

1                                    IN THE UNITED STATES DISTRICT COURT  
2                                    FOR THE NORTHERN DISTRICT OF CALIFORNIA

3  
4 UNITED STATES COMMODITY FUTURES  
5 TRADING COMMISSION,

6                                    Plaintiff,

7                                    v.

8 PARON CAPITAL MANAGEMENT, LLC;  
9 and JAMES D. CROMBIE,

10                                   Defendants.

No. C 11-4577 CW

ORDER DENYING  
MOTION FOR LEAVE  
TO FILE AMENDED  
THIRD-PARTY  
COMPLAINT  
(Docket No. 137)

11 \_\_\_\_\_/  
12 JAMES D. CROMBIE,

13                                    Third-party Plaintiff,

14                                    v.

15 PETER J. MCCONNON; TIMOTHY LYONS;  
16 and DOES 1-25,

17                                    Third-party Defendants.

18 \_\_\_\_\_/  
19 Defendant and Third-party Plaintiff James Crombie seeks leave  
20 to file an amended third-party complaint. Third-party Defendants  
21 Peter McConnon and Timothy Lyon oppose the motion. The Court  
22 takes Crombie's motion under submission on the papers and DENIES  
23 it.

24                                    BACKGROUND

25 I. Procedural History

26 On September 15, 2011, Plaintiff United States Commodity  
27 Futures Trading Commission (CFTC) filed this action against  
28 Defendants Paron Capital Management, LLC and Crombie. CFTC  
alleges that Crombie violated the Commodity Exchange Act by making

1 false statements and providing fictitious documents on Paron's  
2 behalf to the National Futures Association (NFA), a registered  
3 futures association auditing Paron, and by soliciting potential  
4 customers, individually and on Paron's behalf, by using fraudulent  
5 promotional materials based on falsified and counterfeit account  
6 trading statements. In connection with each count, CFTC alleges  
7 that Crombie was in control of Paron and failed to act in good  
8 faith or knowingly induced the acts constituting Paron's  
9 violations and is therefore liable for them.

10 In a separate lawsuit brought on April 14, 2011 in Delaware  
11 Chancery Court, Paron, along with Peter McConnon and Timothy Lyon,  
12 who co-founded Paron with Crombie and are now the sole remaining  
13 members of Paron, sued Crombie for fraud. In the suit, they  
14 alleged that Crombie forged account statements from Fimat Futures  
15 USA LLC and Access Securities, LLC and made misrepresentations  
16 about his performance record, employment history and personal  
17 financial situation, to induce McConnon and Lyons to leave their  
18 jobs and form Paron with him, providing him with access to their  
19 money and valuable client contacts. Paron Capital Mgmt., LLC v.  
20 Crombie (Paron I), 2012 WL 2045857, at \*4 (Del. Ch.).<sup>1</sup> Because  
21 Crombie continued to make and perpetuate these misrepresentations  
22 while working as the initial manager of Paron, they also asserted  
23 that he breached his fiduciary duty of loyalty to McConnon, Lyon  
24 and Paron under the incorporation agreement. Id.

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25  
26 <sup>1</sup> McConnon and Lyons ask the Court to take judicial notice of  
27 this decision, and Crombie does not oppose the request. Because  
28 its accuracy can be ascertained by reference to a source that  
cannot be readily questioned, the Court grants their request and  
takes judicial notice of this filing.

1 The Delaware Chancery Court held a trial in early October  
2 2011. Id. Claiming financial hardship, Crombie did not appear at  
3 trial and did not present any evidence in his defense. Id.

4 On December 21, 2011, Crombie filed a third-party complaint  
5 against McConnon and Lyons in this Court, alleging that they were  
6 responsible for the misrepresentations in the promotional  
7 material, which they had authored and distributed, and that they  
8 had made false statements to the NFA, CFTC, this Court and the  
9 Delaware Chancery Court, including the denial of their involvement  
10 in the creation of the fraudulent promotional materials.

11 On January 24, 2012, the Delaware Chancery Court issued a  
12 memorandum opinion, denying various post-trial motions made by  
13 Crombie. Paron I, 2012 WL 214777, at \*1-8 (Del. Ch.). In the  
14 opinion, the court indicated that it considered the "matter fully  
15 submitted and ripe for a final determination on the merits." Id.  
16 at \*8.

