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ROBERT B. JOHNSON,
Complainant,

v. — CFTC Docket No. 08-R042

MICHAEL ZALMAN HURWITZ,
KERRY DEAN MARSHALL,
TODD OWEN MARSHALL, and
MATTHEW ELLIOT MEYER,
Respondents.

Notice of Correction for Initial Decision and Default Order

The Initial Decision dated December 30, 2009, and the Default Order dated July 16, 2009, contain a minor ($306) addition error in the calculation of complainant's damages and hence the amount of the award.[1] The parties should note that the correct amount for complainant's damages and award is $21,249. Accordingly, the references to the amount of complainant's total net losses, out-of-pocket losses, damages, or award should be changed from $20,943, to $21,249:

- on line 21, of page 2 of the initial decision
- on lines 6 and 7, of page 10 of the initial decision
- in the fourth sentence of finding 15, on page 22 of the initial decision
- on the last line of page 47 of the initial decision
- on the last line of the first full paragraph on page 49 of the initial decision
- on the third line of page 50 of the initial decision
- on lines 5 and 7, of page 51 of the initial decision

[1] None of the parties disputed any calculation or noted any typos in the default order.

- on pages 2, 4, 14, 32 and 33 of the default order.

The Initial Decision and the Default Order also contain isolated typographical errors concerning deposits and refunds. The parties should note that the correct amount for complainant's total deposits is $34,595; that the correct amount for complainant's total refunds is $13,346; and that the correct total amount solicited by Miles was $31,595. Accordingly:

The references to the amount of complainant's total deposits should be changed from $31,595, to $34,595:

- in the first sentence of the first full paragraph, on page 2, of the initial decision
- in the third sentence of finding 11, on page 17 of the initial decision
- in the first sentence of finding 15, on page 22, of the initial decision
- on page 14 of the default order.

The reference to the total amount refunded should be changed from $13,356, to $13,346:

- in the third sentence of finding 15, on page 22 of the initial decision.

The reference to the total amount solicited by Miles should be changed from $28,595, to $31,595:

- in the third sentence of finding 11, on page 17 of the initial decision
- on page 14 of the default order.

The phrase "over half" should be changed to "about half" on the second line of page 18, of the initial decision.

Finally, the last sentence in the first full paragraph on page 48 is corrected to read (revised language underscored):

> Thus, Marshall had assumed responsibilities regarding the awareness of certain regulatory requirements that do not attach to the public at large.

These corrections do not affect the filing deadline for any Notice of Appeal, or Appeal Brief.

Out of an abundance of caution, other calculations in the Initial Decision have been re-checked and confirmed, including those calculations concerning strike prices, account liquidation values, profits and losses, commission totals, and commission-to-premium-paid ratios.

Dated January 14, 2010.

Philip V. McGuire,
Judgment Officer

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MATTHEW ELLIOT MEYER,
Respondents.

CFTC Docket No. 08-R042

INITIAL DECISION

[Corrected version]

Before: Philip V. McGuire

Appearances:

Robert B. Johnson, complainant, *pro se*, Bend, Oregon

Michael Zalman Hurwitz, respondent, *pro se*, Del Ray Beach, Florida

Kerry Dean Marshall, respondent, *pro se*, Boca Raton, Florida

Todd Owen Marshall, respondent, *pro se*, Deerfield Beach, Florida

Gary Sinclair, Esq., Chicago, Illinois, for
Mathew Elliot Meyer, respondent, Boca Raton, Florida

Introduction and Credibility Assessment

Robert Johnson is a self-employed carpenter in his fifties. When Michael Hurwitz and Matthew Meyer convinced Johnson to open a non-discretionary account with Sterling International Commodities, he had conservative investment objectives, limited investment experience, and modest income and savings. Johnson alleges a variety of boiler room violations by a gaggle of agents and principals of Sterling International Commodities, a small, now defunct, introducing broker located in Pompano Beach, Florida: deceptive and high-pressure sales tactics, lulling, churning and other fraudulent fiduciary breaches, aiding and abetting, and failure to supervise. According to Johnson:

> I'm writing this letter to you, as I feel I have been manipulated, wrongly steered and fraudulently cheated out of thousands of dollars. . . .
>
> Living alone, with no wife, kids or roommate, I fell prey to a lesson I was about to learn. I'm a high school graduate. I became a carpenter out of school. I've never taken any kind of risk in business. I don't subscribe to any financial information. Four years ago, I stopped using credit cards, because of the [identity theft] that I went through.
>
> Now I always ask myself, why me, why not my neighbors or my friends? Why me, why would Sterling International Commodities call me 3500 miles away? Telling me "we're going to make you wealthy on unleaded gasoline." I must have been the lucky one. I learned a lesson in the power of persuasion, greed, and how ignorant I have been all my life. I'm just a very hard-working honest person. It took me to the age of 50 to start understanding the word trust. . . .
>
> Because I am a victim of fraud, cheat[ing] and crude sales tactics, I learned my lesson. Trust, for me, that's always going to be a hard commodity to buy in to.[1]

Johnson seeks to recover his out-of-pocket losses: $21,249.

