available as a remedy for unlawful but not fraudulent conduct. (Appellant's Brief ["App. Br."] at 4.) On this basis,

Forma argues that the Court below erred by failing to require the Commission to isolate the proceeds of Forma's fraudulent conduct from proceeds of his other unlawful conduct, and by failing to limit the amount of disgorgement to the former. (E.g., App. Br. 33.) But, as we show below, disgorgement is plainly available to remedy unlawful--although non-fraudulent--conduct such as violations of registration laws; thus, the Commission was not required to isolate one form of illegal proceeds from another.22/

In its landmark decision, SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971), this Court ruled that Section 21(e) of the Securities Exchange Act of 1934, which empowers the SEC to seek injunctive relief for securities law violations, does not limit the SEC to this one remedy, but authorizes it also to seek to deprive the violators "of the gains of their wrongful conduct." Id. at 1307-08. Accord, SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d 90, 95 (2d Cir. 1978); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2d Cir. 1972). The standard of appellate review for challenges to the validity of disgorgement orders is the "abuse of discretion" standard. E.g., SEC v. Shapiro, 494 F.2d 1301, 1309 (2d Cir. 1974).

No case in which disgorgement has been ordered for securities law violations has limited this very broad remedy to violations of antifraud

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22/ In addition, because all of Forma's proceeds in 1977 were derived from illegal conduct--either unregistered brokerage activities or fraud--the District Court correctly ruled that this was not the kind of case in which the Commission, as proponent of an order for disgorgement, bore the burden of isolating proceeds of illegal conduct from proceeds of other, lawful conduct. All of the cases cited by the appellant (App. Br. 33) which impose a duty on the part of the proponent for an order for disgorgement to isolate unlawful proceeds, involved circumstances where disgorgement was sought of income from both lawful activity and unlawful activity. E.g., SEC v. Wills, 472 F. Supp. 1250, 1276 (D.D.C. 1978); SEC v. Galaxy Foods, 417 F. Supp. 1225 (E.D.N.Y. 1976).

statutes or rules. In SEC v. Blavin, 760 F.2d 706 (6th Cir. 1985), an injunctive action brought to restrain an unregistered investment advisor from future violations of the registration provisions of the Investment Advisers Act, as well as the antifraud provisions of the securities laws, the Sixth Circuit affirmed a district court's order of disgorgement of the subscription fees which the defendant had received for unregistered advisory services. In so ruling, the Court observed that "disgorgement orders are not limited to confiscation of trading profits," and that "[b]ecause Blavin failed to register with the Commission, he was prohibited from selling investment advice, and was not entitled to keep the fees paid by subscribers to his newsletters." 706 F.2d at 713. Thus, the Court concluded that the district court was well within its equitable power to make registration violations unprofitable by ordering disgorgement of the defendant's subscription income. Id.

As the disgorgement remedy for violations of the commodity laws is as broad as for violations of the securities laws, CFTC v. British American Commodity Options Corp., 560 F.2d 135, 141 n. 11, every court to have considered the issue has held that disgorgement is available to remedy violations of the Commodity Exchange Act, even if unrelated to fraud. Thus, in CFTC v. Hunt, 591 F.2d 1211 (7th Cir. 1979), an injunctive action under Section 6c of the Act to restrain unlawful trading in excess of the speculative position limits imposed by Commission Regulations, the Seventh Circuit reversed the district court's refusal to grant injunctive and disgorgement relief, because nothing in the Act restricted the judiciary from ordering disgorgement, and because permitting "a violator to retain profit from his [trading limit] violations would frustrate the purposes of the

regulatory scheme." 591 F.2d at 1223.[23/] Significantly, the Commission did not charge that the defendants' conduct violated any of the antifraud provisions of the Act or the Commission's regulations.

