UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

SUBHASH CHAUDHRY,
Complainant,

v. — CFTC Docket No. 02-R42

RANDI ELLEN LIVOTI a/k/a Randi Ellen Gold,
Respondent.

INITIAL DECISION

Subhash Chaudhry alleges that his FSG broker Randi Ellen Livoti fraudulently induced him to approve the purchase of seven, out-of-the-money, Treasury bond call options by guaranteeing profits, and seeks to recover the $5,640 loss on that trade. Livoti denies any violations. The findings and conclusions below are based on the parties' documentary submissions and oral testimony, and reflect my determination that Chaudhry's testimony was significantly more plausible and credible than Livoti's testimony.[1] Thus, as explained below, it has been concluded that Chaudhry has established violations by Livoti causing damages of $5,093. The amount of damages is based on the difference between the total purchase cost of $5,640, and the $547 liquidation value of the T-bond calls when Chaudhry' account was transferred from FSG and Livoti ceased to be his account executive.

[1] The documentary record includes affidavits by Chaudhry and Livoti, tape recordings of certain conversations that were selectively recorded by FSG, and various documents produced by the carrying broker, including account-opening documents, account statements, and profit-loss summaries. *See* Order dated September 3, 2002.

Factual Findings

The parties

1. Subhash Chauhdry, a resident of Indianapolis, Indiana, has worked as a quality control inspector for Nucor Steel since 1988. Chaudhry has a Bachelor of Science degree in Production Engineering from The University of Punjabi North. He indicated on his account application that his annual income was about $80,000, that his liquid net worth was about $50,000, that he had traded stocks for five years and stock options for one year, and that he had no previous experience with commodity futures or options. [*See* account application (exhibit to complaint); and pages 5 to 8 of hearing transcript.]

2. FSG International, Incorporated, introduced Chaudhry's account to Vision Limited Partnership, a futures commission merchant located in New York City. FSG failed to file an answer and was found in default. However, FSG did assist Randi Livoti by giving her tape recordings and a copy of the log that memorialized conversations between Chaudhry, and Livoti and Maurice Batlle, Chaudhry's first FSG broker. [*See* pages 52-54 of hearing transcript.]

FSG, located in Fort Lauderdale, Florida, was a registered introducing broker during the relevant time. FSG's registration was terminated on November 28, 2000, pursuant to a National Futures Association Decision that concluded that FSG had used deceptive, misleading and unbalanced promotional materials and had failed to diligently supervise its agents. (*In re FSG, International, Inc., et al.*, NFA Case No. 99BCC22).[2]

[2] FSG had previously been sanctioned by the NFA for fraudulent sales practices. *In re FSG, et al.*, 96BCC8 (NFA May 24, 1996) ($75,000 fine and enhanced supervisory procedures); and *In re FSG, et al.*, 89BCC21 (NFA September 28, 1989) ($5,000 fine). In addition, FSG has been named in approximately 59 reparations complaints, most of which alleged fraudulent sales or trading practices. [CFTC records.]

3. "Maurice" Mauricio Alfonso Batlle solicited Chaudhry's account in late 1999, and recommended Chaudhry's first trade, the purchase of five out-of-the-money soybean options. Batlle was compensated with a large cut of the $1,175 in commissions on this trade, plus a 50% cut of the $1,156 in commissions and fees on the second trade that was recommended by Livoti. In 1998, Battle opened and handled 51 accounts, only two of which realized any net profits. Trading in these 51 accounts realized an aggregate net loss of $496,294, and generated $241,739 in commissions. In 1999, Batlle opened and handled 36 accounts, only five of which realized any net profits. Trading in these 36 accounts realized an aggregate net loss of $319,239, and generated $226,364 in commissions. [Vision profit-loss reports.]

