UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

JEFFREY R. FRYE,
Complainant,

v.

ALLAN STEVEN ADER,
and PHILIP COHEN,
Respondents.

CFTC Docket No. 02-R057

INITIAL DECISION

Introduction

Jeffrey Frye's principal allegations are that Philip Cohen and Alan Ader combined to defraud him into opening a nondiscretionary account with Concorde Trading Group, and that Ader churned his account. Frye seeks to recover the more than $18,500 that he lost on the option trades recommended by Ader. According to Frye, Cohen falsely promised that Frye could reasonably expect to make substantial profits at minimal risk if he opened an account with Concord and followed the trading advice of Alan Ader. In turn, Ader allegedly reinforced and perpetuated Cohen's misleading message by making a variety of baseless, extravagant claims about his expertise, by falsely promising to consult Frye every day, by repeatedly guaranteeing that he would quickly double Frye's money, and by pressuring Frye with false claims that he was missing out on huge profits enjoyed by Ader's current clients.

Frye also alleged that Ader tricked and pressured him into quadrupling his intended investment by grossly understating the cost of the first trade and then deflecting

Frye's protests about the unexpected costs with a series of lies and subterfuges, such as reporting falsely that the trade was already profitable. According to Frye, Ader next concealed his deceptions by disregarding Frey's request to liquidate the purportedly profitable trades. Lastly, when the first trade failed to realize the promised profits, Ader allegedly deceptively downplayed the size of the loss, represented that the loss was an anomalous and temporary set-back, and guaranteed that he would still double Frye's money with a second trade, which in turn realized yet more losses.[1]

In reply, Cohen denied the allegations, but provided a mostly generic description of his conversations with Frye. Ader generally denied that he had made any misrepresentations or guarantees, and asserted that he had "provided good faith trade recommendations." However, Ader provided no factual description of his conversations with Frye and provided no rationale for his trading advice. As a result, I found that Ader's and Cohen's answers were deficient, especially in contrast to Frye's detailed complaint, and thus ordered Ader and Cohen to perfect their answers by producing affidavits that provided detailed descriptions of their dealings with Frye.[2]

Cohen delayed filing his affidavit until he had been defaulted, but then made a reasonable effort to produce a fairly responsive and slightly more detailed affidavit. Cohen asserted that "I can say with complete confidence that Mr. Frye knew everything one would need to know to make an educated decision to either open or not to open an account." However, Cohen also candidly conceded that he could not remember many meaningful details of his conversations with Frye. [*See* ¶4 of Cohen's affidavit ("Due to

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[1] Concorde Trading did not file an answer, and a default judgment against Concorde was issued on November 8, 2002.

[2] CFTC rules 12.13(b)(iv) and 12.18(a)(2) require that the reparations complaint and answer, respectively, include "a precise and detailed description of the facts."

the amount of time that has passed, I cannot remember [the] specifics of the [key] conversation I had with Mr. Frye.").] In contrast to Cohen, Ader added absolutely nothing in support of his defense. Ader merely asserted that he had "framed his description of his case as best he could" and otherwise declined to provide any description of his conversations with Frye or to offer any rationale for his trading advice. Ader also made the implausible assertion that he could not recall whether or not his Concorde customers had typically realized overall net profits.

At the hearing, Frye's oral testimony was candid and believable. Frye remembered his conversations with Ader and Cohen in vivid and convincing detail. Frye's version of the events was internally consistent. Frye's version also was substantiated by reliable documentary evidence that established that Frye had to quadruple his initial investment to pay for the first set of trades recommended by Ader. And Frye's assertion that Ader had repeatedly stressed his purportedly successful track record was reinforced by Ader's own testimony, during which he slipped into a blustering spiel touting his "track record." [*See* Frye's testimony at pages 11-64 of the hearing transcript; pages 2-5 of Frye's affidavit; pages 4-13 of factual description of Frye's complaint; and Ader's testimony at pages 112-114 of the hearing transcript.]

Cohen's testimony was often forthright and responsive. However, compared to Frye's testimony, Cohen's testimony was significantly less reliable and less convincing, principally because Cohen recalled few, if any, meaningful details of their conversations. For example, although in his answer Cohen had stated that he "specifically remembered" that Frye "had a ton of questions," Cohen could not recall a single specific question or answer. In addition, Cohen's testimony that he had no idea how Concorde customer accounts had been performing was inherently implausible, because all of the accounts that he had opened during his two stints at Concorde had failed to enjoy overall net profits. Moreover, Concorde's avowed raison d'être was providing reliable trading advice for profit-seeking customers. Thus, it is reasonable to conclude that Cohen would have gleaned and accumulated sufficient knowledge about trading results that inevitably would have come up during his daily interactions with Concorde brokers and supervisors.

I generally credited Cohen's testimony as to his normal course of dealing with prospective customers. However, I did not credit Cohen's testimony about his specific dealings with Frye where Frye gave detailed, plausible or convincing testimony, and Cohen recalled nothing or provided little meaningful detail. For example, in his affidavit Cohen had asserted, "I sent Mr. Frye the account-opening documents, and true to his analytical nature, we spent several hours going over every single line of every document." However, at the hearing Cohen could not recall any detail of these conversations, such as whether he had explained the significance of Concorde's written disclosure concerning the extremely high risks associated with deep-out-of-the-money options. Cohen similarly could not recall whether he ever revealed to Frye that Concorde would be recommending the purchase of substantially out-of-the-money options, which are only incrementally less risky than deep-out-of-the-money options. In contrast, Frye credibly testified that he did not read or discuss the account-opening documents until after he had begun speaking exclusively to Ader, because before that point he had been leaning toward not opening an account. Frye also credibly testified that Cohen never even mentioned the term "out-of-the-money option." [Cohen's testimony at page 74 of hearing transcript ("I remember explaining to him some of the recommendations by the firm and why they were recommended. But I don't remember what. I don't remember what was recommended at the time at all. I don't remember the details of that.") and at pages 78-79 hearing transcript ("I couldn't tell you what examples [of typical trades] were used. I really have no idea. I don't remember at all."); *see* pages 69-82, and 85-87, of hearing transcript.]

I found Cohen's testimony more credible than Ader's testimony on those matters where they disagreed, such as whether Concorde had instituted, in 2000, a scheme where Cohen and other "junior" brokers solicited and opened new accounts, and Ader and other "senior" brokers then took over the accounts and provided all of the trading advice. Cohen's testimony that Concorde had in place such a scheme was corroborated by Frye's credible testimony that it was Ader, not Cohen, who gave trading advice to Frye. Cohen's testimony on this matter was also substantiated by the fact that the first two sets of trades in the Frye account involved S&P index options and the fact that Ader asserted that trading S&P index options had been his forte and province at Concorde. [*See* Cohen's testimony at pages 68-69, and Ader's testimony at pages 93-95 of hearing transcript.]