Other courts faced with the issue have similarly ordered disgorgement for violations of the Act not related to fraudulent misconduct. E.g., CFTC v. CoPetro Marketing Group, Inc., 680 F.2d 573 (9th Cir. 1982) ("CoPetro") (ordering disgorgement for violations of Section 4 and 4h of the Act, prohibiting the sale of off-exchange futures contracts). Accord CFTC v. Commercial Petrolera International S.A., [1980-1982 Transfer Binder] Comm. Fut. Law Rep. (CCH) ¶ 21,222 (S.D.N.Y. 1981) (Knapp, J.) ("Petrolera") (ordering disgorgement for per se violations of Sections 4 and 4h of the Act).[24/] See CFTC v. American Board of Trade, 473 F. Supp. 1177 (S.D.N.Y. 1979); id., 79 Civ. 2134 (VLB) (Orders filed May 21, 1982 and July 13, 1982 and July 13, 1982, and opinion filed October 1, 1981) (ordering disgorgement of proceeds derived from prohibited commodity options sales in violation of Sections 4c(b) and 4c(c) of the Act).

Finally, permitting individuals to profit from violating the Act's registration requirements would plainly thwart the important purpose of this registration provision recognized by this Court to be the "kingpin" of the statutory design of the Commodity Exchange Act. CFTC v. British American Commodity Options Corp., 560 F.2d 135, 139-40 (2d Cir. 1977). Because it is

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23/ Cf. SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2d Cir. 1972); SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971).

24/ 7 U.S.C. § 6 (1976) (The violations of Section 4 of the Act found in CoPetro and Petrolera are analogous to the registration violations found to have been committed by Forma in this case. Section 4, in effect, prohibits trading futures contracts in any commodity which has not been designated (i.e., registered or licensed) by the Commission as a "contract market").

clear that disgorgement is not limited to violations of the antifraud provisions of the Commodity Exchange Act, but is a remedy available to correct abuses of the Act's registration requirements, the District Court properly ordered disgorgement of all of the 1977 income Forma received after January 17, 1977, the date Regulation 32.3 became effective.

Forma argues alternatively (App. Br. 40) that the District Court should have declined in its equitable discretion to order disgorgement for his registration violations on the ground that his operation of an unregistered options brokerage business had been "sanctioned" by the District Court in the CTA litigation (see pages 7-8, supra).25/ But, as this Court stated in reversing the District Court's decision in that case:

> to the extent that British American's business activities succeeded . . . while not registered, British American has been acting at its own peril. A court of equity is under no duty 'to protect illegitimate profits or advance business which is conducted illegally.'

CFTC v. British American Commodity Options Corp., 560 F.2d at 135, quoting, FTC v. Thomsen-King & Co, 109 F.2d 516, 519 (7th Cir. 1940).26/ Thus, the

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25/ Under Forma's "sanction" argument, one would never be subject to disgorgement for registration violations unless he is enjoined, and until he violates the injunction. As previously shown, disgorgement is a proper remedy for registered violations that precede an injunction. SEC v. Blavin, 706 F.2d at 713; cf. CoPetro, 680 F.2d at 583-84; Petrolera, Comm. Fut. L. Rep. (CCH) ¶ 21,222.

26/ Moreover, it strains credulity for Forma to state a belief that he had the District Court's imprimatur to continue in business as an unregistered FCM after January 17, 1977. The District Court certainly did not believe that its earlier decision in the CTA litigation constituted an "imprimatur" for BACO and Forma to continue in business as an unregistered FCM. The District Court specifically characterized Forma's unregistered violative conduct as "flagrant." Comm. Fut. L. Rep. (CCH) ¶ 20,662, at 22,697. Forma was well aware that the District Court's refusal to issue an injunction in the CTA proceeding had been appealed to this Court by the Commission and, therefore, he was fully conscious that the District Court's denial of the injunction was not the courts' final say on the matter.
(Footnote continued)

District Court properly exercised its discretion in refusing to protect the illegitimate profits Forma received for BACO's unregistered FCM activities.27/