Batlle was a registered associated person with FSG for two stints, the first from September 1993 to December 1994, and the second from March 1996 to June 2001. Before working for FSG, Battle had been associated with Diversified Trading Systems, Incorporated and Guardian Investment Company. Between his FSG stints, he was associated with Universal Commodity Corporation and First Investors Group of the Palm Beaches. After leaving FSG, he was associated with First Elite Investment Group, Incorporated. Batlle is currently a registered principal of Investor One Financial Group Corporation. [NFA records.][3]

4. John Bernadine Wilson, a registered branch office manager and principal with FSG, tried to convince Chaudhry to invest additional funds soon after Chaudhry had approved the first trade. Before working for FSG, Wilson had been associated with a string of firms that have been sanctioned for fraudulent sales practices and named in

[3]Chaudhry did not name Batlle as a respondent because the soybean trade recommended by Battle realized a net profit of $1,375. Neither side sought to produce Batlle as a witness.

numerous reparations complaints alleging fraudulent sales and trading practices: Edco Management Corporation, Chicago Commodity Corporation, Commonwealth Financial Group, Incorporated, and Cromwell Financial Services, Incorporated. Wilson currently is not registered.

5. Randi Livoti succeeded Batlle as Chaudhry's account executive and recommended the purchase of seven out-of-the-money Treasury bond call options.[4] Livoti was a registered associated person with FSG for about eight years, and was principally compensated with a percentage of commissions charged to customer accounts. Before working for FSG, she was associated with Chicago Commodity Corporation and Multivest Options. In 1998, Livoti opened and handled 64 accounts, only three of which realized any net profits. Trading in these 64 accounts realized an aggregate net loss of $799,491, and generated $319,473 in commissions. In 1999, Livoti opened and handled 38 accounts, only four of which realized any net profits. Trading in these 38 accounts had realized an aggregate net loss of $302,794, and generated $211,724 in commissions. [NFA records; Vision profit-loss reports; Livoti's supplement to her motion to vacate; ¶ 1 of Livoti affidavit; and pages 51 to 55 of hearing transcript.]

6. John Edwin Dryden was a registered principal of FSG. Before joining FSG, he had been associated with E. David Stephens Commodities Corporation and Chilmark Commodities Corporation, among others. Dryden is not currently registered.

Dryden was the first FSG agent to call Chaudhry about trading options with FSG. On this record it cannot be determined how Dryden got Chaudhry's name and number. Chaudhry did not describe this conversation in any detail, other than that he told Dryden

[4] Randi Livoti was known as Randi Gold for most of her career and during the life of Chaudhry's account. However, for simplicity's sake, she will be referred to as Livoti.

that he was not interested. [NFA records; and Chaudhry's submission dated October 8, 2002.]

Batlle's solicitation and trade recommendation

7. A few months after Dryden's first contact, Batlle called Chaudhry about trading options. Chaudhry told Batlle that he was reluctant to consider trading options because he was not familiar with options. Chaudhry also told Batlle that he could not afford to lose a substantial portion of any investment. However, Chaudhry did not discourage Batlle from calling him back, because he was intrigued by Batlle's claims that he was making money for all of his clients. Over the course of several calls, Batlle convinced Chaudhry that he was an experienced and knowledgeable trader who had consistently traded profitably for his clients, and who was currently making "good money" for all of his clients in the soybean market. Batlle assured Chaudhry that if Chaudhry trusted him he would make more money more quickly than Chaudhry had been slowly making with his modest investment in the stock market. Batlle's message was decidedly distorted because he never mentioned customers with losing trades and never said anything that accurately conveyed the underlying reality that almost all of his and FSG's customers had failed to realize any profits, and that few, if any, customers had realized the sort of large profits that he was touting. Batlle also never mentioned that he would be recommending the purchase of substantially out-of-the-money options, which would significantly undermine profit potential by generating substantial commission loads. After Batlle developed a good rapport with Chaudhry, and successfully convinced Chaudhry that he could successfully trade options with little downside risk, Chaudhry

decided to open an account with a deposit of $5,000. [*See* Chaudhry's affidavit; and pages 8 to15 of hearing transcript.]