Ader's written and oral testimony was patently insincere, persistently vague, evasive and inconsistent, and at times nonsensical, and thus found to be completely unconvincing and unreliable. For example, in connection with Frye's churning allegation, reliable documentary evidence had established that Ader had recommended a questionable trading strategy that was destined, if not designed, to generate substantial commission charges: *i.e.*, the simultaneous purchase of multiple, cheap out-of-the-money July S&P puts and calls, shortly before expiration; followed by a quick "roll-over" into cheap, out-of-the-money August S&P calls, also shortly before expiration and just before Ader voluntarily left Concorde. Thus, Ader was asked to describe, in his affidavit, the specific rationale for these trades, and to explain how the trades had been consistent with Frye's investment objectives. Ader replied by asserting that someone else -- Richard Padron -- had generated the recommendations, and then explained curtly and flippantly that the trade recommendations had been "based on market activity," in accord with Frye's objective "to speculate." Ader also asserted implausibly that he "was not involved" in the purchase of five July S&P puts, which had been purchased simultaneously with fifteen July S&P calls. Subsequently, at the hearing, Ader contradicted these assertions when he testified not only that he had recommended Frye's simultaneous purchase of the July S&P calls and puts, but also that he had generated most of the S&P trade recommendations at Concorde. [Pages 115-116 of the hearing transcript ("At Concorde, as most firms, I made most of the trades."); *see* pages 107-108, and 114-115, of the hearing transcript.]

It is reasonable to conclude that Ader inevitably would have acquired and accumulated extensive knowledge of customer wins and losses as he generated, relayed and monitored his firm-wide trade recommendations, and as he spoke to Concorde customers and to other Concorde brokers about their trading results. Thus, Ader's assertion that he had no idea whether most of his Concorde customers had made or lost money was inherently implausible and unconvincing. [*See* Ader's testimony at pages 111-112 of the hearing transcript ("Usually, when someone loses their money, I say 'I'm sorry you lost your money. I'm sorry you had a bad experience.' . . . I mean, it's very difficult to tell people that. But we do.").] Moreover, Ader's purported ignorance cannot be squared with his testimony that he was the 'go-to' guy at Concorde for clients with "serious money." [*See* Ader's testimony at pages 91-116; ¶¶ 1-12 of Ader's affidavit; and the factual description on page 4 of Ader's answer.]

After careful consideration of the parties' oral testimony and the entire documentary record,[3] it has been concluded that Jeffrey Frye has established that Philip Cohen and Alan Ader defrauded Frye during the account solicitation, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10; that Ader defrauded Frye during the trading of his account, also in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10; and that these violations proximately caused $18,529 in damages.

Factual Findings

The parties[4]

1. Jeffrey Frye, a resident of Bloomfield, Indiana, is a self-employed accountant who provides bookkeeping and tax-preparing services. On his account application, he stated that he had been born in 1947, had one dependent, had an annual income of about $55,000, and had a liquid net worth of $125,000. Frye owns four rental homes, made his first stock investment in late 1999, and had no previous experience with commodity futures or options before he opened his Concorde account. [Frye's testimony at pages 6-

[3] The documentary record consists principally of the parties' pleadings, affidavits, and discovery replies, as well as various records produced by the carrying broker, Vision Limited Partnership, in response to three *sua sponte* subpoenas. In addition, official notice has been taken of: (1) CME price data, for the July and August S&P options and futures, from June 22 to July 19, 2000, supplied by the CFTC Office of the Chief Economist, and reported in the Wall Street Journal, (2) respondents' registration and disciplinary history in National Futures Association records, and (3) respondents' reparations case history in CFTC records.

[4] Frye and Cohen have appeared *pro se* throughout this proceeding. Ader was represented by counsel up to the eve of the hearing, and appeared *pro se* at the hearing.

10 of hearing transcript; Frye's replies to Ader's interrogatories 5, 6, 11, 12 and 17; and Frye's account application.] Frye's testimony revealed him to be direct and intelligent.

2. Concorde Trading Group, Incorporated, with its principal place of business in Aventura, Florida, was a registered introducing broker from March 1988 until May 21, 2002.[5] Concorde solicited members of the public to open accounts to purchase and sell exchange-traded futures and options contracts. During the relevant time, Concorde's advertisements and promotions typically pitched trading strategies based on seasonal trends in the demand for unleaded gasoline and heating oil. [*See* Ader's testimony at page 97 of the hearing transcript.] Concorde introduced the Frye account to its carrying broker Vision Limited Partnership ("VLP"). And Concorde charged the Frye account a total of $6,017 in commissions and fees.

Concorde was sanctioned, and eventually was put out of business, for systemic fraudulent sales practices in one CFTC injunctive action,[6] and in three National Futures Association disciplinary actions.[7] So far, Concorde has been named as a respondent in 110 reparations cases, most of which have involved allegations of fraudulent sales and trading practices. [CFTC and NFA records.]

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[5] An introducing broker ("IB") is defined in Section 1a(14) of the Commodity Exchange Act, and CFTC rule 1.3(m), as "any person who for compensation or profit, whether directly or indirectly, is engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market who does not accept any money, securities or property to margin, guarantee, or secure trades or contracts that result or may result there from."

[6] *In re Concorde Trading Group, et al.,* Civ. 93-1567, Consent Order of Permanent Injunction (S.D. Fla. July 19, 1996) ($1.5 million restitution and enhanced supervisory procedures).

[7] *In re Concorde Trading Group, et al.*, 92-BCC-20, Decision Accepting Settlement Offer (NFA March 5, 1993) ($25,000 fine and enhanced supervisory procedures); *In re Concorde Trading Group, et al.*, 95-BCC-5, Decision Accepting Settlement Offer (NFA October 14, 1998) ($120,000 fine and enhanced supervisory procedures); *In re Concorde Trading Group, et al.*, 01-BCC-14, Decision Accepting Settlement Offer (NFA May 21, 2002) (termination of registration).

In 2000, Concorde consolidated its operations and instituted a new scheme where new accounts were solicited and opened by "junior" brokers, such as Cohen, but were handled and traded by "senior" brokers, such as Ader. Concorde would then split the commissions between the junior and senior brokers.[8] Concorde principally compensated its brokers and branch office managers with a percentage of the commissions collected from its customers. In this connection, Concorde charged commissions based on the number of contracts traded, and Concorde's research department – headed by Alan Ader and Richard Padron -- favored recommendations to trade cheaper out-of-the-money options.[9] Thus, Concorde provided the motivation and the means for its account executives to recommend trading strategies designed to maximize commission income to the detriment of their customers' best interests. Here, Alan Ader would maximize respondents' commission income – and quickly consume a quarter of Frye's investment – by placing an order costing much more than Frye had anticipated or approved, and by recommending the purchase of multiple, cheap out-of-the-money options.

3. Alan Ader, who divides his time between Ft. Lauderdale, Florida and Costa Rica,[10] was a registered associated person with Concorde from January 24, 1999, to July

[8] Concorde treated as an internal matter the allocation of responsibilities, and the splitting of commissions, amongst its junior and senior brokers. As a result, VLP business records – *i.e.*, the customer account statements, and the broker monthly year-to-date profit-loss reports – often showed accounts assigned to junior brokers even though senior brokers were providing the trading advice and directing the trading activity. Thus, VLP's records, by themselves, cannot be used to determine reliably the performance of Ader's trades for those accounts that Concorde had assigned to other brokers.

[9] *See Zemen v. Ader, et al.*, [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,058, at 53,617 (CFTC 2002).