Entirely apart from ordering the disgorgement of Forma's 1977 income received from his registration violations, which, as discussed supra, involved all of the income he received after January 17, 1977, the District Court found Forma's pervasive fraudulent conduct to be an independent basis for ordering disgorgement of his 1977 income. (A408-409) Forma, throughout his brief, concedes that disgorgement is an appropriate remedy for fraudulent conduct. (E.g. App. Br. at 34-36.) And, he does not challenge the District Court's findings that he engaged in pervasive fraud as "clearly erroneous." See Fed. R. Civ. P. 52(a); Sygma Photo News, Inc. v. High Society Magazine, 778 F.2d 89, 95-96 (2d Cir. 1985) ("Sygma"); Joseph Scott Co. v. Scott Swimming Pools, Inc., 764 F.2d 62, 66-67 (2d Cir. 1985); United States v. Juno Construction

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And Forma could have had no doubt about the legality of the Regulation 32.3; Forma specifically challenged the regulation in the Bagley litigation discussed supra, and the District Court in Bagley rejected this challenge on December 21, 1976, before BACO and Forma became subject to the registration requirement of Regulation 32.3.

27/ Attempting to portray registration violations as harmless, or even victimless, illegal conduct, Forma also argues that BACO's "non-registration did not cause customer losses any more than a personal injury can be said to have resulted from the fact that a motor vehicle was unregistered." (App. Br. 36.) Even if true, a proposition that non-registration does not cause customer loss is irrelevant to whether illegal income should be disgorged, because as Forma concedes (App. Br. 28.), it is not customer loss, but illegal gain to the violator, that justifies an order of disgorgement. Moreover, the proposition itself is untrue. Customers who entrusted their funds to BACO would be justified in assuming that BACO was registered with the Commission, as it was required to be. Moreover, all applicants for FCM registration are subjected to a fitness inquiry prior to registration. See Section 8a(2) of the Act, 7 U.S.C. § 12a(2) (Supp. V, 1975). Customers who entrust funds to an unregistered violator, unaware of its unregistered status, may have done so upon a mistaken belief that its broker has satisfied all fitness requirements under the Act, and this belief would certainly be a contributing factor in any subsequent loss to the customer.

Corp., 759 F.2d 253, 255 (2d Cir. 1985). Thus, it was entirely proper for the District Court to order Forma to disgorge the proceeds that he derived from his fraudulent conduct, which as discussed infra, given his pervasive fraud and deception throughout 1977, amounted to all the 1977 income he received from BACO.

II. THE INCOME FORMA RECEIVED FROM BACO IN 1977 IS A PROPER MEASURE OF DISGORGEMENT FOR HIS UNREGISTERED FCM ACTIVITIES AND HIS PERVASIVE FRAUDULENT AND DECEPTIVE CONDUCT.

Appellant Forma also argues (App. Br. 27) that there was no nexus between Forma's fraudulent conduct (as opposed to his illegal, unregistered FCM conduct) and the amount of income he received from BACO in 1977, and thus he contends that the District Court's disgorgement order lacks an adequate evidentiary basis. However, all of Forma's 1977 BACO-related income represented gain from an entirely illegal enterprise. On and after a January 17, 1977, until September 7, 1977, when, following this Court's decision in the CTA litigation, Forma closed down BACO's operations permanently, BACO's and Forma's unregistered activities with respect to the marketing and sale of London commodity options were illegal in toto.[28/] All proceeds received by Forma during that period are thus subject to disgorgement.[29/]

28/ At App. Br. 36, Forma concedes that his registration violations continued after the May 3, 1977 evidentiary hearing. And, as the district court found in Commodity Futures Trading Commission v. British American Commodity Options Corp., 422 F. Supp. 622, 667-68 (S.D.N.Y. 1976) (Gagliardi, J), and, as this Court found in Commodity Futures Trading Commission v. British American Commodity Options Corp., 560 F.2d 135, 140-41 (2d Cir. 1977), BACO and Forma had been continuously acting in an illegal unregistered capacity since April 16, 1976.