Two respondents lie at the heart of this dispute: Stephen Miles and Todd Marshall. Stephen Miles was a major producer at Sterling and was Robert Johnson's principal broker, and in that capacity quickly garnered $14,840 in commissions on Johnson's investment of $34,595. Todd Marshall owned and controlled Sterling, and in that capacity: directly supervised Miles and respondents Kerry Marshall, Matthew Meyer and Michael Hurwitz; established Sterling's commission-based compensation scheme; selected each of the 21 trades that were recommended

[1] Johnson's complaint; and Johnson's statement filed June 16, 2009.

to Johnson; succeeded Miles as Johnson's broker; and broached the idea of an unconditional, modest, partial refund "out of my own pocket" when Johnson closed his account.

Todd Marshall and three other named respondents, out of a total of seven named respondents, filed separate answers to Johnson's complaint: Kerry Marshall, Michael Hurwitz and Matthew Meyer.[2] Hurwitz and Meyer teamed up to solicit and open the account, to recommend the first round of trades, and to hand Johnson to Miles. Kerry Marshall is Todd Marshall's brother and was his Guy Friday at Sterling. In that capacity, according to Johnson, Kerry Marshall employed a variety of prevarications, delays and threats to tease, frustrate and exhaust Johnson before Sterling paid – after two months -- two thirds of his brother's promised refund.

In each answer, Todd and Kerry Marshall, Hurwitz and Meyer generally denied the alleged violations, and asserted that the written risk warnings alone provided adequate disclosures and explanations for Johnson to make an informed investment decision. Each respondent also asserted the affirmative defense of accord and satisfaction based on Todd Marshall's delayed and diluted "out-of-my-own-pocket" refund. Each respondent's description of the factual circumstances in support of his defense was noticeably devoid of specifics, which indicated that he was unable or unwilling to recall meaningful details of his dealings with Johnson, and which offered nothing substantial to rebut or undermine Johnson's compelling allegations. Subsequent submissions and oral testimony by the respondents were similarly vague and evasive, and also suffered from inconsistencies.[3]

[2] At the beginning of the hearing, a separate settlement agreement was mediated between Johnson and Meyer. As a result, the complaint against Meyer has been dismissed below.
[3] For example, Hurwitz complicated matters for himself with his indiscriminate use of the term "recall." In his February 17th statement, Hurwitz asserted: "I do recall Mr. Johnson signing [in August 2007] a settlement agreement absolving Sterling." However, when asked to elaborate on this assertion, Hurwitz recanted: "I had no conversations concerning a release at all with Mr. Johnson, nor do I know anything about it. I had no conversations

Todd Marshall assured that he and his co-respondents had no ostensibly reliable means to refresh or substantiate their recollections of their dealings with Johnson, because Marshall had never required Sterling agents to maintain a log of communications with their customers. In this connection, when asked to produce a small quantity of routine business records -- promotional materials, pay stubs, cancelled checks, office tickets and itemized phone bills -- Marshall first represented that they had been "for all intents and purposes, destroyed by water damage by Hurricane Fay." However, when asked to substantiate that Sterling's records had actually been systematically created, organized, indexed, retained and stored, and then actually been destroyed, Marshall backtracked, representing in his typical evasive and non-specific manner that the records had "never [been] stored or kept anywhere."[4] Marshall's second explanation was probably a closer approximation of the truth, which still indicated a basic indifference to maintaining books and accounts at Sterling during the relevant time.[5] In any event, Marshall's replies were sufficiently evasive, implausible and unconvincing to accord little weight to any representation by him about record-keeping and regulatory compliance at Sterling.

In subsequent submissions and oral testimony, respondents' purported memory loss extended to other more mundane matters. For example, Kerry Marshall, Hurwitz and Meyer each claimed he could not even roughly estimate the approximate number of brokers at their Sterling office, which could not have been particularly difficult since Todd Marshall and NFA

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with anybody [at Sterling] concerning the release that you are telling me Johnson signed." Hurwitz's May 8th statement.

[4] *See* Todd Marshall's April 9th and May 14th statements, in reply to March 23rd and April 22nd orders, respectively.

[5] Todd Marshall's uncertain grasp of basic record-keeping requirements was underscored by his nonsensical assertion that the carrying broker, Comtrust, Incorporated, would possess copies of the sort of records that in actuality an independent introducing broker like Sterling would generate and use in the normal course of operations, but that a non-guaranteeing futures commission merchant like Comtrust would never have possessed in the first place: the IB's promotional materials, the IB's pay stubs, cancelled checks drawn on the IB's bank, the IB's office tickets and the IB's itemized phone bills. Marshall's alternate excuse for non-production – that he supposedly could not locate Comtrust's owners – was belied by the fact that Comtrust responded to several *sua sponte* subpoenas by timely producing responsive affidavits from a principal of Comtrust, and copies of fairly voluminous records that a futures commission merchant is actually required to retain: commission and profit-loss summaries, equity runs, account statements and account-opening documents.

records indicated that fewer than ten people worked at their office, which was Sterling's main office.