[10] *See* Ader's testimony at pages 91-92 of the hearing transcript. On May 29, 2002, as a condition of his counsel's withdrawal on the eve of the hearing, Ader filed an affidavit affirming his understanding: (1) that he is responsible for monitoring the progress of this proceeding and responsible for complying with any orders or applicable rules, whether he is representing himself or represented by counsel, (2) that he must immediately notify the CFTC Proceedings Clerk of any change in mailing address and day-time telephone number

27, 2000.[11] [CFTC and NFA records.] According to Ader, he was the 'go-to' guy for Concorde customers who wanted to make serious money trading S&P Index options:

> I was the guy that people would speak to, because I knew more about the market than most of the brokers. And the S&P is what I traded most. And in those days we had a very hot S&P market. And most people wanted to learn how to make serious money. And they spoke to me.

[Page 93 of hearing transcript.] Throughout the hearing, Ader exhibited a pronounced tendency to be impulsive and aggressive.[12]

Normally, Ader did not solicit new accounts, but he did call customers who had been assigned to other Concorde brokers, primarily to convince the customers to invest additional funds to pay for additional S&P trades. Also, Concorde would assign responsibility for new accounts to Ader, but only after junior brokers had opened the accounts. However, respondents would improvise on this routine when Cohen brought in Ader to overcome Frye's reluctance to open an account. Ader then successfully convinced Frye to open the account with Concorde. Although Frye initially intended to limit his risk to $5,000, Ader would quickly pressure and finagle Frye into almost quadrupling his stake to a total of $19,112.

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as long as this proceeding, or any other reparations proceeding, is pending, and (3) that, pursuant to CFTC rule 3.30(b), he must promptly notify the NFA of any change in address not just while he is registered, but also for two years after the termination of his registration, *i.e.* until at least May 26, 2005.

[11] An associated person is defined in Commission rule 1.4(aa) as "a natural person associated with any . . . IB, as a partner, officer, employee, consultant, or agent (or any person occupying a similar status or performing similar functions), in any capacity that involves: (i) the solicitation or acceptance of clients' orders, . . . or (ii) the supervision of any person or persons so engaged."

[12] In this connection, Ader had to be warned several times to refrain from disrupting and dominating Frye's and Cohen's testimony. *See* pages 9-10, 13-14, 19, 65, 66 and 83 of the hearing transcript. Finally, when Ader ignored admonitions to cease interrupting Frye's closing comments, I found him in contempt and had him removed from the hearing by instructing the conference operator to terminate Ader's connection to the conference call. *See* pages 110, and 117-119, of the hearing transcript.

Ader also would recommend the first two sets of trades in Frye's account. Ader's first recommendation involved the simultaneous purchase of multiple, substantially out-of-the-money July S&P Index call and put options, just 30 days before expiration. Ader's second recommendation involved the "rollover" into cheap, out-of-the-money August S&P Index call options, just 28 days before expiration and 15 days before Ader voluntarily left Concorde. These trades would realize a total net loss of $18,557. These trades also would generate $5,057 in commissions and fees, which would consume about 26% of Frye's investment. [*See* Frye account statements dated July 12 through August 7, 2000.][13]

Records produced by Concorde's carrying broker, Vision Limited Partnership establish the baseless quality of Ader's representations to Frye that his clients had been enjoying huge profits and that he only handled accounts with $20,000 minimum balances, and also underscore the fatuous nature of Ader's testimony that he specialized in handling only those clients who were interested in making "serious money." VLP's records show that when Frye opened his Concorde account, Ader had been assigned a total of seventeen Concorde accounts, all of which had small balances, had mostly losing trades with a few negligibly profitable trades, and had no significant unrealized profits. Viewed in aggregate, trading in Ader's seventeen accounts had realized total gross profits of $24,913, but had also generated a total of $30,412 in commissions, resulting in total

[13] Each VLP account statement reported a 5-digit identification number for the broker whom Concorde advised VLP had been assigned the account. The VLP statements for the Frye account identified Cohen as Frye's broker from June 19 to July 3, Ader from July 12 to August 7, and Hader Mahmoodi from August 8 to November 30, 2000. *See* VLP's statement in reply to third subpoena (filed May 30, 2003).

net losses of $5,498.[14] Finally, just one account other than Frye's account had experienced any recent trading activity. [VLP monthly "year-to-date profit-loss" statements for accounts assigned to Ader, and VLP May, June and July 2000 monthly account statements for accounts assigned to Ader (produced November 27, 2002).]

In the exchange set out below, Ader foundered when asked to square his dismal trading record with his claim to be a legitimate, on-call, S&P maven. However, Ader did succeed in revealing that in reality his main function at Concorde had been to convince Concorde clients to spend more money on more trades:

> *McGuire:* Mr. Cohen stated that he solicited accounts, and other more senior brokers would take over and make the trade recommendations.
>
> *Ader:* Only if the client wanted or was interested in <u>making</u> money. . . . I traded S&P predominantly. And we had very hot market. So, if the client was interested in trading the S&P's, they would put them onto me. But only if he was interested, and could afford to <u>make</u> serious money.
>
> *McGuire:* What do you mean by "afford to <u>make</u> serious money?"
>
> *Ader:* Well. The broker would say, you know, "Can you afford to <u>trade</u> serious money?"
>
> *McGuire:* What does that mean?
>
> *Ader:* Well. That means more than the money he opened the account with.
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> . . . .
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> *McGuire:* [According to the VLP documents that showed losses or minimal profits, low balances and little trading activity in the accounts assigned to Ader,] it doesn't look like you were handling what one would call 'serious money.'

[14] Nothing in the record remotely suggests that Ader's performance was any better with customers whose accounts had been assigned to other Concorde brokers. Thus, Ader's evasive, implausible written and oral testimony about his track record supports an adverse inference that the vast majority of the Concorde customers who followed Ader's trading advice had failed to realize overall net profits.

> *Ader:* Then it wasn't serious. It depends on what was serious. What's serious to you doesn't mean it's serious to me. $5,000 may be serious to somebody who doesn't have much money. . . . What determines serious balances? It only depends on what the person considers serious. If serious money is $10,000, the client could afford to trade $10,000. He was serious about that.

[Underlining added for emphasis; pages 93-94 of hearing transcript. *See* pages 91-97 of hearing transcript.]

All of the registered firms for whom Ader has worked – Commonwealth Financial Group, Cromwell Financial Services, Concorde Trading Group, and Executive Commodity Corporation -- have been sanctioned by the NFA or the CFTC for fraudulent sales practices. As noted above, Concorde was closed down for fraudulent sales practices in May 2002. Before working for Concorde, Ader had been a registered associated person with Commonwealth Financial Group for five years, which was closed down by the NFA for sales practice fraud in 1997. As part of that same disciplinary proceeding, the NFA found that Ader had engaged in fraudulent sales practices at Commonwealth, and imposed a $10,000 fine, imposed an 18-month suspension of his registration, and imposed various restrictions and conditions on his post-suspension activities for two years.[15] Also, in connection with his employment at Commonwealth, Ader had been named as a respondent in 27 CFTC reparations cases.[16] Thus, Ader had been named in

[15] *In re Commonwealth Financial Group, Inc., et al.*, 94-BCC-13 (NFA April 4, 1997); *affirmed sub nom. Commonwealth Financial Group, Inc. v. National Futures Association,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,993 (CFTC March 18, 1998; *affirmed sub nom. Commonwealth Financial Group, Inc. v. CFTC*, 79 F.3d 1159 (11th Cir. June 22, 1999). July 27, 2000, the date that the NFA lifted the various restrictions and conditions on Ader's activities, was also the date that he left Concorde for Executive Commodity Corp. [NFA records.]