8. When Chaudhry agreed to open an account, Batlle sent him the account-opening package. Batlle called Chaudhry a couple of times before the account-opening documents arrived. Batlle urged Chaudhry to fill out and sign the account-opening documents as soon as he received them, so that he could begin making the same sort of profits that his other customers were supposedly making in soybeans. Batlle portrayed the documents as a mere formality on the way to sure profits. Also, Batlle did not advise Chaudhry to carefully read and review the documents, and did not suggest that he make a copy of the documents for his files.

When Batlle next called Chaudhry, the account-opening package had just been delivered to his front door. Batlle then quickly guided Chaudhry through the documents, and told him where to check off, initial and sign his name. Chaudhry signed a Vision Limited customer agreement, a standard risk disclosure statement, an FSG "fee schedule disclosure," and FSG "additional disclosure," and an FSG "new account check list." The FSG fee schedule disclosure stated that FSG charged about $240 in commissions and fees for each option. When Chaudhry stated that that seemed high, Batlle assured him that the amount would be justified by the services that he would receive from Batlle and by the profits he would make. After Chaudhry had signed the documents, Batlle urged him to return them in the pre-addressed envelope. [See Chaudhry affidavit and pages 14-27 of hearing transcript.]

9. Upon receipt of Chaudhry's signed account-opening documents, Batlle called Chaudhry and told him that he had selected a trade involving the purchase of five soybean options. Batlle assured Chaudhry that he would realize a large profit in 45 to 60 days, but did not explain in any detail the basis for the trade, and did not mention that the recommended options were substantially out of the money. Batlle next explained that the last formality before placing the order would be the compliance review, which would be recorded by FSG, and Batlle told Chaudhry that he need only answer affirmatively to the series of questions in order to expedite the process.

The FSG employee conducting the review was identified as "Ellen." Ellen told Chaudhry that the purpose of the review was to "make sure that you completely understand the investment you are about to make." However, the format of the review and the manner in which Ellen conducted the review indicates otherwise. For example, Ellen asked Chaudhry whether he understood the general risks associated with trading options, but did not ask him to explain in his own words his understanding of the specific risks associated with the strategies to be recommended by Batlle and FSG, or to describe what Batlle had said about those risks. During the first two minutes, Ellen confirmed the accuracy of information on the account application, and asked a series of questions that sought yes answers, such as: "People can and do lose money in these markets. Do you understand that?" "In an option purchase you cannot lose more money than you invested. Do you understand that?" "The deep out-of-the-money option has only a remote chance of becoming profitable; and FSG does not generally recommend such options. Do you understand that?" Chaudhry's replies to the few non-leading questions indicated that he barely comprehended what he was getting into, as shown by the following exchange at the beginning of the conversation:

Ellen:	Why do you feel this investment is right for you at this time?
Chaudhry:	Well, you know, I'm in, I've been talking to Maurice, and he's a professional, and so I trust him.
Ellen:	Do you feel that this investment compliments your overall investment objective?
Chaudhry:	I think so.

Ellen then obtained Chaudhry's authorization to "buy five July soybean 5.75 call at the market." Ellen estimated the total cost at $4,600 and disclosed the "$200 commission for each option," but Ellen did not clearly disclose the total commission and fee cost of $1,175, and did not clearly disclose that the calls that Chaudhry was buying were substantially out of the money.[5] After discussing the trade, Ellen returned to a new series of routine questions that dealt generally with matters such as break-even points and the time decay of out-of-the-money options. However, Ellen did not discuss the specific break-even point for Chaudhry's soybean trade, and did not clearly disclose that he had purchased out-of-the-money options. Next, when Ellen asked Chaudhry if he had received any guarantees, he replied: "Well [Batlle] suggested to me that that I could make money." Ellen then stated, "I don't want you to think that <u>every trade</u> is a profitable trade." Chaudhry replied affirmatively, since Batlle had indicated merely that most of his trades were profitable. However, when Ellen next asked Chaudhry if Batlle had made "any representations contrary to what we have just reviewed," Chaudhry replied: "This is confusing to me ma'am. I don't feel comfortable." Ellen then stopped

[5] The actual total cost on this trade would be $4,425. The commission-to-premium-paid ratio on this trade was approximately 35%.

the recording and shifted Chaudhry back to Batlle, who assured him not to worry, and just tell Ellen that he understood that there were no guarantees and that he could lose no more than $5,000. Batlle handed Chaudhry back to Ellen who quickly concluded the review. [Transcript of account-opening review (underlining added for emphasis); *see* pages 27-33 of hearing transcript; and Chaudhry's letter to Sal Martarano dated April 26, 2000 (attachment to complaint).]