On the other hand, respondents were able to recall some isolated, but significant, matters about Sterling's operations. First, Todd and Kerry Marshall, Hurwitz and Meyer concurred that Todd Marshall had solely controlled the operations of Sterling, directly supervised all Sterling employees and agents in the main office, and exclusively supplied all trade recommendations that they and other Sterling associated persons passed on to their customers. Second, Hurwitz and Meyer eventually conceded that their primary role at Sterling had been to open new accounts which, after an initial deposit and round of trades, would be transferred to a more experienced broker – most times Miles – who in turn would urge the customer to commit additional funds and approve more trades.[6] Third, Hurwitz and Meyer each testified that he knew that the vast majority of Miles' and Sterling's customers had lost most or all of their investments following Sterling's trade recommendations.[7]

Fourth, when asked to describe the circumstances around Miles taking over from Hurwitz as Johnson's account executive, Hurwitz recalled that he had asked Miles to speak to Johnson while Hurwitz took off for a few days. And fifth, Todd Marshall recalled: that throughout Miles' eight-month tenure at Sterling he had been perturbed by Miles' spotty attendance and

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[6] Hurwitz initially asserted: "I did not introduce anybody to anyone." ¶ 3h Hurwitz's June 22nd statement, in reply to April 22nd order. Subsequently, Hurwitz claimed that he could not even recall the approximate percentage of his accounts that had been transferred. *See* ¶ 3h Hurwitz's May 8th statement, in reply to June 8th order. However, after Comtrust had produced an affidavit stating that its records showed that a substantial majority of accounts opened by Hurwitz were transferred to two senior brokers, including Miles, Hurwitz conceded that a majority of the accounts opened by him had been transferred to Miles, and moreover that he had treated the transfer of Johnson's account to Miles as a normal occurrence. *See* Hurwitz testimony at pages 31-32, and 80-82, of the hearing transcript. Similarly, Meyer initially stated in his first affidavit that only "on occasion" had he opened accounts that were subsequently transferred to senior brokers. However, Meyer backtracked in a subsequent affidavit and stated that about 90% of his new accounts were transferred to senior brokers. Meyer produced the second affidavit after I had issued a subpoena asking the carrying broker, Comtrust, Incorporated, to produce an affidavit which would establish the number of Meyer's new accounts that had been transferred to other brokers. *See* ¶ 3g of Meyer's May 11th affidavit, and ¶ 1a of Meyer's June 19th affidavit.

[7] Hurwitz testimony at pages 27-31, and Meyer's testimony at page 36, of hearing transcript.

insolent, freelancing attitude; and that he had been displeased when Miles left Sterling and began "stealing" his Sterling customers for his new firm, Miles, Inc.[8]

When it came to their dealings with Johnson, however, each respondent exhibited a remarkable inability to recall any meaningful details. Whether due to simple memory loss, or due to selective recall or stone-walling inspired by the example of Todd Marshall, this near total blackout was a factor in my determination that the oral testimony of Todd Marshall, Kerry Marshall, Michael Hurwitz and Matthew Meyer was markedly less reliable, less plausible, less forthright, and less convincing than the testimony of Robert Johnson.

In contrast, Johnson's oral testimony about his dealings with respondents was generally sincere, believable, and plausible. Like respondents, Johnson had not taken notes of his conversations with them. As a result, he could not precisely recall the specific dates, or specific number of times, that he had spoken to each respondent. However, unlike respondents, Johnson could clearly recall specific words spoken by the participants in pivotal conversations – such as easy-to-grasp statements regarding the purported profitability and suitability of Sterling's trading strategies -- and he could more convincingly recall the course of dealing with each of the various respondents.[9]

Like Meyer and Hurwitz, Johnson produced inconsistent accounts in his written and oral testimony about whether it was Meyer or Hurwitz who had made the cold-call, who had made subsequent calls during the solicitation, who had gone over the account-opening documents, who had recommended the first set of trades, and who had introduced Miles to Johnson. The

[8] *See* Todd Marshall's statement dated June 22, 2009.
[9] Johnson understandably could not clearly recall respondents' more technical explanations about the mechanics of trading options, because he had no previous exposure to the terminology, because he had little capacity to master the concepts, and because respondents did not provide him a glossary of options terms. Also, the fact that the respondents were completely unwilling or unable to articulate a rationale for their trading recommendations strongly suggests that they had never provided Johnson, in the first place, with particularly coherent or diligent explanations, which assured his continuing inability to comprehend their trading advice.

confusion arose in part from the fact that Hurwitz and Meyer and other Sterling personnel had not always clearly identified themselves when they answered the phone, and the fact that Hurwitz and Meyer seemed to hand Johnson back and forth between themselves with little warning or explanation. As a result, from the day of the first cold-call to the day that Miles assumed exclusive control of Johnson's account, Johnson was never completely certain whether Meyer or Hurwitz would be speaking to him. This uncertainty and confusion extended to Johnson's written statements and oral testimony in this proceeding.