29/ Therefore, the District Court's findings of fraud are germane to this appeal only to the extent that they afford a basis for disgorgement of Forma's income from January 1, 1977 through January 16, 1977, the period prior to the (Footnote continued)

In any event, the District Court's finding in its April 1985 disgorgement order that appellant Forma's fraudulent and deceptive conduct was "pervasive," as well as its findings in its 1978 opinion with respect to the specific fraudulent activities conducted by Forma, amply justify disgorgement of Forma's entire 1977 income, including the period from January 1st through January 16th. As the District Court found, Forma's fraudulent activities extended to virtually all phases of BACO's marketing and sales operations. CFTC v. British American Commodity Options Corp., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,662 at 22,702-03 (S.D.N.Y. 1978). These activities included routine misrepresentations of the risks, probable returns, performance guarantees, commissions and mark-ups, costs, and market mechanics of the London options offered for sale. Forma was also found to have falsely held BACO out as a "licensed" or "registered" options dealer, and held its salesmen out as specialists, and to have falsely represented that BACO has a "research department" and that BACO was a long-established "Wall Street" institution. Id. at 22,698-704. (See pages 13-14, supra.)30/

Assuming that he was subject to disgorgement only for his fraudulent activities, which, as we have shown, is an erroneous proposition, Forma argues (App. Br. 43-44) that the income he received after May 3, 1977, when the evidentiary hearings ended, could not be the subject of disgorgement because there is no evidence in the record that Forma continued his fraudulent

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effective date of the FCM registration rule.

30/ Forma complains about the District Court's use of what Forma describes as generalized labels of "pervasive fraud" and "illegal enterprise" (App. Br. 26). Yet, he fails to challenge the evidentiary bases for any of the District Court's findings in its 1978 Opinion in Commodity Futures Trading Commission v. British American Commodity Options Corp., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,662.

activities after May 3, 1977 through September 7, 1977, when BACO closed down permanently. Yet, in its 1978 opinion, the District Court found that Forma continued his "very profitable" options trading until September 7, 1977, the date of the injunction ordered by this Court in the CTA litigation. Id. at 22,706. (See pages 7-8, supra.) Forma also testified that BACO did not alter its business procedures at any time between 1976 and September, 1977. (A343) Given this testimony, the 1978 findings, which Forma has not challenged, and Forma's failure to allege that he ever "conformed to CFTC regulations" between May and September, 1977 (A409),[31/] the record amply supports the Court's finding that Forma's 1977 income derived from fraudulent activities between May and September 1977, and should therefore be disgorged.

Next, Forma argues that there is no evidence in the record tying the income he received from BACO during 1977 to proceeds of the illegal conduct charged in the Commission's complaint. In other words, Forma suggests that the compensation he received during 1977 could have been proceeds collected and deferred from an earlier period (i.e., prior to December 9, 1976) when his activities were not charged as unlawful (App. Br. 44-46). But Forma's own testimony in the record overwhelmingly demonstrates that Forma's compensation for his illegal activities during 1977 derived from BACO's 1977 revenues.[32/] At

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31/ Forma argues that any imposition of a duty to come forward with evidence showing that he discontinued his fraudulent scheme after the May, 1977 hearings amounts to an improper shifting of the burden of proof to the opponent of a disgorgement order. (App. Br. 41-42.) The District Court did not, however, shift the burden. Rather, after considering the Commission's presentation, which included Forma's deposition that he did not change BACO's business procedures between 1976 and September 1977 (A343), the Court correctly noted that Forma did not come forward with any evidence to the contrary.