[16] These cases typically involved allegations that Ader had falsely represented that he was an experienced and successful stock index trader. *See Ricci v. Albino, et al.*, [1994-1995 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,945, (Initial Decision November 28, 1995), *affirmed* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,917 (CFTC December 12, 1996);

over 20% of the 125 reparations complaints brought against Commonwealth.[17] After working for Commonwealth, Ader worked for Cromwell, which has twice been disciplined for fraudulent sales practices.[18] [CFTC and NFA records.]

After working for Concorde, Ader was registered with Executive Commodity Corporation from August 14, 2000, to May 26, 2003. On September 26, 2002, the NFA's Business Conduct Committee issued a complaint against Executive Commodity Corp., and several of its brokers, including Ader. The NFA alleged that Ader had made several deceptive and misleading sales solicitations and used high-pressure sales tactics. By Decision dated June 6, 2003, the NFA accepted Ader's settlement offer in which Ader neither admitted nor denied the allegations of the complaint, and Ader agreed to a set of sanctions designed to constrain Ader's re-entry into the regulated derivatives industry. In its Decision, the NFA ordered that Ader: (1) withdraw from NFA associate membership and not act as a principal of any NFA member for 21 months; (2) pay a $35,000 fine (in $1,000 installments) in the event that he becomes a member; (3) not act as a supervisory associated person for one year after the date that he becomes an NFA member or associate; (4) tape record all conversations with customers for one year from the date that he becomes an NFA member or associate; (5) promptly report any oral or written

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Grindell v. Ader, et al., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,060 (Initial Decision, February 27, 1997), *affirmed* unpublished slip opinion (CFTC April 4, 1998); and *Emmett v. Ader et al.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,101 (Initial Decision, June 30, 1997), *affirmed* unpublished slip opinion (CFTC April 24, 1998). [CFTC records.]

[17] So far, Ader has been named as a respondent in a grand total of 35 reparations cases. Most of these cases have been resolved by settlement agreements. One complaint against Ader was dismissed as a discovery sanction: *Kissel v. Ader, et al.* (September 1997). One case resulted in a default judgment against Ader: *Ramsey v. Ader, et al.* (July 8, 1998). Four cases resulted in Initial Decisions finding violations by Ader: *Ricci, id.*; *Grindell, id.*; *Emmett, id.*; and *Zemen id.* [CFTC records.]

[18] *In re Concorde Financial Services, et al.*, 95-BCC-9 (NFA, January 2, 1999) ($75,000 fine); and *In re Concorde Financial Services, et al*, 99-BCC-12 (NFA, March 20, 2000) ($100,000 fine and enhanced supervisory procedures).

customer complaint to the NFA; (6) take an NFA-approved ethical sales course before he becomes an NFA member or associate; and (7) meet with a designated principal or supervisor, who will maintain a written memo of each meeting, twice a month for a year.[19]

At the hearing – held the day before the NFA issued its decision -- Ader offered his own representative interpretation of the NFA consent order:

> *McGuire:* What is your current employment status?
>
> *Ader:* Unemployed.
>
> *McGuire:* So you withdrew from registration?
>
> *Ader:* I withdrew. Yes.
>
> *McGuire:* And what was the reason for terminating your registration?
>
> *Ader:* Due to lose a lot of money so – another 18 months.
>
> *McGuire:* I'm sorry. I do not understand that last statement.
>
> *Ader:* NFA decided that people lose too much money when they deal with me, because I tell it the way it is. They don't realize that the broker, most of the brokers are the reason most people lose their money. The opening-account (sic) broker is the reason.[20]
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> *McGuire:* Has there been some disciplinary action by NFA?
>
> *Ader:* Yeah. BCC.
>
> *McGuire:* And did the NFA issue a decision?
>
> *Ader:* No. I voluntarily said "take it."

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[19] Ader's assertion that he does not intend to seek re-registration should be taken with a grain of salt in light of the fact that the negotiated restrictions and conditions are similar to those imposed in his previous NFA disciplinary action. *See* pages 110, and 112-114, of the hearing transcript.

[20] This was but one of several attempts by Ader to deflect responsibility. For example, I asked Ader to explain why he had taken no apparent steps to limit Frye's losses, such as by frequently calling Frye as promised, or by placing stop-loss orders if he had not intended to frequently call Frye. Ader replied that stop orders are totally unreliable, because floor brokers "are the biggest bunch of thieves [who] will do what they want." Page 105 of hearing transcript.

McGuire: Is the disciplinary action still pending?

Ader: It's done. It's a done deal.

McGuire: So this is pursuant to a consent order?

Ader: Absolutely.

[Page 92 of hearing transcript.]

4. Philip Cohen, a resident of Lighthouse Point, Florida, was Frye's first contact at Concorde. Cohen would speak to Frye several times before introducing him to Ader. Cohen's testimony revealed him to be restrained and intelligent.

Cohen was a registered associated person with Concorde for two stints: the first stint from January to August 1998, and the second stint from March 23 to August 11, 2000. He is currently not registered. [NFA records.] During his second stint at Concorde, Cohen's duties were limited to soliciting and opening accounts. Once he opened an account, a "senior" broker – such as Ader – would take over and provide all trading advice. Under this arrangement, Cohen would receive a split of the commissions generated from trades recommended by the senior broker. For the Frye account, Cohen received a 50% split of the commissions on the first trade – the simultaneous purchase of the July puts and calls -- but received no split on the subsequent trades. [*See* pages 66-73, and 85-97, of hearing transcript; ¶¶ 1-3 of Cohen's affidavit; and Frye account statements dated June 19 through July 3, 2000.]

At the end of his first stint with Concorde – *i.e.*, as of December 12, 1998 -- Cohen had opened 22 accounts, none of which had realized an overall net profit. Trading in these 22 accounts had generated total commissions of $57,795, and realized total net losses of $134,950. When Cohen solicited Frye's account – about ten weeks into his second stint -- Cohen had opened five accounts, none of which had realized an overall net profit. Trading in these five accounts had generated total commissions of $34,248, and realized total net losses of $50,622. [VLP monthly year-to-date profit-loss-reports for Cohen (filed November 27, 2002); and VLP's statement in reply to the third subpoena (filed May 30, 2003).]

As noted in the introduction, I have found implausible Cohen's testimony that he had no idea how Concorde customer accounts had been performing. Even if found credible, that testimony only would have buttressed other evidence that established that Cohen had no factual basis to tell Frye that he could reasonably expect profits if he opened an account and followed Concorde's or Ader's trading advice:

> *McGuire:* I don't know that you can 'with complete confidence say that [Frye] knew everything he needed to know [in order] to make an educated decision to either open or not to open an account.' And I would like to give you one more chance to address that issue, before Frye and Ader cross-examine you.
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> *Cohen:* Okay. . . . There's no way that I would have known whether Concorde's customers would make or lose money. So how could I explain to Mr. Frye that the majority of Concorde's customers lost money when I never had that information. . . . I mean, I never did any background check. . . . And that information was never offered to me by the firm. So there was no way that I could know. Therefore, no way that I could explain it.