For their part, respondents did not try to clear up the confusion that they had created, and otherwise failed to produce a scintilla of reliable evidence that showed when it was Hurwitz, and when it was Meyer, who spoke to Johnson.[10] As noted above, Marshall did not require Sterling brokers to maintain logs of their conversations with current and prospective customers. Also, throughout this proceeding, Hurwitz and Meyer tried to minimize, at each other's expense, their role in the early stages of the Johnson account: Hurwitz insisted that it was Meyer, and Meyer insisted that it was Hurwitz, who made the first cold call, who convinced Johnson to open the account, who went over the account-opening documents, who recommended the first round of trades, and who introduced Miles to Johnson. Nonetheless, Hurwitz and Meyer each have conceded from the beginning of this case that he had spoken to Johnson before he opened the account, and Johnson convincingly recalled that Hurwitz and Meyer had operated as a *de facto* team and dealt with him in varying degrees at various times, from the cold call in late November 2006 to the hand-off to Miles in mid-January 2007. Hurwitz conceded that he continued to

[10] The most reliable evidence that touched on this issue was Meyer's business card, which was produced by Johnson, and the complete sets of account statements and equity runs, which were produced by the non-party carrying broker, Comtrust, Inc. Meyer's business card had been attached to the account-opening documents sent to Johnson, and the account statements and equity runs included the designation "MHURW" when the account was assigned to Michael Hurwitz, and "SMILE" when assigned to Stephen Miles.

receive a cut of the commissions for the trades recommended by Miles. They all agree that Hurwitz and Meyer never again spoke to Johnson after Miles took control.

Stephen Miles, Sterling International Commodities, and Miles, Incorporated failed to file answers to Robert Johnson's complaint, and were found in default by Order dated July 16, 2009. The pertinent conclusions in that default order were: one, that Stephen Miles had used a combination of high-pressure tactics, deceptions, misrepresentations and omissions to perpetuate a load and churn scheme, and convert Johnson's funds for his and Sterling's enrichment; two, that Miles had churned Johnson's account by steering him into out-of-the-money option trades that were structured to generate excessive commissions, by urging Johnson to approve trades before Johnson had sent additional funds, by entering and exiting trades without Johnson's prior approval, and by accelerating the depletion of Johnson's account with a series of short-term option trades; three, that soon after April 19, 2007, Miles had stopped monitoring Johnson's account and stopped returning Johnson's calls, and then left Sterling to start up his new firm;[11] and four, that after Miles renewed contact with Johnson in early June, he had baselessly guaranteed that Todd Marshall would honor his promise to promptly pay Johnson the unconditional $1,500 partial rebate.

The default order also concluded that Sterling was liable for its owner aiding and abetting Miles' fraud: first, and most significantly, by generating the recommendations for the trades that were patently designed to generate excessive commissions; and second, by deliberately deflecting and disparaging Johnson's complaints that Sterling had charged excessive commissions, that Miles had urged him to tap his savings and equity line of credit, that Hurwitz, Meyer and Miles had guaranteed huge profits and assured that Sterling's trading strategies were

[11] After Johnson had closed his Sterling account, Miles convinced him to open a second account at Miles, Inc. That second account was the subject of a separate award in the default order.

suitable for Johnson's conservative investment goals, and that Miles and other Sterling personnel had thwarted his efforts to limit his losses and close his account. The default order further concluded that Sterling was liable for its owner's failure to adequately supervise Miles and Sterling, in connection with Miles' abandonment of Johnson's account.

The default order noted that the evidentiary record showed that the trades recommended by respondents – multi-contract, deep or substantially out-of-the-money options and bull call option spreads, which generated excessive account-depleting commissions, and which were characterized by commission-to-premium-paid ratios averaging 45% and ranging as high as 83% – were precisely the sort of option trades that the Commission has found to be presumptively contrary to a customer's best interest.[12] Thus, the default order explained, the burden of proof had shifted to the non-defaulting respondents to show that these trades had a reasonable basis and were consistent with Johnson's interests and trading objectives. Despite ample opportunity to present supporting evidence and arguments on this issue in their pre-hearing statements and during the hearing, the remaining respondents -- most notably Todd Marshall who had selected each of the trades passed on to Johnson – did not attempt to articulate any rationale for the patently abusive trades.[13]

As explained in more detail below, after carefully considering the parties' oral testimony and evidentiary submissions, it has been concluded:

> That Johnson has established that Michael Hurwitz defrauded him during the solicitation and the first round of trades;

[12]*See Ferriola v. Kearse-McNeill*, Comm. Fut. L. Rep. ¶ 28,172, at 50,154-50,155 (CFTC 2000) (When a customer is charged commissions on a per-contract basis, a broker's recommendation to buy an out-of-the-money option is presumptively contrary to the interests of the customer.)

[13] The best that Hurwitz could offer about the rationale for the trades was that he "stood behind" the trades in Johnson's account. *See* Hurwitz testimony, at pages 83-86 of hearing transcript. Todd Marshall merely offered: "Don't recall specific trade recommendation research." ¶ 23 of Marshall's statement filed May 9, 2009.

that Johnson has established that Todd Marshall aided and abetted the fraud of Hurwitz and Miles, and failed to supervise Miles;

that Johnson has not established any violations causing damages by Kerry Marshall;

that respondents have not established the affirmative defense of accord and satisfaction; and

that Hurwitz's and Marshall's violations proximately caused $21,249 in damages.

As a result, Johnson is entitled to an award of $21,249, plus pre- and post-judgment interest on that amount, plus the cost of the filing fee, less the $5,000 that he has received from Meyer pursuant to their separate settlement agreement.