10. Ten days later, Batlle called Chaudhry and reported that the soybean options had gained five points and thus could be liquidated at a profit. Batlle then urged Chaudhry to talk to another broker, identified as "David M" in the phone log, who tried to convince Chaudhry to buy Treasury bond options. Chaudhry declined because, based on Batlle's promises, he was expecting to hold the soybeans options longer and to make much greater profits. Had Chaudhry accepted the trade urged by Batlle and David M, he would have collected a $4,550 premium, but would have only made a minimal $125 net profit. A few days later, Batlle and John Wilson urged Chaudhry to sell the soybean options. However, Chaudhry declined, because Batlle had led him to expect greater profits than would be realized if he sold at this point. Subsequently, the soybean options retreated, and once Chaudhry indicated that he was not interested in investing additional funds or engaging in frequent trading, Batlle and his co-brokers stopped calling Chaudhry with any regularity.

A few weeks later, Chaudhry called FSG to ask about the status of his soybean options. When told that they had rebounded and could be liquidated for a reasonable profit, he instructed FSG to sell them. The trade realized a gross profit of $2,700, and a net profit of $1,375. Despite the profit, Chaudhry was upset with Batlle, because Batlle had not called him to report that the soybean options had rebounded and become profitable. Batlle further aggravated Chaudhry, first by bragging that he had "made $2,700" for Chaudhry, when Chaudhry had already figured out that the net profit was half that amount, and second, by abruptly telling Chaudhry that he had the recorder on and was ready to take his authorization for a heating oil trade that they had not even discussed. Chaudhry told Batlle that his services had not been worth the commissions that he had paid, and instructed that the account be closed. However, Batlle and his supervisor, Harold Siegel, disregarded Chaudhry's instructions, and asked Randi Gold to call Chaudhry with an offer to continue trading at reduced commissions. [*See* pages 27-41 of hearing transcript; and Chaudhry affidavit.]

Livoti's trade recommendations

11. Chaudhry credibly testified that he told Livoti that although he was happy that the soybean trade had been profitable as promised by Batlle, he was upset that Batlle had not called him to report that option was profitable and that Batlle had tried to push him into buying heating oil options. In reply, Livoti offered to lower his commissions to $125 per option, and assured Chaudhry that she was a successful trader who also was making good money for her clients. Livoti said that FSG's research department had a Treasury bond trade that she was sure would make significant profits within a month. Livoti otherwise made no effort to cure Chaudhry of his erroneous belief that profits could be guaranteed, or to ascertain whether Chaudhry actually understood the specific risks and rewards associated with the trading strategies recommended by FSG. Chaudhry

then agreed to approve the purchase of seven out-of-the-money Treasury bond calls, which generated $1,160 in commissions and fees.[6]

Livoti undermined her credibility by making wildly inconsistent descriptions of her first conversation with Chaudhry. Initially, she asserted that Chaudhry had selected the trade before she called and wanted to "hedge" his stock portfolio. But then she later asserted that Chaudhry was "looking for a fast turnover" profit. [*See* Livoti's answer and supplement to answer, and pages 56-59 of hearing transcript.] Livoti's assertion that Chaudhry wanted to hedge appeared especially absurd in light of Chaudhry's modest finances and stock holdings, and in the absence of any reliable evidence that the purchase of T-bond calls would have created a valid hedge for Chaudhry "portfolio." Moreover, even if she had produced such evidence, she still failed to explain how the purchase of more risky and more costly out-of-the-money calls could be considered a viable hedging strategy, when less risky and less costly in-the-money call options were available. As for the basis for her recommendation to buy the out-of-the-money calls, Livoti testified that FSG had a "strong recommendation" to buy the call, because FSG was expecting interest rates to go up. However, Livoti conceded that she could not "remember the specifics" underlying the recommendation to buy calls that were substantially out of the money.[7] [*See* pages 56-59 of hearing transcript.] Finally, Livoti's assertion that Chaudhry had a sophisticated understanding of her trade recommendation was undermined by the following exchange during the tape-recorded trade authorization:

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[6] The commission-to-premium-paid ratio on this trade was approximately 26%.