[Pages 86-87 of the hearing transcript. *See also* page 71 of the hearing transcript ("I don't know how everybody else's customers did over time.")]

5. Hader Mahmoodi succeeded Ader as Frye's account executive. Hader convinced Frye to continue trading, and to deposit another $741, with assurances that Hader would recommend low cost, small scale trades until he had "proved himself." According to Frye: "I thought I might be able to make back a little of my money. . . . When you've lost $20,000, what's another $700? I wasn't thinking real rational [after

losing almost $20,000 in just five weeks.]" [Page 60 of hearing transcript.] Hader would recommend a series of small heating oil and cotton trades that would realize a modest overall net profit, despite generating another $960 in commissions. Frye did not name Mahmoodi as a respondent. And none of the parties called Mahmoodi as a witness. [Frye's testimony at pages 58-62 of hearing transcript; Frye's supplemental replies to Ader's interrogatories 6 and 8 (filed May 12, 2003); and Frye account statements dated August 7 through November 30, 2000.]

Cohen sets up Ader's successful solicitation

6. In April of 2000, Cohen called Frye. On this record, it cannot be determined how Concorde got Frye's number. Cohen told Frye that Concorde was currently recommending the purchase of options on unleaded gasoline futures. Cohen explained how the price of gasoline had historically increased 20 to 35 cents each summer in response to increased demand, how a penny move in the price of gasoline translated into a $400 profit on one option, and how Frye could quickly make a ten to twenty thousand dollar profit on an investment of only $5,000. Cohen used a pyramid chart to explain relative risks, with savings accounts at the conservative low-risk, low-return base of the pyramid, and futures and options at the high-risk, high-return top of the pyramid. However, Cohen then indicated that he could sharply reduce the risk and limit any loss to under $500, by closely watching the account and quickly getting Frye out of any trade that started to sour. Frye told Cohen that he was intrigued, but was too busy with the tax season to properly evaluate what Cohen was proposing.

In late May, Cohen spoke to Frye a handful of times.[21] Cohen also sent an account-opening package to Frye, which Frye would not read or discuss until after Cohen had handed him off to Ader.[22] These conversations had a "leisurely" and "cordial" tone. Cohen did mention again that trading options was generally speculative and generally involved higher risks than trading stocks. However, Cohen's main message was that the gasoline market was "moving," and that if Frye opened an account with Concorde he could reasonably expect to quickly realize substantial profits with limited downside risk. Cohen buttressed this message by using "sample" option trades that consistently resulted in profits. Frye indicated to Cohen that he was reluctant to dump his Wal-Mart stock at loss in order to open a Concorde account because -- despite Cohen's efforts -- he could not comfortably grasp the terminology, concepts and risks of trading options. In response, Cohen assured Frye that, when compared to holding Wal-Mart stock, trading options under Concorde's guidance actually would be no more risky, with the distinct possibility of making much more money.

When Frye informed Cohen that he did not have any readily available funds, Cohen stated that he could open an account with as little as $5,000, and repeated his promise that he would closely monitor the account and limit any loss to under $500. Cohen made these confident representations and promises despite the fact that he knew that he would not be handling the account, and despite the fact that he possessed no

[21] Frye testified that he and Cohen spoke about three or four times. Cohen asserted in his affidavit that they spoke "many times" over "many weeks."

[22] In its response to the first subpoena, VLP produced an incomplete set of account-opening documents which included: (1) the 2-page VLP customer application, (2) the signature page of what appears to be a 2-page standard risk disclosure statement, (3) the signature page to what appears to be a standard VLP multi-page customer contract, (4) a Concorde agreement, (5) a supplemental Concorde disclosure concerning fees and deep-out-of-the-money options, and (6) a Concorde "For Our Mutual Protection" disclosure that authorized Concorde to tape record the account-opening "compliance review."

reliable information that indicated that Concorde customers had consistently enjoyed significant profits or avoided large losses. Cohen otherwise never remotely alluded to the underlying reality that his and Concorde's customers had typically experienced substantial trading losses. Cohen also never mentioned that Concorde would be steering Frye toward the purchase of multiple, cheap out-of-the-money options, which would be certain to consume a large share of his investment with substantial commission charges.

After a few conversations, Frye indicated to Cohen that he was leaning toward "backing out." Cohen then urged Frye talk to Alan Ader, whom Cohen described as an experienced and savvy broker who specialized in stock index options and who had consistently made money for his customers. Cohen extravagantly praised Ader despite the fact that he possessed no reliable information indicating that Ader had ever consistently made meaningful profits for any of his customers at Concorde or elsewhere. This would be the last time that Cohen and Frye would converse. About five weeks later, after Frye had become disenchanted and disgusted with Ader, he would ask to speak to Cohen. Ader, in a rare moment of candor, would tell Frye that Cohen could not help him, because Cohen had been seriously injured in a bike accident and had left Concorde. [*See* Frye's testimony at pages 9-18 of hearing transcript; page 4 of Frye's complaint; Cohen's testimony at pages 73-85 of hearing transcript; ¶¶ 4, 5 and 13 of Cohen's affidavit; pages 2-3 of Cohen's answer; Ader's testimony at pages 93-99 of hearing transcript; and ¶ 7 of Ader's affidavit.]

Ader guarantees big profits and trades Frye's account into the ground

7. Soon after Cohen suggested that Frye and Ader talk, Ader called Frye and introduced himself as a successful stock index options trader who had consistently made

money for all of his clients. Ader claimed that if Frye opened an account with Ader, it would be a "win-win" situation. Ader also claimed that he only handled accounts with $20,000 minimum investments. Frye replied that he was uncomfortable investing more than $5,000, because he knew nothing about stock index options and because $20,000 represented a third of his savings. Ader then asked if Frye could come up with "say ten to fifteen thousand," and Frye replied that technically he could, but only if he sold more of his Wal-Mart stock at a loss. Ader denigrated Wal-Mart and asserted that "retail was the worst place" to be, and confidently claimed that he would "double fifteen thousand" in less than a month. At this point, Frye understood that Ader was "tooting his own horn." However, Cohen's extravagant praise and Ader's confident and insistent manner convinced Frye that Ader's swagger was rooted in reality.

Frye said that he could not afford to sell the stock at a loss and then lose more on trading options. Ader confidently predicted that he would double Frye's money in a short time. Ader assured Frye that "this is what I do for a living," and promised that he would closely watch Frye's investment. Ader also gave his explicit "100% guarantee" that -- in the unlikely event that a trade started to reverse -- he would sharply limit any losses to the amount of commissions. At this point, since neither Cohen nor Ader had disclosed that the commission charges would be in the thousands of dollars, Ader's promise to limit any losses to the amount of commissions appeared consistent with Cohen's promise to limit any losses on a $5,000 trade to under $500.

Frye said he needed time to think, because he had just recently purchased the Wal-Mart stock as a long-term investment, and thus was reluctant to sell even a portion of the stock at a loss. Ader replied, "I cannot believe that you don't want to double your money." Frye said that of course he would like to double his money, but still felt uncomfortable selling the stock at a loss and then exposing the $5,000 proceeds to even greater risk in an investment that he did not understand. Ader assured Frye that his money was "not really at risk," and promised "I give you my word and Concorde's word that we will keep your capital intact." Ader promised to closely watch the account, and Ader repeated his guarantee to double Frye's money in less than a month. Ader buttressed his guarantee by reminding Frye that he had a "proven track record" of consistently making big money for his clients. Frye concluded the conversation by insisting that he needed more time to decide.