Factual Findings[14]

The parties

Robert Johnson

1. Robert Johnson lives alone with no dependents in Bend, Oregon, is in his fifties, has a high-school degree, and is self-employed as a carpenter. Johnson generally does not read all that much, and typically agrees to perform a job with a hand-shake and without any written contract: "I was a strong believer in a man's word. Sterling changed that for me forever."[15] In November 2006, when he was cold-called by Hurwitz, Johnson was an unsophisticated and naïve, novice

[14] The evidentiary record consists of: Johnson's complaint, addenda to the complaint dated Sep. 18, and Oct. 30, 2008, and statement filed June 16, 2009; Hurwitz's amended answer, and May 8, June 22, and July 30, 2009 statements; Meyer's answer, and affidavits dated May 11, June 19, and August 4, 2009; Kerry Marshall's amended answer, and statements filed March 25, April 23 and June 22, 2009; and Todd Marshall's answer and amended answer, and statements filed April 9, May 9, June 20, and July 30, 2009. Also, in light of the defaults by Sterling and Stephen Miles, the purported destruction of Sterling records, and the reluctant and faded recollections of Sterling's principals and associated persons, I looked elsewhere for relevant evidence and took official notice of National Futures Association records regarding the registration and disciplinary history of the respondents, and I subpoenaed documents and affidavits from the carrying broker for Johnson's account, Comtrust, Incorporated. The subpoenaed evidence included account-opening documents, account statements and equity runs for Johnson's account, as well as affidavits from a principal of Comtrust, Timothy Redding, dated April 23, May 22, June 17, and July 28, 2009. Finally, I obtained exchange price data from the Office of the CFTC Chief Economist. *See Ricci v. Commonwealth Financial Group, Inc.*, Comm. Fut. L. Rep. (CCH) ¶26,917, at 44,444 (CFTC 1996) (In cases involving *pro se* litigants, it is appropriate for a presiding officer to take an active role in highlighting the relevant issues and fully developing the factual record.)

[15] Johnson's reply to Meyer's request for admission #7.

speculator with conservative investment objectives geared toward his retirement: he had modest income, he had partially paid off his mortgage and had been maintaining a small IRA for a few years, he had no investment experience beyond his money market IRA, he did not read any financial press, and he knew nothing about commodity markets or commodity options.[16]

Sterling International Commodities and the Marshall Brothers

2. Sterling International Commodities, located in Pompano Beach, Florida, with a branch office in Deerfield Beach, Florida, was registered with the National Futures Association as an introducing broker ("IB") from August 2001 to July 2008. During the relevant time, Sterling introduced its customer accounts to Comtrust, Incorporated, a futures commission merchant also located in southern Florida.

Sterling was started up by Stephen Miles, who was its first registered principal. After a few months, Todd Marshall came on board as a principal of the firm, and eventually became the sole owner.[17]

3. Todd Marshall was first registered with the NFA in early 1998. Many of the firms for whom Todd Marshall had worked before he bought into Sterling had been disciplined by the NFA or CFTC for fraudulent sales practices: American Financial Trading Corp.; Concorde Trading Group; Group One Financial Services, Inc.; and Barkley Financial Corp.[18]

During the relevant time, Todd Marshall controlled the operations of Sterling.[19] In that capacity, Marshall: directly supervised Miles, Hurwitz, Meyer, and Kerry Marshall; established

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[16] *See* Johnson testimony at pages 19-22, and 72, of hearing transcript; 4th page of factual description to Johnson's reparations complaint; ¶ 2 of Johnson's June 22nd statement; and Comtrust *Individual Information Form.*
[17] NFA records.
[18] *Id.*
[19] Todd Marshall: was Sterling's 100% owner, president and sole principal; controlled the firm's finances; was the signatory of the firm's corporate checking account; signed paychecks; had the exclusive and final authority to hire, supervise, discipline and fire Sterling employees; ran sales meetings; had exclusive and final compliance authority; and regularly reviewed trading activity in Sterling customer accounts. *See* Todd Marshall's May 9th statement, and

Sterling's commission-based compensation scheme; and selected all of the trades that Sterling brokers passed onto their customers, including the trades that Hurwitz, Meyer, and Miles recommended to Johnson. Under Marshall's compensation scheme: Sterling brokers were compensated exclusively by a percentage of the commissions charged to customers' accounts; and brokers who opened accounts which were subsequently then transferred to more senior brokers continued to receive a cut of future commissions.[20]

Todd Marshall would take over as the *de facto* account executive for the Johnson account after Miles had abandoned the account. Marshall's tenure as Johnson's account executive stretched April 19, to May 29, 2007. However, despite the fact that Johnson had been regularly calling Sterling soon after April 19th asking for help to liquidate the account, Marshall would not direct another Sterling broker to monitor Johnson's account or speak to Johnson, and would not himself speak to Johnson until on or about May 11. On April 27, the liquidation value of Johnson's account hit an interim high of $6,746. On May 29, the account was liquidated at $3,490. Thus, Johnson's losses during Marshall's tenure as his account executive totaled $3,256.[21]

Todd Marshall would speak to Johnson two or three times between May 11 and 29. During the course of these conversations, Marshall would disregard and deflect Johnson's complaints about his treatment by respondents, and would convince Johnson to place one more trade. During his last conversation with Johnson, Marshall would unconditionally promise to

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Marshall's testimony at page 42 of hearing transcript. Todd Marshall's brother and trusted assistant, Kerry Marshall, begrudged that he could merely "assume" that it was Todd who performed these functions. *See* ¶¶ 1, and 5-16 of Kerry Marshall's May 10th statement. However, Kerry Marshall did not remotely suggest anybody else -- except himself for a few days during a NFA audit -- who could have plausibly shared with Todd Marshall the executive, supervisory and trade selection responsibilities at Sterling.