32/ Although Forma makes much of the argument that his 1977 income could have stemmed from revenues generated by BACO in 1975 and 1976, Forma overlooks the (Footnote continued)

his depositions, Forma testified that he never received dividends (A130) and had no formal compensation agreement with BACO (A139-140). Forma did not receive periodic compensation of any set amount (A388-389); rather, whatever cash BACO received, he took (A359). He took cash from BACO on an "as needed" basis (A391), and did not keep track of income as he received it in 1976 or 1977 (A390-391). Any cash Forma took out of BACO would have been included on his 1977 IRS tax return (A358). From this testimony, the Court properly infer red that Forma's 1977 income was not deferred compensation from previous years, but was derived from BACO's current 1977 earnings.33/ Forma has not shown that this finding was clearly erroneous. See, e.g. Sygma, 778 F.2d at 95-96. Thus, the District Court's finding that the $1,023,375 received in income from BACO for

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fact that it would have been illegal for him to fail to declare those revenues as income on his 1975 and 1976 tax returns. Forma was a calendar year-basis taxpayer, as evidenced by his 1977 IRS 1040 tax returns (A193) U.S. taxpayers are not permitted to earn unrestricted income and then simply wait until the next year to declare it as such. See, e.g. Burnet v. Sanford & Brooks, 282 U.S. 359, 363 (1931); 26 U.S.C. §§ 441, 451 (1976). Forma did not receive dividends from BACO (A130), had no deferred compensation agreement with BACO (A139-140), but took cash from BACO whenever he needed it, and as much as he needed, (A359,A391) Thus, it was properly inferable that none of BACO's revenues were reinvested in the company, and all such revenues were available to Forma under the "claim of right" doctrine. See United States v. Lewis, 340 U.S. 590, 591 (1951); North American Oil Consolidated v. Burnet, 286 U.S. 417, 424 (1932). This being the case, Forma was required to declare the unexpended cash available to him at BACO in 1975 and 1976 on his tax returns for those years, not on his 1977 return. Absent proof to the contrary, it may be presumed that Forma complied with the tax laws in 1975, 1976 and 1977, and thus the funds he declared as income in 1977 were presumptively received by BACO in 1977.

33/ Even if there had been no evidence that the compensation which BACO paid Forma for his services in 1977 derived from revenues earned between January 1, 1977 and September 7, 1977, those funds would nevertheless be exclusively ill-gotten gains in the hands of Forma, whose BACO-related activities in 1977 were entirely illegal. Forma testified that whatever cash he took from BACO in 1977, he declared on his 1977 IRS tax returns. (A358,366-367) Since these funds represented compensation for his 1977 services (A366-367,A348-349) rendered solely in connection with BACO's options business (A367,A340-342), it was all illegal gain as to Forma.

1977 was subject to disgorgement is fully supported by the record.

Forma also contends that the income he received from BACO after September 7, 1977 throughout the remainder of 1977 should not be disgorged because BACO had completely closed down its operations during this period, and thus Forma was not engaged in any unlawful activities then. In deposition testimony, however, Forma stated that after September 7, 1977, he received compensation for winding down BACO's business affairs (A348-349,A353), and that all cash and assets on hand in September, 1977 derived from BACO's options business (A341-342,A362). He also testified that BACO did not generate any additional revenues after September 7, 1977. (A342) Thus, appellant's argument amounts simply to the proposition that compensation for winding down an entirely illegal enterprise, derived from entirely illegal proceeds, must be considered "lawful proceeds" not subject to disgorgement. This Court should not indulge appellant's fiction that a violator can transform illegal proceeds into lawful proceeds, by "lawfully" compensating himself for winding down an entirely illegal business operation with proceeds derived from entirely illegal conduct. The District Court did not err in this regard.[34/]

Finally, Forma raises a number of challenges to the 1982 Court-approved distribution of proceeds (with accrued interest) of the $250,000 bond BACO posted in 1977 in connection with this Court's stay of its mandate in British American Commodity Options v. Bagley, 552 F.2d 482 (2d Cir. 1977), cert. denied, 434 U.S. 398 (1977). None of the distribution-related arguments

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34/ Forma relies heavily on his deposition testimony that part of BACO's assets existing as of September 7, 1977, derived from 1975 and 1976 as well as 1977. (App. Br. 44.) The District Court has already accepted this testimony by declining to order Forma to disgorge the $175,995 he declared as compensation from BACO in 1978 (A410,A250), thus finding that proceeds of the sale of BACO's pre-1977 assets were limited to that amount.