Over the next ten days, Ader relentlessly called Frye every day, sometimes twice a day, at work and at home, hammering his message that he had a successful track record and could reliably guarantee quick, huge profits for Frye. Ader created a sense of urgency by claiming he had reliable sources who reported that an expected summer rally would "take off" before the approaching Fourth of July weekend. Ader confidently promised that in just one or two weeks he would get Frye in and out of a trade with double or triple profits; return Frye's principal; and then use the profits to fund additional profitable trades. Ader made these unabashed guarantees despite the fact that few, if any, of his customers had ever consistently realized significant overall net profits or closed their accounts with a profit. Ader also never mentioned that he would be steering Frye toward the purchase of multiple, cheap out-of-the-money options, which would generate substantial commission charges.

In subsequent conversations, Ader maintained the pressure and reported that, as predicted, the S&P had shot up and that his other clients were making big profits. Ader also claimed that if Frye had been in the market he already would have recouped the losses on the Wal-Mart stock. As the conversations progressed, Ader heightened the sense of urgency by telling Frye that he was running out of time if he wanted to double his money on the summer rally. Ader thus overcame Frye's caution and convinced Frye to open an account. Frye told Ader that it would take a few days for him to obtain $5,000 from the sale of the Wal-Mart stock. Ader told Frye that the market was "moving" and thus that he must immediately send a check for $5,000, which Ader promised not to cash until Frye had a chance to complete the stock sale. Ader also instructed Frye to immediately sign and express-deliver the account-opening documents. Ader also told Frye not to bother reading the account-opening documents, which he downplayed as "a bunch of legal jargon."

On June 21, soon after Frye's $5,000 check and signed account-opening documents had been received, Ader told Frye that he had a trade where Frye could make money if the market went up or down. Ader said that Frye would be buying calls that would make money on the upside, and also be buying puts that would make money on the downside. Ader told Frye that Frye did not need to understand the trade, because Ader would be personally managing the account and would quickly double his money. Thus, Ader did not explain in any detail the specific rationale, mechanics or costs for the trade that he recommending. For example, Ader did not tell Frye: one, that the premiums alone would cost almost $15,000, that the commissions would cost over $4,000, or that the total cost would be over $19,000; two, that the recommended options were substantially out of the money; or three, that the recommended options would expire in a month. Ader also did not discuss any alternative, rally-based, trades -- such as the purchase of a much smaller quantity of available in-the-money call options – which would have been significantly less risky, would have generated substantially smaller commissions, and would have cost under $5,000.

Once Frye indicated that he was willing to follow Ader's recommendation, Ader said that, before Frye could make the trade, an employee in Concorde's compliance department would be conducting a tape-recorded account-opening interview, which Ader downplayed as a meaningless "legal technicality." Ader rehearsed Frye for the heavily scripted review by having him write down the correct answers to the questions. When Frye questioned Ader's instructions to exaggerate Frye's investment experience and not to reveal Ader's guarantees, Ader impatiently claimed that Frye had just missed a three-point market move, and that Ader was trying to help Frye get into the market as quickly as possible to reap the same profits enjoyed by his other clients. Frye then said "I can't do this." Ader replied "Don't you want to recover your Wal-Mart losses, and make $20,000 in a week?" Ader assured Frye that "I could not stay in the business if I did not make money for my clients." Ader promised that he and Frye also would have a profitable long-term relationship, and for good measure repeated his guarantee to double Frye's money. Frye acquiesced and agreed to begin the compliance review.[23]

After the compliance review, Frye was transferred back to Ader to place his first order. Ader advised Frye that the trade would cost a total of $14,062, and thus that Frye had to send in an additional $9,062. When Frye balked at dumping more stock, Ader

[23] Frye was not asked to describe the compliance review. None of the parties sought to obtain the recording of the compliance review. And it is not clear that Concorde would have responded to any requests, since Concorde is defunct. However, it is noteworthy that in previous cases, when Concorde did produce a recording of its compliance review, I found that Concorde's heavily scripted compliance review had obviously not been designed to detect or cure misrepresentations and omissions of the same sort that were made here by Cohen and Ader. *See, e.g., Zemen, id.*

exclaimed, "Haven't you been listening to what I've been saying?" and repeated his "100 guarantee" to protect and double Frye's investment. Ader waxed on: "How do you think I succeeded in this business for years? It wasn't by losing my clients' money." Ader further assured Frye that he would be "personally responsible" for the account, and that he wanted to make Frye money so they would have a solid relationship "for years."

Frye then agreed to authorize the purchase of fifteen July S&P calls and five July S&P puts, and to send an additional $9,062, for a total of $14,062. At this point, Ader had not revealed that the $14,062 would only cover (most of) the cost of the premiums, and thus would not cover the substantial cost of commissions and fees. When the order was filled, the premium cost would total $14,875, and the commissions and fees would total $4,237, for a total cost of $19,112.[24] [Frye's testimony at pages 16-44 of the hearing transcript; ¶¶ 1 and 2 of Frye's affidavit; and pages 4-9 of Frye's complaint. *See* Ader's testimony at pages 97-111 of hearing transcript; ¶¶ 4-7 of Ader's affidavit; page 4 of Ader's answer.]

8. Frye would hold the July puts from June 21 to July 3, and would hold the July calls from June 21 to July 12. On June 22, the July calls plummeted to half of their value. The July calls never rebounded and never traded above the break-even point, and steadily lost value. The July puts traded slightly above their breakeven point from June 22 to June 26, but never sufficiently peaked to offset the large losses on the July calls. After June 26, the July puts plummeted, and by July 3rd had lost over half of their value. Thus, at no time between June 22 and July 12, could Frye have liquidated the July trade for an

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[24] The commission-to-premium-paid ratios for the purchase of the five July puts was 36%, and for the fifteen July calls was 25%. The commission-to-premium-paid ratio indicates the rate at which an option must appreciate, before expiration, to overcome costs and break even. Thus, the higher the ratio, the less likely an option will break even or realize a profit.

overall net profit. Concealing this realty would be the focus of Ader's dealings with Frye.

On June 22, Ader called Frye and represented that he had "made a mistake in calculating" the costs of the trade, and had somehow inadvertently underestimated the total cost of the trade by about $5,000, an amount that happened to approximate the total commissions for the trade. Ader did not offer to remedy his purported mistake by busting out a $5,000 portion of the trade, or by waiving the $4,237 in commissions. Rather, Ader said he could "do nothing," because Frye had "already taped and agreed to the deal," and thus, according to Ader, was legally obligated to pay the whole amount. Not surprisingly, Frye was upset and stated that he would prefer to sell and be satisfied to collect a small profit. However, Ader refused to acknowledge Frye's instruction, and used a variety of deceptions to convince Frye to send the extra $5,000. Ader falsely reported that the trade was already profitable, and joshed: "Anyway, another five thousand will make you another ten thousand." Ader also guaranteed that he would refund the commissions if the trade did not make a double profit. Thus, Ader not only talked Frye out of selling the contracts and into paying the extra $5,000, but Ader also forestalled Frye from discovering that the July trade had begun to plummet and that Ader had blatantly lied when he reported that the trade was profitable.