17 On February 10, 2012, Crombie filed a voluntary petition for  
18 bankruptcy. In re Crombie, Case No. 12-10389 (Bankr. N.D. Cal.),  
19 Docket No. 1. As a result, the Delaware action was stayed. Paron  
20 I, 2012 WL 2045857, at \*4. Pursuant to a motion by McConnon and  
21 Lyons, the stay was lifted on or about February 23, 2012. Id.; In  
22 re Crombie, Case No. 12-10389 (Bankr. N.D. Cal.), Docket No. 16.

23 On April 6, 2012, this Court granted McConnon and Lyons'  
24 motion to dismiss Crombie's third-party complaint and quashed  
25 service upon them. Docket No. 117. The Court found, among other  
26 things, that Crombie had not sufficiently plead the elements of  
27 fraud and misrepresentation under California and that he lacked  
28 standing to pursue his claims because of his bankruptcy filing.

1 The Court stated that, if the bankruptcy trustee abandoned the  
2 claims, Crombie could move for leave to file an amended complaint,  
3 if he could truthfully remedy the problems identified in the  
4 order.

5 On May 11, 2012, the bankruptcy trustee notified the Court of  
6 his intent to abandon the claims contained in the third-party  
7 complaint. Docket No. 135.

8 On May 22, 2012, the Delaware Chancery Court issued an  
9 opinion adjudicating the merits of the Delaware action and finding  
10 Crombie liable on both claims. Paron I, 2012 WL 2045857, at \*4.  
11 On that date, the Delaware Chancery Court also issued a judgment  
12 based on the opinion. Paron I, 2012 WL 1850728 (Del. Ch.). The  
13 ruling has not yet been reduced to a final judgment such that it  
14 would be accorded preclusive effect under Delaware law.

15 On May 23, 2012, Crombie filed the instant motion for leave  
16 to file an amended third-party complaint (ATPC).

17 On June 6, 2012, the Bankruptcy Court confirmed the  
18 abandonment of the claims asserted in the third-party complaint.  
19 In re Crombie, Case No. 12-10389 (Bankr. N.D. Cal.), Docket No.  
20 49. Thus, Crombie has standing to pursue the claims.

21 II. Contents of the Proposed ATPC

22 In the proposed ATPC, Crombie alleges that, in June 2010,  
23 McConnon, Lyons and Crombie formed a partnership and signed an  
24 operating LLC agreement for Paron. According to Crombie, he was  
25 to be in charge of managing and developing the intellectual  
26 property which he had contributed to the company and managing  
27 trading operations. ATPC ¶ 21. He also alleges that McConnon and  
28 Lyons were responsible for all operational, banking, marketing and

1 solicitation activities on behalf of Paron, including authorship  
2 of marketing materials and solicitation of potential clients. Id.  
3 at ¶ 22.

4 Crombie asserts two causes of action against McConnon and  
5 Lyons. In the first cause of action, titled "negligence," Crombie  
6 alleges that McConnon and Lyons violated section 9(a)(4) of the  
7 Commodity Exchange Act, codified at 7 U.S.C. § 13(a)(4), in  
8 several ways. First, he contends that they "did not have the  
9 correct disclosures for JDC Ventures, LLC," that Paron never did  
10 business as JDC and that they "were negligent to project that the  
11 prior track record of JDC Ventures, LLC was a prior track record  
12 for Paron doing-business-as JDC Ventures, LLC." Id. at ¶ 23.

13 Second, he claims that they did not make certain legal disclosures  
14 in a due diligence questionnaire (DDQ) or in any other marketing  
15 material, which was "non-compliant with the regulatory obligations  
16 of a registered Commodity Trading Advisor." Id. at ¶ 24.

17 Finally, he alleges "McConnon was negligent to publish Paron  
18 monthly letters with inaccurate and inflated assets under  
19 management in the investment strategies, which he admitted  
20 telephonically to a NFA agent during its audit of Paron in March  
21 2011." Id. at ¶ 25.