[7] On the day of the purchase, the September T-bond future contract settled at 99.21875. The September T-bond calls bought by Chaudhry had a 104 strike price. Livoti's description of her conversation with Chaudhry indicates that she knew that in-the-money options were available. [Supplement to answer.]

Livoti:	Now, also remember something, these are call options. So we're speculating that the bond prices will move higher form here. Do you understand?
Chaudhry:	Uh huh.
Livoti:	And finally, do you realize that the commission of $125 per option could be the difference between you making money or losing money on the purchase of the option?
Chaudhry:	What does that mean?

[Page 6 of transcript of trade authorization.]

When the T-bond calls quickly dropped, Livoti assured Chaudhry that the calls would rebound and become profitable. However, when Chaudhry realized that the $125 reduced commission had not included $80 in various fees, Chaudhry strongly objected, and his relationship with Livoti and FSG sufficiently disintegrated to the point that FSG transferred his account to another firm. On the date of the transfer, the T-bond options had a $547 liquidating value. [*See* pages 41-48, and 55-59 of hearing transcript; and Chaudhry's letter to Sal Martarano dated October 4, 2000 (attachment to complaint)]

Conclusions

Fraudulent trading advice

The preponderance of the evidence establishes that Randi Livoti, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10,[8] used a combination of blatantly false and deceptive misrepresentations and omissions to

[8] Section 4c(b) provides that: "No person shall . . . enter into or confirm the execution of any transaction involving any . . . option . . . contrary to any . . . regulation of the Commission." CFTC rule 33.10 provides that: "It shall be unlawful for any person directly or indirectly -- (a) to cheat or defraud or attempt to cheat or defraud any other person; (b) to make or cause to be made to any other person any false report or statement thereof or cause to be entered for any person any false record thereof; (c) to deceive or attempt to deceive any other person by any means whatsoever -- in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction."

reinforce and perpetuate the false impression created by Maurice Batlle that Chaudhry could reasonably expect large returns with little risk. Livoti, like Batlle, falsely stated that she was making money for her customers, when she knew that almost all of her customers, and almost all of FSG's customers, had actually experienced substantial losses. It is "rudimentary" that these sort of misrepresentations and omissions about profit potential and risks are material. *In re JCC,* [1994-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,059 at 41,576 n.23 (CFTC 1994), *affirmed* 63 F.3d 1557 (11th Cir. 1995).

By principally compensating its account executives and branch office managers with a cut of the commissions, FSG supplied its brokers with the necessary motivation to convince Chaudhry to approve trading strategies that emphasized their interests over Chaudhry's interests. Moreover, the fact that Livoti was the fourth in a quick series of brokers who had urged Chaudhry to invest more money and to make more trades indicates that pushing trades to generate commissions was a pervasive practice at FSG. As part of this commission-generating scheme, Livoti recommended a trade in a position that was substantially out of the money ("OTM"), even when comparable in-the-money ("ITM") positions were available. This trade significantly increased Livoti's, Batlle's and FSG's income, because FSG charged Chaudhry commissions based on the number of contracts traded, rather than the value of the position, and because more OTM options could be purchased since the premium for an OTM option is lower than the premium for a comparable ITM option.