Although Ader had promise to call Frye each day – much as he had called Frye every day during the solicitation – he did not call Frye afterwards. A week later, on or about June 28, Frye called and asked Ader why he had not called as promised. Ader replied that the rally had taken longer to materialize, but assured Frye that the July trade was still profitable and still looking good. Thus, Ader did not tell Frye that July puts and calls had collectively lost well over half their value. Frye was upset that Ader had not called as promised and upset that Ader had maneuvered him into quadrupling his investment, and thus told Ader that he wanted "to get out of the trade and close the account," even if the profits were less than the guaranteed double profits. Ader tried to dissuade Frye, but at the end of the conversation agreed to "immediately take care" of Frye's instructions to "get out of the trade," and to close the account.

On July 3, Ader called. Frye asked when he would be receiving his check. Ader replied that the reason he was calling was to tell Frye "for some reason, the order got lost, deleted or ignored by someone." Ader said, "I'm sorry about the mistake," and again claimed that, "there is nothing I can do." Thus, Ader did not offer to remedy the purported mishandling of the order. For example, he did not offer to sell the July calls and puts, and refund the difference between the premiums collected and the amount that would have been collected had his order been actually placed and competently executed. Rather, Ader convinced Frye that the S&P rally had taken longer than usual to develop, but was certain to take off sometime after the Fourth of July holiday. Thus, Ader advised Frye, he would still double his money, but should now sell the July puts, and then wait another week to roll over the July calls into August calls. Frye agreed to sell the July puts, and then on July 12, agreed to sell the July calls and buy the August calls. At no time did Ader mention the extent of the combined net loss on the July puts and calls, which was $17,139. For the purchase of the August calls, the premium cost was $2,000, and the commissions and fees were $430, for a total cost of $2,430.[25]

A week later Ader called to recommend that Frye sell the August calls, send in more money and buy September calls. By now Frye had received the July 12th account

[25] The commission-to-premium-paid ratio for the purchase of the two August calls 21%.

statement and was "in shock" at the sudden loss of most of his investment. However, Frye was sufficiently composed to decline Ader's advice to send in another $5,000 for another round of supposedly guaranteed S&P trades. Frye did agree to sell the August calls, realizing a net loss of $1,390. Thus, the total net losses on the July and August S&P trades totaled $18,529. Ader and Frye did not speak again, and soon afterwards Ader left Concorde.

After a series of small, negligibly profitable trades with Mahmoodi, Frye closed the account in November 2000. Due to a combination of health problems, the demands of his business, and the fact that he had not been aware of the CFTC's reparations forum, Frye waited another nineteen months to file his complaint. [Frye's testimony at pages 44-58 of hearing transcript; ¶¶ 3, 4, 5, 6 and 7 of Frye's affidavit; pages 9-12 of Frye's complaint; Ader's testimony at pages 111-112 of the hearing transcript; and ¶¶ 8-13 of Ader's affidavit.]

CONCLUSIONS

Fraudulent solicitation and lulling

Frye complains that Cohen and Ader fraudulently induced him to open an account, and that Ader fraudulently induced him to approve trades designed to maximize commissions and fraudulently induced him to invest additional funds and to continue trading. The applicable antifraud provision, Section 4c(b) of the Commodity Exchange Act, provides, in relevant part, that:

> No person shall offer to enter into or confirm the execution of, any transaction involving any commodity regulated under this Act which is of the character of, or is commonly known to the trade as an "option, . . . contrary to any rule or order of the Commission . . . allowing any such transaction under the terms and conditions as the commission shall prescribe."

7 U.S.C. § 4c(b). In turn, 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 report thereof; (c) To deceive or attempt to deceive any other person by any means whatsoever -- in or 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.

17 C.F.R § 33.10 (2003). For Frye to prevail on his claim that Cohen and Ader defrauded him, he must prove by a preponderance of the evidence that Cohen and Ader (i) made a misrepresentation or omission; (ii) of material fact; (iii) intentionally or recklessly; and (iv) on which Frye justifiably relied and which proximately caused Frye's damages. *Bishop v. First Investors Group* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,004 at 44,840-42 (CFTC 1997).

Cohen's misrepresentations

Frye has established by a preponderance of the evidence that Cohen, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10, fraudulently induced Frye to open an account with Concorde by falsely representing that Frye could reasonably expect large returns with little risk if he opened an account with Concorde and followed Ader's trading advice. Partly because Cohen did maintain a measured demeanor and did mention the general risks associated with options trading, Cohen on his own could not completely overcome Frye's reluctance to open an account. However, by the time that Cohen called in Ader to save the solicitation, Cohen had also employed a combination of bad faith promises and false representations to create a grossly distorted and misleading impression of the relative risks and rewards associated with the trading strategies pushed by Concorde and Ader.

From the start, Cohen had deceptively downplayed the risks when he falsely stated that Concorde's option trading strategies were no more risky than trading stocks, when he used sample trades that consistently made profits, and when he falsely promised that he would sharply reduce the risk and strictly limit any losses by closely monitoring the account. Cohen made these confident representations and promises despite the fact that he knew that he would not be handling the account, and despite the fact that he possessed no reliable information that indicated that Concorde customers had consistently enjoyed significant profits or avoided large losses. Cohen otherwise never remotely alluded to the underlying reality that his and Concorde's customers had consistently experienced substantial trading losses. And Cohen never mentioned that Concorde would be steering Frye toward a dubious, high-risk trading strategy -- the purchase of multiple, cheap, substantially out-of-the-money options – that was far more certain to generate large commissions for respondents than realize any profits for Frye.

Cohen also laid the groundwork for Ader's fraudulent guarantees and serial deceptions when he introduced Ader as an experienced and savvy broker who specialized in stock index options and who had consistently made money for his customers. Cohen made this unrestrained endorsement, and lent credence to Ader's boasts, despite the fact that he possessed no reliable information indicating that Ader had ever consistently made meaningful profits for any of his customers at Concorde or elsewhere, and despite the fact that Ader had worked for a string of discredited firms and had left in his wake a multitude of losing customers, numerous reparations complaints alleging fraud, and a

NFA disciplinary action imposing significant sanctions for fraudulent sales practices. 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) ¶ 26,080 at 41,576 n.23 (CFTC 1994), *affirmed* 63 F.3d 1557 (11th Cir. 1995). Moreover, a reasonable novice investor who hires a broker to select trades and provide advice would clearly find it material that the broker and his firm seldom, if ever, closed an account with a profit. *Jakobsen v. Merrill Lynch, Pierce, Fenner & Smith,* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,812 at 31,392 (CFTC 1985).

The intentional nature of Cohen's fraud is underscored by his knowledge of Frye's unfamiliarity with options and reluctance to trade options, by his bad faith promise to take care of Frye's account, and especially by his reckless indifference to the truth that he showed in his extravagant endorsement of Ader. The fact that Cohen was new to Concorde and subordinate to Ader did not excuse him from making unqualified claims about Concorde's and Ader's capabilities that he had no legitimate reason to believe to be true.