22 In the second cause of action, titled "misrepresentation,"  
23 Crombie charges McConnon and Lyons with violating section  
24 4b(a)(1)(A),(B) of the Commodity Exchange Act, codified at 7  
25 U.S.C. § 6b(a)(1)(A),(B). Id. at ¶ 29. In support, he alleges  
26 that "McConnon provided all initial responses to the NFA's request  
27 for documents" and "later falsely stated to the CFTC that Crombie  
28 had provided all the documents to the NFA." Id. at ¶ 27. Crombie

1 also claims that McConnon provided the documents to the NFA in  
2 March 2011, which was the document production "in which the CFTC  
3 complaint alleges there were false and misleading statements and  
4 documents." Id. He states that "McConnon and Lyons had claimed  
5 that Crombie was responsible, and that he had authored, controlled  
6 and distributed all marketing materials," but that documents they  
7 produced in February 2012 showed that their "assertions were  
8 patently false," because they showed that "the native files for  
9 Paron's monthly letters, power point presentation, DDQ, and other  
10 marketing materials were all created and further modified by  
11 McConnon." Id. at ¶ 28.

12 Crombie requests a declaration that McConnon and Lyons  
13 violated the relevant sections of the Act and restitution "should  
14 the Court decide that their violations had caused harm to any  
15 person or entity associated with Paron." Id. at 11.

16 LEGAL STANDARD

17 Federal Rule of Civil Procedure 15(a) provides that leave of  
18 the court allowing a party to amend its pleading "shall be freely  
19 given when justice so requires." Courts consider five factors  
20 when assessing the propriety of a motion for leave to amend: undue  
21 delay, bad faith, futility of amendment, prejudice to the opposing  
22 party and whether the plaintiff has previously amended the  
23 complaint. Ahlmeier v. Nev. Sys. of Higher Educ., 555 F.3d 1051,  
24 1055 n.3 (9th Cir. 2009). Although these five factors are  
25 generally all considered, "futility of amendment alone can justify  
26 the denial of a motion." Id. at 1055.

DISCUSSION

McConnon and Lyons oppose Crombie's motion for leave to amend on the basis that amendment would be futile. They argue that he failed to allege properly the elements to state a claim for any violation, that he lacks standing and that he did not comply with the heightened pleading requirements of Rule 9(b). In the alternative, they contend that res judicata will bar his claims once the Delaware Chancery Court enters its final judgment and that the Court should hold this motion in abeyance until that time.

I. First claim for violation of Section 9(a)(4)

Section 9(a)(4) of the Commodity Exchange Act makes it unlawful for

[a]ny person willfully to falsify, conceal, or cover up by any trick, scheme, or artifice a material fact, make any false, fictitious, or fraudulent statements or representations, or make or use any false writing or document knowing the same to contain any false, fictitious, or fraudulent statement or entry to a registered entity, board of trade, or futures association designated or registered under this Act acting in furtherance of its official duties under this Act.

7 U.S.C. § 13(a).

Section 22(a) of the Commodity Exchange Act also provides for a private right of action for actual damages resulting from a violation of the Act. 7 U.S.C. § 25(a). Except as provided by other specified sections, this section is the "exclusive" remedy "available to any person who sustains loss as a result of any alleged violation of this Act." Id. at § 25(a)(2). This remedy, however, is limited to persons who received trading advice from the violator for a fee, who made a contract for the sale of a

1 commodity for future delivery through the violator, or who  
2 purchased from or sold to the violator certain options or  
3 contracts. Id. at § 25(a)(1)(A)-(D). The Ninth Circuit has also  
4 held that the Act did not preempt "common law remedies . . .  
5 available to commodity customers who had suffered financial injury  
6 as a result of a breach of common law duties," including common  
7 law fraud claims. Kotz v. Bache Halsey Stuart, Inc., 685 F.2d  
8 1204, 1207-1208 (9th Cir. 1982) (noting that the Act created the  
9 CFTC as the exclusive authority for regulating commodities trading  
10 and as such preempted any substantive state law on that subject  
11 that was contrary or inconsistent with federal law).

12 It is not clear from Crombie's proposed ATPC if he is  
13 attempting to assert a cause of action for negligence per se or  
14 directly for violation of section 9(a)(4). See Cal. Evid. Code  
15 § 669 (elements of negligence per se are that (1) defendant  
16 violated a statute or regulation; (2) the violation caused  
17 plaintiff's injury; (3) the injury resulted from the kind of  
18 occurrence the statute or regulation was designed to prevent; and  
19 (4) plaintiff was a member of the class of persons the statute or  
20 regulation was intended to protect). While he titles his first  
21 claim as "negligence," in the text, he alleges that McConnon and  
22 Lyons violated the statute itself and seeks a declaration that  
23 they did so. Either, Crombie has failed to state a claim.