advanced by Forma is a proper subject for this appeal. Forma was required by Rule 3(c) of the Federal Rules of Appellate Procedure to designate in his notice of appeal "the judgment, order or part thereof appealed from." In his notice of appeal (A1), Forma designated only the judgment entered May 8, 1985, which pertained only to the District Court's April 17, 1985 order directing Forma to disgorge all of his 1977 income. Neither his notice of appeal (or his pre-argument statement filed by current counsel (A3)) made any designation of the District Court's December 15, 1982, consent order distributing BACO's proceeds to former BACO customers as a subject that he wished to be reviewed by this Court. By failing, explicitly or implicitly, to notify this Court and the Commission of its appellate objections to the manner in which funds were distributed to former BACO customers in 1982, Forma manifested an intention to leave the 1982 distribution undisturbed. See, e.g., Terkildsen v. Waters, 481 F.2d 201, 206 (2d Cir. 1973); see also Conway v. Village of Mount Kisco, 750 F.2d 205, 211 (2d Cir. 1984). Thus, none of Forma's arguments about the 1982 distribution is a proper subject for this appeal.

In any event, none of these arguments has any merit. In challenging the 1982 court-approved distribution, Forma first argues that the customer claims verification procedure utilized by the Receiver, and approved by the District Court, in determining who would participate in the distribution of these assets did not yield sufficient proof that each of the customers who had filed claims had been defrauded by BACO and Forma. (App. Br. 28,43.) This argument is premised mainly on what we have already shown (see pages 21-24, supra) to be Forma's mistaken assumption that registration violations alone cannot sustain the imposition of a receivership and an equitable distribution to

persons who lost money as a result of entrusting money to the unregistered violator. See SEC v. Blavin, 760 F.2d 706, 713 (6th Cir. 1985). These customer claimants were entitled to participate in the Receiver's 1982 distribution of BACO's assets because of the District Court's finding that BACO acted in an illegal unregistered capacity after January 17, 1977. That finding alone would enable BACO's customers to share in the funds to be distributed, based solely upon proof that they invested funds with BACO while it was operating illegally.

Given the District Court's finding that BACO engaged in widespread and pervasive fraud, all customers who invested with BACO from December 9, 1976 through September 7, 1977 were, in any event, entitled to share in the distribution, without the need for an oral evidentiary procedure requiring each of the 199 customers to testify as to each element of a fraud claim. Thus, there is no basis for Forma's argument that the undistributed portion of the funds held by the Receiver should be returned to Forma.35/

Next, Forma argues that it was error for the District Court to consider proof of BACO's customers' out-of-pocket loss in determining the amount of assets to be distributed to BACO's former customers, because only gain to the violator, not loss to the victim, is relevant to the proper measure of disgorgement. (App. Br. 29.) But the $1,476,484.10 in customer losses, see note 19, supra, were directly relevant to the Receiver's pro rata distribution

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35/ Even if no former BACO customers had been located to share in a distribution, and there had been no distribution in the nature of restitution, Forma, as sole shareholder of BACO, would not be entitled to a return of these assets, for that would undermine the deterrence policies to be furthered by ordering disgorgement of BACO. E.g., SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2d Cir. 1972); SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971); SEC v. Golconda Mining Co., 327 F. Supp. 257, 259 (S.D.N.Y. 1971).

in 1982 because the record demonstrates that this distribution was not in fact disgorgement of BACO; rather, it was equitable relief in the nature of restitution.[36/] In seeking court approval of the distribution of BACO's assets, the Receiver did not expressly seek disgorgement of either of BACO or Forma. (A37-83) And Forma in 1983 clearly indicated that he did not consider the 1982 distribution to be disgorgement of BACO. (A272-274) Even if the distribution could be considered disgorgement, which it was not, Forma did not object to it on the basis that it was improper to consider the amount of loss to the victim, as opposed to unlawful gain to the violator. (A84-96,A115-121)[37/]