Here, Livoti offered no explanation or evidence that shows that her recommendation to purchase OTM options was consistent with Chaudhry's objective to make trades with a reasonable likelihood of profits. Moreover, no patently plausible rationale can be discerned. The "increased leverage" rationale typically raised by respondents who recommend OTM options can almost never be justified for customers whose trading objective includes a reasonable chance of profit. First, the value of a low-priced option is almost always less responsive to price changes in the underlying commodity or asset. Second, the total premium value represents the amount of risk, regardless of the number of contracts. And third, the profit potential of an OTM option, as measured by its delta, is lower than that of an ITM option of the same type. *See Ferriola v. Kearse-McNeill*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,172, at 50,154-50,155 (CFTC 2000). For these reasons, the Commission has emphasized that "when customers are paying commissions on a per-contract basis, an account executive seeking to serve his customer's interests will purchase the lower-cost ITM position." *Id.*, at 50,155. Thus, Livoti's promise of certain profits when she convinced Chaudhry to trade OTM options failed to reflect the reality that the strategy of buying OTM options, compared to buying comparable ITM options, was significantly more risky and less profitable, and that the only real guarantee was that Livoti's, Batlle's and FSG's stream of commission revenue would be unnecessarily increased.

Livoti's promises of certain profits similarly failed to reflect the detrimental effect of FSG's burdensome commissions on profit potential. Here, the commissions and fees charged to Chaudhry's account resulted in a commission-to-premium-paid ratios of 35% and 26% for the trades recommended by Batlle and Livoti, respectively, and a commission-to-investment ratio in excess of 46 percent, which represented a formidable barrier to profit potential. Thus, Livoti's unrestrained profit projections were materially deceptive:

> Because the size of a firm's commissions and fees affects the profit potential of an investment, it affects the kinds of representations that can be made about profitability. . . . All else being equal, customers of a firm with a high commission or fee structure will have a more difficult time making a profit than those who employ a less expensive firm. As a result, the firm charging higher commissions and fees is more limited in what it can claim regarding profit potential.

Johnson v. Fleck, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,957, at 37,502 (CFTC 1990) (Chairman Gramm concurrence).

The intentional nature of Livoti's fraud is underscored by her deliberate disregard of Batlle's questionable actions, her blatantly false and deceptive claims of trading expertise, and her knowledge that Chaudhry was inexperienced and was relying on her to provide fair and reasonable trading advice.

Reliance and proximate causation

Chaudhry's decision to continue trading was consistent with his testimony that he relied on Livoti's message that he would make quick and large profits with minimal accompanying risk. Chaudhry's intelligence, education and work experience do not bar finding that he reasonably relied on Livoti's misrepresentations and omissions to his detriment, especially where he had no previous experience in the futures and options markets, where the profit on the first trade appeared to validate Batlle's guarantee, and where Livoti had overcome Chaudhry's decision to stop trading with FSG with false and deceptive statements about the consistent profits enjoyed by her customers. *See Ricci v. Commonwealth Financial Group, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,917 (CFTC 1996).

FSG's written disclosures of general risks by themselves did not cure the false impression of guaranteed large profits created by Batlle, and reinforced by Livoti, where the overall effect of their intentionally deceptive statements substantially outweighed and vitiated the written risk warnings. *Ferriola,* at 50,153; *Bishop,* at 44,841; and *Levine v. Refco,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,488, at 36,115-36,116 (CFTC 1989). Similarly, FSG's perfunctory compliance review cannot be used as "advance exoneration" of Livoti's fraud, especially where the compliance review was obviously not designed or conducted to discover or to cure the sort of misrepresentations made by Batlle and Livoti, and failed to disclose fairly and accurately that the trades Chaudhry had approved were high-risk and high-cost out-of-the-money options. *JCC, Incorporated v. CFTC,* [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,492, at 43,217-43,218 (11th Cir. 1995). The proper measure of damages for Livoti's fraudulent trade recommendation is Chaudhry's loss on the Treasury bond trade as of the date that his account was transferred from FSG: $5,093.

ORDER

Chaudhry has established that Randi Ellen Livoti violated Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10 and that these violations caused $5,093 in damages. Accordingly, Randi Ellen Livoti is ORDERED to pay to Subhash Chaudhry reparations of $5,093, plus interest on that amount at 2.27 %, compounded annually from April 10, 2000, to the date of payment, plus $125 in costs for the filing fee.

Dated April 8, 2003.

Philip V. McGuire,
Judgment Officer