24 As McConnon and Lyons point out, Crombie has failed to allege  
25 that he suffered any damages or that their actions were the cause  
26 of any such damages. While, in his reply, Crombie asserts that  
27 the alleged actions of McConnon and Lyons "permanently destroyed  
28 my reputation and livelihood and placed me into the epicenter of



1 regulators alleges [sic] of same acts by McConnon and Lyons,"  
2 Reply at 5, such allegations are not contained in his ATPC. As  
3 noted above, damages are a required element for both negligence  
4 per se and for a claim made pursuant to section 22(a). See also  
5 In re Amaranth Natural Gas Commodities Litig., 587 F. Supp. 2d  
6 513, 530 n.104 (S.D.N.Y. 2008) (because "a person who violates the  
7 CEA is liable to a private plaintiff only for 'actual damages  
8 resulting from' the violation, . . . a plaintiff who failed to  
9 allege damages or causation would have failed to state a claim").

10 Crombie has also failed to allege that any fraudulent  
11 statement or misrepresentation made by McConnon and Lyons was done  
12 willfully, which is required by the plain terms of section 9(a)(4)  
13 and further renders both potential claims defective. For his  
14 first and third theories, Crombie plainly alleges that McConnon  
15 and Lyons acted "negligently," and thus he could not remedy this  
16 deficiency without contradicting the contents of the proposed  
17 ATPC. In the second theory, Crombie has not alleged that McConnon  
18 and Lyons affirmatively and willfully falsified, concealed, or  
19 covered up anything; instead, he merely alleges that they failed  
20 to make certain disclosures.

21 To the extent Crombie may be attempting to bring a claim  
22 pursuant to section 22(a), he does not fall into the classes of  
23 people who may bring such actions. He does not allege that he  
24 received trading advice from McConnon and Lyons for a fee, that he  
25 made a contract for the sale of a commodity for future delivery  
26 through McConnon and Lyons, or that he purchased from or sold to  
27 McConnon and Lyons any options or contracts. See 7 U.S.C.  
28 § 25(a)(1)(A)-(D).

1 To the extent Crombie may be seeking to pursue a claim for  
2 negligence per se, he is likewise not a member of the class of  
3 persons the statute was intended to protect. The statute appears  
4 to be intended to assist in the effective oversight of commodities  
5 traders in order to protect investors and the public from the harm  
6 of improper trading practices, not to protect traders from fraud  
7 by their business partners.

8 McConnon and Lyons also argue that Crombie failed to plead  
9 that certain alleged misstatements were material. In the context  
10 of the Commodity Exchange Act, a "statement or omitted fact is  
11 'material' if there is a substantial likelihood that a reasonable  
12 investor would consider the information important in making a  
13 decision to invest." R & W Tech. Servs., Ltd. v. CFTC, 205 F.3d  
14 165, 169 (5th Cir. 2000). See also Tsc Indus. v. Northway, 426  
15 U.S. 438, 449 (1976). Crombie does not specify what "legal  
16 disclosures" McConnon and Lyons purportedly failed to make or how  
17 such failures were material.

18 II. Second claim for violation of section 4b(a)(1)(A),(B)

19 Section 4b(a)(1) of the Commodity Exchange Act makes it  
20 unlawful

21 for any person, in or in connection with any order to  
22 make, or the making of, any contract of sale of any  
23 commodity in interstate commerce or for future delivery  
24 that is made, or to be made, on or subject to the rules  
of a designated contract market, for or on behalf of any  
other person . . .

25 (A) to cheat or defraud or attempt to cheat or  
defraud the other person; [or]

26 (B) willfully to make or cause to be made to the  
27 other person any false report or statement or willfully  
28 to enter or cause to be entered for the other person any  
false record . . .