Next, Forma argues that the Commission presented no evidence showing that the $250,000 bond posted in connection with BACO's appeal to the Supreme Court

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36/ In its amended complaint, the Commission sought, in addition to injunctive relief and disgorgement "[s]uch other and further relief as the Court may determine to be just, equitable and necessary in connection with the enforcement of the federal commodities laws." (A20) In its July 29, 1980, order appointing Thomas Egan as permanent Receiver, the District Court specifically authorized the Receiver to seek restitution for customers. (A67)

37/ Forma complains that it was improper for the Commission to present evidence relative to Forma's present financial circumstances and ability to pay a disgorgement award, because such information is irrelevant to the question of disgorgement. (App. Br. 45.) Yet, it is clear that the Commission's inquiry into Mr. Forma's personal finances did not relate to the question of the proper measure of disgorgement. Rather, the Commission examined Forma as to his financial circumstances solely to alleviate concern expressed by the Court and the Receiver that proceedings to collect disgorgement proceeds from Forma might prove unduly costly to the receivership. (A295-298)

In direct contradiction to his argument that a violator's ability to pay is not relevant to whether disgorgement should be ordered (App. Br. 45), Forma argues that the District Court should not have ordered disgorgement against him because "he does not have sufficient assets to satisfy such an order or any part thereof." (App. Br. 45.) Aside from the conceded irrelevancy of this argument to the propriety of disgorgement, see App. Br. 45, the Commission has already demonstrated in the District Court that the appellant had ample financial resources with which to satisfy a disgorgement order. (A141-268)

in the Bagley litigation represented funds derived from unlawful conduct from December 9, 1976 through September 7, 1977. Thus, he argues that these assets of BACO could not be subject to disgorgement. BACO posted the $250,000 bond on or about June 14, 1977, near the end of its illegal business activities, which concluded in early September, 1977. (A43) The timing of this bond payment alone supports an inference that the $250,000 derived from income earned by BACO in 1977.

In any event, Forma waived any objection to the alleged lack of evidence showing that the $250,000 bond derived from unlawful 1977 income, because: (1) in March 1979, BACO and Forma stipulated to the release of these funds to the custody of the Receiver (A44), demonstrating by this conduct that they believed that these funds were illegally obtained assets subject to the receivership;[38/] (2) prior to the actual distribution in December, 1982, Forma failed to object to the Receiver's proposed distribution on the grounds of alleged insufficiency of proof that the funds to be distributed derived from illegal conduct (A84-96,A115-121); and (3) Forma expressly gave his written consent to the 70% distribution of BACO's assets in December, 1982. (A122-123) Had Forma made this evidentiary objection before he consented to the distribution, the Commission could have taken additional depositions of Forma to show that these funds derived from illegal conduct in 1977. Forma is thus precluded from

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38/ Forma complains that he paid income taxes on his 1977 BACO-related income, and therefore, should not be required to disgorge his pre-tax income for 1977. (App. Br. 27.) The payment of 1977 taxes on such income was mandatory because Forma received it under a "claim of right." See, e.g., North American Oil Consolidated v. Burnet, 286 U.S. 417, 424 (1932). Once Forma satisfies the District Court's disgorgement order, he may take a deduction from his gross income in whatever year he disgorges his illegal 1977 income. Id.

making this objection here by laches and estoppel, as well as by waiver.[39] This Court should not overturn the court-approved distribution of BACO's assets on the basis of an evidentiary objection not presented to the District Court in a timely fashion. E.g. Terkildsen v. Waters, 481 F.2d 201, 204-05 (2d Cir. 1973).[40]