[20] *See* ¶¶ 5-19 and 27 of Todd Marshall's May 9th statement; ¶¶ 1, and 5-16 of Kerry Marshall's May 10th statement; ¶ 3 of Hurwitz's May 8th statement; ¶ 3 of Meyer's May 11th affidavit, ¶ 1b of Meyer's June 19th affidavit, and ¶¶ 1 and 2 of Meyer's August 5th affidavit; and testimony of Todd Marshall, Kerry Marshall, Hurwitz and Meyer, at pages 23-41 of hearing transcript.

[21] *See* equity runs for Johnson account.

pay Johnson $1,500 "out of my own pocket," but would never make that payment. Rather, Marshall would shift, without any notice or explanation, responsibility for handling Johnson's queries about the promised payment to his brother, Kerry.

4. Kerry Marshall was registered as an associated person with Sterling from April 7, 2006, to August 28, 2007. Before his brother hired him, Kerry Marshall had no futures or options experience. He has not been registered since June 2008.

Kerry Marshall functioned as Todd's Guy Friday, performing various tasks like opening and closing the office, taking phone calls, cutting checks, keeping records, reconciling office order tickets and Comtrust's daily trade report, and handling a small number of accounts. Kerry Marshall also was briefly registered as a principal in February 2007, "for purposes of an NFA audit."[22] This audit would lead to a National Futures Association disciplinary complaint, issued in June 2007, which would allege fraudulent sales practices by Todd Marshall, Stephen Miles and other Sterling agents, as well as supervisory and record-keeping violations by Sterling.[23]

Kerry Marshall would take over unannounced as Johnson's exclusive contact at Sterling after May 29, 2007. In that capacity, he would employ empty promises, surprise conditions, shrinking offers and blunt coercion to delay and dilute the payment of his brother's promised rebate. Kerry Marshall would incrementally reduce the amount of the payment over time, from the $1,500 unconditionally promised by Todd Marshall in late May, to the $1,400 offered in June, to the $1,000 offered in late July after Johnson had complained to Comtrust about the delays and runarounds by Todd and Kerry Marshall.

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[22] NFA records; Kerry Marshall's March 26th statement, ¶¶ 1-17, and 27 of Kerry Marshall's April 23rd statement, ¶¶ 1-4 of Kerry Marshall's June 20th statement; ¶ 1, and 10-11, of Todd Marshall's May 9th statement; and Kerry Marshall's testimony at pages 38-42 of hearing transcript.

[23] *In re Sterling International Commodities*, NFA case number 07-BCC-28. The allegations and conclusions in this NFA action do not form the basis for any factual finding in this initial decision. This and another NFA action are merely referenced to explain background factual circumstances.

5. Sterling International Commodities was a small operation. During the life of Johnson's account -- December 28, 2006 to June 22, 2007 – Sterling employed 16 associated persons at its two offices, with seven associated persons, and no receptionist and no back-office staff, at its main office, and nine associated persons at its branch office. Miles, Hurwitz, Meyer, and Kerry and Todd Marshall worked at the main office. Since Sterling had no receptionist, Hurwitz and Meyer often answered incoming calls from each other's clients.[24]

6. During the two years before Hurwitz cold-called Johnson, Sterling customer accounts typically realized substantial losses, principally because they had been depleted by excessive commissions.[25] In 2005, just five out of 119 Sterling customer accounts (4%) realized an over-all net profit, and Sterling customers paid $1,075,788 in aggregate commissions and realized $1,797,314 in aggregate net losses. In 2006, a larger number of Sterling customer accounts, 45 out of 233 (20%), realized an over-all net profit. However, profits in these winning accounts were typically small and paled in comparison to the losses in the losing accounts: overall, in 2006, Sterling customers paid $3,827,706 in aggregate commissions and realized $2,846,768 in aggregate net losses. Similarly, during the first half of 2007, Sterling customers paid $891,432 in aggregate commissions, and realized $827,192 in aggregate net losses.[26]

7. On June 28, 2007 – about a month after Todd Marshall had closed out Johnson's account, and about a month before Sterling finally paid the reduced rebate -- the National Futures Association would bring the disciplinary action against Sterling, Todd Marshall, and Stephen Miles and two other Sterling agents. As previously noted, the NFA alleged a variety of fraudulent sales and trading practices, and supervisory and record-keeping violations. Marshall

[24] NFA records; and ¶ 3 of Todd Marshall's May 9th statement.
[25] Comtrust remitted to Sterling 84% of commissions collected in 2006, and 88% in 2007. Redding affidavit dated June 17.
[26] Redding affidavits dated April 23, May 22, June 17, and July 28, 2009.