Ader's fraudulent guarantees and serial deceptions

Frye has also established that Ader, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10, perpetuated Cohen's fraud and fraudulently induced and pressured Frye to open an account by repeating and amplifying Cohen's baseless, extravagant claim that he had consistently made money for his clients; by echoing Cohen's bad faith promise to sharply limit any losses; by guaranteeing that he would double Frye's investment in a few weeks; by falsely reporting that Frye was missing out on profits enjoyed by Ader's customer; by failing to disclose the specific risks associated with the trading strategy that he would be recommending; and by failing to provide a remotely fair and accurate estimate of the costs of the first recommended trade.

From the start, Ader held himself out as a successful stock index options trader who had consistently made money for all of his clients. Subsequently, Ader touted his track record and guaranteed profits any time that Frye expressed an intention that threatened to reduce the flow of Ader's commission income or to reveal Ader's deceptive status reports: that is, whenever Frye hesitated to open the account, balked at sending more money, or stated that he wanted to liquidate the July trade and close the account. Ader's unrestrained claims and guarantees were completely divorced from the reality that few, if any, of his past customers had ever consistently realized profits or closed their accounts with a profit, and that none of his current clients were making money. These sort of misrepresentations and omissions about profit potential and risks are clearly material. *JCC, id.* and *Jakobsen, id.* Also, Ader failed to provide a fair and adequate risk disclosure by not mentioning any customers who had lost money, by downplaying the written risk disclosures as meaningless "legal jargon," and by dismissing Frye's concerns about risk with blatantly false statements that all of his clients were making huge profits.

By principally compensating its account executives and branch office managers with a cut of the commissions, Concorde supplied Ader with the necessary motivation to convince Frye to approve trading strategies that emphasized respondents' interests over Frye's interests. Alan Ader would maximize respondents' commission income – and quickly consume a quarter of Frye's investment – by maneuvering Frye into approving an order costing considerably more than Frye had anticipated, by grossly understating the costs of the order and then pressuring and deceiving Frye into paying the extra costs, and by recommending the purchase of multiple, cheap out-of-the-money options. Ader exclusively recommended trades in positions that were out of the money ("OTM"), even when comparable in-the-money ("ITM") positions were available. These trades recommended by Ader significantly increased respondents' income, because Concorde charged Frye 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 a substantially out-of-the-money option is significantly lower than the premium for a comparable ITM option.

Here, Ader essentially offered no explanation or evidence that shows that the recommendations to purchase OTM options were consistent with Frye'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 at a loss to explain a dubious recommendation to buy 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, Ader's promises of certain profits when he convinced Frye 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 respondents' stream of commission revenue would be unnecessarily increased. Moreover, by not articulating any rationale for the dubious simultaneous purchase of puts and calls in the same contract month, Ader failed to dispel the appearance that he had pushed Frye into betting against himself rather than making a legitimate hedge.

Ader's promises of certain profits similarly failed to reflect the detrimental effect of Concorde's burdensome commissions on profit potential. Here, the commissions and fees charged to Frye's account resulted in commission-to-premium-paid ratios of 36%, 25% and 21%, and a commission-to-investment ratio of 26%, which represented formidable barriers to profit potential. Thus, Ader's unrestrained profit guarantees 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).

Finally, by duplicitously dribbling out the true costs of the July option trade, Ader fraudulently pressured and tricked Frye into investing much more than the $5,000 that he had initially, and reluctantly, deposited. Ader initially pressured Frye to rush in the first

$5,000 to avoid missing the purported rally. Ader then would not tell Frye that he had to send another $9,062, until after the initial $5,000 had been received and after Frye had agreed to make the trade recommended by Ader. Lastly, Ader would not reveal the total cost of the trade until after it had been made, at which point Ader made the spurious assertions that he had miscalculated the costs and that Frye was legally obligated to keep the trade and pay another $5,000.

Fraudulent lulling by Ader

Frye has also established that Ader, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10, fraudulently lulled Frye to continue trading and incur even larger losses by zealously concealing the reality that the July trade was badly losing money. Ader disregarded and deflected Frye's legitimate protest about Ader's delayed disclosure of the costs for the first trade with a variety of subterfuges. Ader disingenuously reported that he had made an inadvertent mistake calculating the costs, falsely represented that Concorde could not legally adjust the trades, and falsely reported that the trades were already profitable in support of his worthless guarantee that the trade would soon realize double profits. A week later, Ader used a similar set of ruses to dissuade Frye from liquidating the July trade and thus prevented Frye from discovering his mounting losses. After another week, Ader ignored Frye's instruction to liquidate the trade, and continued to conceal Frye's mounting losses, with a yet another spurious excuse, this time that the order had been mysteriously lost. When Ader finally did liquidate the July trade, he deceptively downplayed the true extent of Frye's loss. And by the time that Frye received the written account statement and determined that he had already lost most of his investment, he had already approved the purchase of the

August calls in reliance on another round of guarantees by Ader. *See Modlin v. Cane*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,059, at 49,500 (CFTC 2000) ("Lulling perpetuates the effect of the initial wrongdoing."); and *O'Hey v. Drexel Burnham Lambert, Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,754 at 31,142 (CFTC 1985).

The intentional nature of Ader's fraud is underscored by the pervasive and blatantly false nature of Ader's misrepresentations and omissions, by Ader's persistent high-pressure tactics, and by Ader's knowledge of Frye's inexperience and Frye's reliance on him to provide accurate and useful information about the status of the trades in his account.

Reliance and proximate causation

Frye's decision to invest a considerable sum of money was consistent with his testimony that he relied on respondents' message that Frye was certain to make quick and large profits with minimal accompanying risk, and that he relied on their promise to sharply limit losses and to closely monitor the account. Frye's intelligence, education and work experience do not bar finding that he reasonably relied on respondents' misrepresentations and omissions to his detriment, especially where he had no previous experience in the futures and options markets, and where respondents overcame Frye's reluctance with false promises, worthless guarantees, and baseless claims about Ader's expertise. *Ricci v. Commonwealth Financial Group, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,917 (CFTC 1996).

Concorde's written disclosures of general risks by themselves did not cure the false impression of guaranteed profits created by Cohen's and Ader's pervasively deceptive solicitation, where the overall effect of the oral representations substantially outweighed and vitiated the written risk warnings, and where Ader downplayed the disclosures as just "a bunch of legal jargon." *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).

The proper measure of damages for Ader's fraud is Frye's total out of pocket losses on the trades recommended by Ader: $18,529. Similarly, the proper measure of damages for Cohen's contribution to the fraudulent solicitation, where Cohen grossly misrepresented Ader's expertise and thus exposed Frye to a steady stream of fraudulent acts by Ader, is Frye's total out of pocket losses on the trades recommended by Ader: $18,529.

ORDER

Jeffrey Frye has established that Alan Steven Ader and Philip Cohen defrauded Frye during the account solicitation, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10; that Ader defrauded Frye during the trading of his account, also in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10; and that these violations, separately and together, proximately caused $18,529 in damages. Accordingly, Allan Steven Ader and Philip Cohen are ORDERED to pay to Jeffrey Frye reparations of $18,529, plus prejudgment interest on that amount at 1.21 % compounded annually from June 19, 2000, to the date of payment; plus $125 in costs for the filing fee. Liability is joint and several.

Dated September 26, 2003,

Philip V. McGuire,
Judgment Officer