39/ Forma also argues that because he "was the sole owner of BACO's stock, [and] . . . owned all company assets, . . . the receiver's taking of $414,000 in BACO funds is tantamount to disgorgement by Forma itself." (App. Br. 46.) See note 17, supra. For this reason, Forma claims that the undistributed portion of such funds should be returned to him. (App. Br. 46.) Yet, Forma concedes that the concept behind the District Court's freeze and distribution of those assets was reimbursement to customers with claims against BACO, a remedy in nature of restitution. (App. Br. 46.) As already discussed, the Receiver did not apply for disgorgement of BACO (A37-48), nor did Forma consider the distribution of BACO's assets to be disgorgement. (A272-274)

Regardless of whether the 1982 distribution is to be considered restitution or disgorgement of BACO, it clearly was not disgorgement of Forma personally. Forma deliberately chose the corporate form of doing business. Forma has made no argument that he is willing to assume personal liability for all outstanding customer claims against BACO, which still exceed one million dollars. (Only $256,594.30 out of $1,476,484.10 has been returned to former BACO customers who have filed valid verified claims with the Receiver. See notes 17 and 19, supra) In any event, the equitable doctrine of "piercing the corporate veil" cannot be invoked to protect wrongdoers. E.g., Schenley Distillers Corp. v. United States, 326 U.S. 432, 436-37 (1946); NLRB v. Miller Trucking Service, Inc., 445 F.2d 927, 930 (10th Cir. 1971); DeSilva Construction Corp. v. Herrald, 213 F. Supp. 184, 193 (M.D. Fla. 1962).

And, Forma makes no convincing argument why, even if the distribution to former BACO customer in December, 1982, were considered to be tantamount to disgorgement of Forma personally, he should not be required to disgorge those additional amounts since they constituted unlawful revenues to BACO. See pages 34-35, supra. It is clear that these proceeds were not declared on his 1977 tax return because Forma testified that he never received them (A363), and that the cash he received from BACO in 1977 was declared on his 1977 individual IRS return. (A358,366-367).

40/ See also Schmidt v. Polish People's Republic, 742 F.2d 67, 70 (2d Cir. 1984); Vintero Corp. v. Corporacion Venezolana De Fomento, 675 F.2d 513, 515 (2d Cir. 1982); Rubin v. Manufacturers Hanover Trust Co., 661 F.2d 979, 996 (2d Cir. 1981); Rodix organization, Inc. v. Mack Trucks, Inc., 602 F.2d 45, 48 (2d Cir. 1979).

Finally, Forma argues that the "taking of his property through a disgorgement order without a full-scale evidentiary hearing to accurately determine the proper level of disgorgement" violates the Due Process Clause of the Fifth Amendment to the United States Constitution. (App. Br. 47.) Yet, Forma had three opportunities to present evidence relative to the proper level of disgorgement at the depositions held on January 14, 1983, April 13, 1983, and November 11, 1984. (A125,A137,A336) All of these depositions were held to determine the appropriate amount of disgorgement. At these depositions, Forma could have arranged to be examined by his own counsel to present facts not brought to light by the Commission's examination. In presenting proof relative to the proper amount of disgorgement, the Commission relied solely upon Forma's testimony at these depositions and upon documents and records produced by Forma pursuant to an order compelling production. Thus, there could be no genuine issue of material fact necessitating a full-scale oral evidentiary hearing. Cf. Fed. R. Civ. P. 56. Because Forma does not challenge the District Court's 1978 evidentiary findings of flagrant registration violations and pervasive fraud, and because the Commission has produced sufficient evidence to warrant disgorgement of Forma's 1977 BACO-related income and Forma has had ample opportunities to contest that proof, the District Court's order of disgorgement does not violate Forma's due process rights.

CONCLUSION

The District Court acted well within its broad discretion in concluding that appellant's illegal unregistered activities, as well as his fraudulent and deceptive options practices, could independently support an order of

disgorgement against John Forma. The record amply supports the District Court's conclusion that all of John Forma's income from BACO received in 1977, or $1,023,375, derived from unlawful activities. Accordingly, the Commission respectfully requests that this Court affirm the District Court's May 8, 1985, judgment in all respects.

Respectfully submitted,

EDWARD S. GELDERMANN
Attorney

Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581
(202) 254-9880

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