and Sterling filed answers generally denying the NFA's allegations, but by consent order dated July 9, 2008, agreed to a variety of sanctions, including a permanent membership bar for Sterling and a three-year membership bar for Marshall.[27]

Stephen Miles

8. Stephen Robert Miles, whose last known addresses were in Chase City, Virginia and Boynton Beach, Florida, was first registered with the NFA in May 2001. Miles was the first registered principal of Sterling, from August 2001 to September 2002. He was also registered as an associated person with Sterling, from August 2001 to December 2002, and again from August 9, 2006, to May 4, 2007. However, well before Todd Marshall filed with the NFA the form 8T terminating Miles' association with Sterling, Miles had already left Sterling -- in mid-April of 2007 – and started up his own firm, Miles, Incorporated.[28]

9. From 2001 to 2007, Miles' business affairs were intertwined in a variety of ways with those of Todd Marshall and Kerry Marshall.

First, as noted above, in 2001 Miles brought on Todd Marshall as a co-owner and principal at Sterling, and in 2006 Todd Marshall returned the favor and hired Miles to be his number one broker.

Second, simultaneously with his second tenure at Sterling, Miles and Marshall had jointly formed a new venture: Vanguard Trading Group, another introducing broker, which apparently was inactive at that time. Miles was a registered associated person with Vanguard from December 15, 2006, to May 15, 2007, and an approved principal with Vanguard from May 1, to June 29, 2007. When Sterling subsequently went out of business in July 2008, its remaining customers' accounts would be transferred to Vanguard, and three Sterling associated persons

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[27] *In re Sterling International Commodities, supra.*
[28] NFA records.

would transfer to Vanguard, including respondents Michael Hurwitz and Kerry Marshall. According to an NFA disciplinary complaint issued against Vanguard, in early April 2007, Todd Marshall provided start-up capital for Vanguard and another introducing broker, but was not properly listed as a principal of either firm. Vanguard did not produce evidence rebutting this allegation and consented to a permanent membership bar.[29] Thus, it appears that in April 2007 Todd Marshall and Stephen Miles, in anticipation of an NFA disciplinary complaint against Sterling, had been contemplating the eventual transfer of Sterling operations to Vanguard and another introducing broker.

Third, Johnson's experience with Miles indicates that although Miles had effectively stopped working at Sterling in mid-April 2007, Miles would remain in regular contact with someone knowledgeable at Sterling throughout May and June 2007.[30] In mid-May, when Miles called from his new Virginia phone number to renew his contact with Johnson, he would open the conversation by telling Johnson that he already knew that Johnson was unhappy and trying to close his Sterling account. In early June, Miles would tell Johnson that he already knew that Johnson had closed the account and received a refund of the account balance, and would falsely assure Johnson that Marshall "was good for" the promised unconditional payment of $1,500.[31]

10. When Miles took control of Johnson's account in January 2007, he would introduce himself as "one of the best brokers on the East Coast." This statement was more than a mere boast: it was patently designed to deceive a naïve, unsophisticated and uninformed investor like Johnson into believing the fiction that Miles had consistently made big money for his clients.

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[29] *In re Vanguard Trading Group, et al.*, NFA case #08-BCC-034 (complaint dated Dec. 22, 2008, decision dated July 7, 2009).

[30] In addition, records produced by Comtrust show that, for several months after Miles had left Sterling, 44 accounts with reported trading activity would remain assigned to Miles.

[31] NFA records; ¶ 21 of Johnson's statement dated June 22, 2009; Johnson's testimony at pages 141-151 of hearing transcript; ¶¶ 20, 27 and 28 of Todd Marshall's statement dated May 9, 2009; and Todd Marshall's testimony at pages 130-135 of hearing transcript.

Miles' self advertisement doubled as an inside joke for Miles and his colleagues at Sterling. In actuality, everyone at Sterling knew that Miles was one of the best at converting customer funds to Sterling, which happened to be located on the east coast of south Florida. Comtrust records confirm that Miles was a prominent broker and big producer at Sterling. Although he had started at Sterling in August of 2006, by the end of that year over a third of the firm's accounts had been assigned to Miles. For 2006, seventy-four out of seventy-seven of the Sterling accounts assigned to Miles (94%) had lost money, with losses totaling $179,669, and commissions totaling $287,638. For January through April 2007 – the second half of Miles' tenure at Sterling which coincided with his tenure as Johnson's broker – Miles amped up his predations and caused his customers to experience $240,524 in aggregate net losses and pay out $515,576 in aggregate commissions. Thus, during his eight-month stint with Sterling – early August 2006 to mid April 2007 -- Miles was noticeably productive for Sterling, and just as noticeably destructive for his customers: reaping a total of $803,214 in commissions while his customers realized aggregate net losses of $420,193.[32]

11. Comtrust account statements and equity runs indicate that Sterling had assigned Johnson's account to Miles on January 16, 2007. On or about this date, a couple of weeks after Hurwitz and Meyer had solicited and opened the account and recommended the initial trades, Miles would take over as Johnson's Sterling account executive. Miles would convince Johnson to deposit an additional $31,595, for a total of $34,595, which Miles would urge Johnson to fund from a home equity line of credit and from funds in Johnson's savings account that Johnson had intended for a year-end transfer to his IRA.