1 7 U.S.C. § 6b(a)(1). The elements of a securities fraud action  
2 under this section "are derived from the common-law action for  
3 fraud." Horn v. Ray E. Friedman & Co., 776 F.2d 777, 780 (8th  
4 Cir. 1985). See also First Nat'l Monetary Corp. v. Weinberger,  
5 819 F.2d 1334, 1340 (6th Cir. 1987); Hartwig Transit, Inc. v. RBS  
6 Citizens, N.A., 2011 U.S. Dist. LEXIS 92483, at \*6 (N.D. Ill.) ("A  
7 claim for relief under 7 U.S.C. § 6b is based on the principles of  
8 common law fraud where the relevant inquiry is whether a plaintiff  
9 actually relied upon the defendant's representations."). "The  
10 elements of intentional misrepresentation, or actual fraud, are:  
11 '(1) misrepresentation (false representation, concealment, or  
12 nondisclosure); (2) knowledge of falsity (scienter); (3) intent to  
13 defraud (i.e. to induce reliance); (4) justifiable reliance; and  
14 (5) resulting damage.'" Cross v. Wells Fargo Bank, N.A., 2011  
15 U.S. Dist. LEXIS 141944, at \*9-10 (C.D. Cal.) (quoting Anderson v.  
16 Deloitte & Touche LLP, 56 Cal. App. 4th 1468, 1474 (1997)).

17 As in his original third-party complaint, Crombie has failed  
18 to state a claim for fraud. As discussed above, Crombie has not  
19 alleged that he was harmed by McConnon and Lyons' purported  
20 misstatements. Crombie again also fails to allege that McConnon  
21 and Lyon intended for him to rely on these statements or that he  
22 did in fact rely on them to his detriment.

23 III. The heightened pleading requirements of Rule 9(b)

24 Because both of Crombie's claims are based on allegations of  
25 fraud, he is required to comply with the heightened pleading  
26 requirements of Rule 9(b). See, e.g., Walrus Master Fund Ltd. v.  
27 Citigroup Global Mkts., Inc., 2009 U.S. Dist. LEXIS 35040, at \*7  
28 (S.D.N.Y.) (applying to fraud claim under section 4b of the

1 Commodity Exchange Act); United States CFTC v. Amaranth Advisors,  
2 L.L.C., 554 F. Supp. 2d 523, 535 (S.D.N.Y. 2008) ("because claims  
3 under section 9(a)(4) sound in fraud, they are subject to the  
4 heightened pleading requirements in Rule 9(b)"). Pursuant to this  
5 rule, when "alleging fraud or mistake, a party must state with  
6 particularity the circumstances constituting fraud or mistake."  
7 Federal Rule of Civil Procedure 9(b). Statements of the time,  
8 place and nature of the alleged fraudulent activities are  
9 sufficient, Wool v. Tandem Computers, Inc., 818 F.2d 1433, 1439  
10 (9th Cir. 1987), provided the plaintiff sets forth "what is false  
11 or misleading about a statement, and why it is false." In re  
12 GlenFed, Inc., Sec. Litig., 42 F.3d 1541, 1548 (9th Cir. 1994).

13 Crombie has again failed to meet this requirement. In his  
14 first claim, Crombie did not state what McConnon and Lyons wrote  
15 to "project" that the prior track record of JDC was attributable  
16 to Paron in the way suggested, or when or in which materials they  
17 did this. He fails to state what disclosures they failed to make,  
18 when and in which documents. He fails to state what statements  
19 they made about "inaccurate and inflated assets" in what  
20 documents, when and how the statements were inaccurate. In his  
21 second claim, he does not identify the time, place and manner of  
22 the alleged statement to the CFTC that Crombie provided all the  
23 documents to the NFA. Crombie also fails to specify to whom  
24 McConnon and Lyons claimed that Crombie was responsible for the  
25 marketing materials or when.

26 CONCLUSION

27 For the reasons set forth above, the Court finds that  
28 Crombie's proposed amended third-party complaint fails to state a

1 claim and DENIES Crombie's motion for leave to file it (Docket No.  
2 137). Further, because Crombie has had an opportunity to correct  
3 the deficiencies in his third-party complaint, denial is without  
4 leave to amend further.

5 Having denied Crombie's motion on other grounds, the Court  
6 does not reach Lyons and McConnon's request to hold his motion in  
7 abeyance pending the final judgment from the Delaware Chancery  
8 Court.

9 The further case management conference and hearing on case  
10 dispositive motions are maintained as currently set on December  
11 20, 2012 at 2:00 p.m.

12 IT IS SO ORDERED.

13  
14 Dated: 6/25/2012

  
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CLAUDIA WILKEN  
United States District Judge