

Statement of Stephen Jay Obie, Acting Director of the Division of Enforcement,
United States Commodity Futures Trading Commission,
Before the United States House of Representatives, Committee on Agriculture,
Subcommittee on General Farm Commodities and Risk Management
June 4, 2009

Good morning, Chairman Boswell and members of this distinguished subcommittee. Thank you for the opportunity to appear before you today to testify regarding the continuing implications of the CFTC v. Zelener case. I am Stephen Obie, the Acting Director of the Division of Enforcement of the United States Commodity Futures Trading Commission. My remarks today represent my views in my capacity as the Acting Director, and I am not testifying on behalf of the Commission.

As Acting Director, I oversee 120 attorneys and investigators in four offices who investigate and litigate enforcement cases in administrative forums and in federal district courts. The Division of Enforcement investigates and brings cases in a wide range of areas including trade practice violations, manipulations, and fraud. Until a few years ago, a sizeable number of the Division's matters involved retail fraud in the area of foreign currency (also called "forex"), many of them involving boiler room operations. "Boiler rooms" are operations that use high-pressure sales tactics, usually including false or misleading information, to solicit generally unsophisticated customers.

In 2003, the CFTC filed what came to be known as the Zelener case. The CFTC complaint alleged that over a two-year period, Michael Zelener operated a foreign currency boiler room that fraudulently solicited millions of dollars from over 200 unsuspecting customers in violation of the Commodity Exchange Act. Although the contracts that Zelener was peddling purported to require delivery of currency within two days, in reality, the contracts were repeatedly rolled over and no delivery of currency was ever made. The CFTC contended that these contracts were, therefore, futures contracts, but the trial court ruled that the CFTC lacked jurisdiction over the contracts because Zelener's "customers were not trading in futures contracts; rather they were speculating in spot contracts."¹ The trial court's ruling that the CFTC lacked jurisdiction over the "rolling spot" contracts at issue in the Zelener case was upheld by an appellate court in 2004.²

Recently, Michael Zelener pled guilty to criminal fraud charges based on the same facts that were alleged in the CFTC civil complaint. In his plea agreement, Zelener admitted that he lied when he told potential customers that they could earn 120% annual returns with almost no risk even after he knew that almost every one of his customers had lost money; he was paid a total of \$ 1.4 million in mark ups and he used false account statements to conceal these mark ups; and he operated a forex boiler room for two years causing customers to suffer losses totaling \$2 million. Justice will soon be served when Zelener is sentenced for his crimes in August.

¹ CFTC v. Zelener, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,621 (D. N.D. Ill. Oct. 3, 2003); No. 1:03CV04346, 2003 WL 22284295 at *5; 2003 U.S. Dist. LEXIS 17660 at *14.

² CFTC v. Zelener, 373 F.3d 861 (7th Cir. 2004).

After the appellate ruling in the Zelener case, the CFTC brought other cases and received similar adverse rulings from another Circuit Court of Appeals³ and other trial courts. The case law spawned by the Zelener decision appeared to narrow the CFTC's reach in the area of foreign currency and created uncertainty as to the CFTC's antifraud jurisdiction over contracts in related areas where the line between futures contracts and spot contracts could be blurred. As a result of these adverse court decisions, the Division of Enforcement's case load in the area of foreign currency diminished, as we could not justify the expenditure of scarce resources to fight jurisdictional battles rather than pursuing wrongdoers in other areas where our jurisdiction was clear. But the lasting effect of the Zelener decision, putting this specific activity out of our jurisdictional reach, set the CFTC's Division of Enforcement forex program back a half a decade.

Fortunately, Congress clarified the CFTC's jurisdiction over the types of forex contracts sold by Zelener and other boiler room operators like him with the passage of the CFTC Reauthorization Act of 2008 (Title 13 of the Farm Bill). I applaud this subcommittee's efforts in drafting that much-needed legislation in the forex area. Since that time, the CFTC has aggressively used its clarified antifraud authority. I am proud to report to this subcommittee that the CFTC's Enforcement Division has opened 84 investigations involving foreign currency frauds, which are pending, and has already filed 9 federal court enforcement actions alleging that more than \$134 million was misappropriated from customers.

The changes in the Farm Bill have been extremely helpful to the Enforcement Division in policing the forex markets. However, because the Zelener-fix was limited to contracts in foreign currency, swindlers have moved on to perpetuate their fraud and are marketing Zelener-type "rolling spot" contracts in other commodities, especially precious metals like gold, silver, and platinum, and, thus, are defrauding customers beyond the CFTC's antifraud jurisdiction. Even worse, Zelener and the cases that followed provided a road map to these fraudsters on how to draft their contracts to escape prosecution by the CFTC. Customer agreements appear to have been drafted specifically with the Zelener decision in mind and language chosen so that, under the analysis in those decisions, the contracts at issue are argued to be spot contracts outside of CFTC jurisdiction and not futures contracts covered by the Commodity Exchange Act.

From my perspective, it appears that these Zelener-type contracts have proliferated and more fraudsters are offering these contracts, believed to be out of the reach of the CFTC's antifraud jurisdiction. Since the enactment of the Farm Bill, the CFTC has received more than 50 complaints from the public relating to potential boiler room frauds involving commodities other than foreign currency. In addition, the National Futures Association has identified approximately 30 firms offering potentially "too-good-to-be-true" investments in purportedly spot metals and energy contracts. Unfortunately, the Zelener decision remains a profound impediment to the CFTC's ability to prosecute these firms and protect the public from alleged wrongdoing. Consequently, the CFTC has had to refer these matters to state law enforcement authorities and other federal agencies.

³ CFTC v. Erskine, 512 F.3d 309 (6th Cir. 2008).

I also know from the NFA, which handles the registration of forex firms, that there has been an increase in registered forex dealer members who have begun to sell non-forex Zelener-type contracts to retail customers. Currently, seven such firms have been identified.

Protecting the public from commodity fraud and preserving the integrity of the commodity markets through swift and decisive action are critical missions of the CFTC's enforcement program. The Farm Bill has made that job easier in the forex area. Should Congress see fit to expand the CFTC's authority over boiler rooms offering metal, energy, and other commodity contracts to retail customers, we will utilize that authority -- as we have with the Zelener-fix provided by the Farm Bill for foreign currency -- to shutter those boiler rooms and protect the American public. With new authority, I can assure this subcommittee that the CFTC will continue to root out these fraudulent enterprises and other Ponzi schemers who prey on innocent Americans.

Thank you Chairman Boswell and members of this distinguished subcommittee. I look forward to answering your questions.