Over twelve weeks, Miles would place a total of 18 trades for the Johnson account, all of which involved deep or substantially out-of-the-money options, and five of which were bull call

[32] Redding affidavits, *supra*.

spreads. Miles' trades for Johnson's Sterling account would quickly generate $14,840 in commissions, which consumed about half of the funds that Miles had convinced Johnson to commit.[33]

Michael Hurwitz and Matthew Meyer

12. Michael Hurwitz, along with Matthew Meyer, was involved at various points during the solicitation, the account opening, the first deposit, the first round of trades in the Johnson account, and the hand-off to Miles -- a period that stretched from late November 2006 to mid-January 2007. Although they did not normally team up, Hurwitz and Meyer did form a *de facto* team in their dealings with Johnson. Hurwitz and Meyer would not speak to Johnson after Miles abruptly took over Johnson's account.

Hurwitz would cold-call Johnson, and after a series of persistent calls would convince Johnson to open the account with Sterling. During these conversations, Hurwitz would tout the huge profits to be made on seasonal changes in the price of unleaded gasoline, assure Johnson that Sterling's trading strategies were consistent with his conservative investment objectives, convince Johnson to open the account with Sterling, walk Johnson through two Sterling account-opening documents, recommend the first round of trades, ask Miles to talk to Johnson, and receive a cut of the substantial commissions from the trades subsequently recommended to Johnson by Miles and Todd Marshall.[34]

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[33] Johnson's account would remain assigned to Miles until the last options expired on June 22, 2007, which was two months after Miles had left Sterling, and a month after Todd Miles had submitted the Form 8T with the NFA, terminating Miles registration as an associated person with Sterling.

[34] Although Todd Marshall generally may not have made accurate and reliable recordkeeping a high priority, it is reasonable to conclude that he would have paid fairly close attention to the accurate assignment of accounts, since that directly related to the allocation of commissions to individual brokers who needed to be kept happy and motivated. Thus, the fact that the first account statements and equity runs designated Hurwitz as the broker for Johnson's account indicates that Marshall had determined that Hurwitz was entitled to compensation for his role in convincing Johnson to open the account and approve the first round of trades.

Comtrust account statements indicate that the account was assigned to Hurwitz from December 28, 2006 to January 12, 2007. During the time that the account was assigned to Hurwitz, Johnson made the initial deposit of $3,000, and approved two trades touted by Hurwitz and Meyer which generated commissions sufficient to consume a third of Johnson's initial deposit.

Hurwitz, who had no previous commodities or derivatives experience, was a registered associated person with Sterling from March 27, 2006 to May 14, 2008. Thus, Hurwitz had worked at Sterling for eight months before the first contact with Johnson, and would remain at Sterling during the entire life of Johnson's account. Hurwitz has not been registered since August 2008.

Hurwitz was at the low end of the Sterling pecking order: his primary responsibility was to open new accounts that, after an initial round of trades, would be transferred to a more experienced and aggressive broker, usually Miles. Hurwitz was compensated by a percentage of the commissions charged to the accounts that he opened. He continued to receive a reduced percentage of commissions after an account opened by him was transferred to another more experienced broker.[35]

Comtrust records establish that in 2006, a large portion --18 out of 29 – of the accounts opened by Hurwitz were transferred to two senior brokers, and that in the first half of 2007, two of the three accounts opened by Hurwitz were similarly transferred.[36] The majority -- 14 of 20 -- of these transferred accounts were transferred to Miles.[37]

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[35] *See* ¶¶ 1-4 of Hurwitz's May 8th statement, ¶¶ 1 and 10 of Hurwitz's June 22nd statement, and ¶¶ 1 and 2 of Hurwitz's July 30th statement; and Hurwitz's testimony at pages 31-33 of hearing transcript.

[36] Todd Marshall testified that in March of 2007 Miles began more aggressively and prematurely taking control of accounts opened by junior brokers: often faxing the transfer notice to Comtrust without Marshall's approval. This may explain the much smaller number of accounts assigned to Hurwitz in 2007. *See* Todd Marshall's testimony at page 132 of hearing transcript.

[37] NFA records, and Redding affidavits *supra*.

When Hurwitz cold-called Johnson in November or December 2006, his customers' accounts, while assigned to him, had been performing dismally: just one out of the 29 accounts had realized a net profit, with trades generating $86,339 in aggregate commissions which accounted for almost half of the $179,669 in aggregate net losses.[38]

13. Mathew Meyer would reinforce Hurwitz's message by touting the purported success of Sterling's seasonality trading strategies, and by assuring Johnson that Sterling's trading strategies were suitable for Johnson's conservative investment objectives. Meyer also would instruct Johnson how to fill out, and where to sign, the Comtrust account-opening documents, and would hand Johnson over to Miles. During the week that Meyer was waiting to receive the documents with Johnson's signature, Meyer would discuss with Johnson the two trades that Sterling was going to recommend. For an employment opportunity at another firm that quickly fizzled, Meyer would leave Sterling about a week after Johnson had signed the Comtrust account opening documents, and a couple of days before Sterling received the signed Comtrust account opening documents and Johnson gave his authorization to Hurwitz for the first set of trades. Meyer would return to Sterling around the time that Miles took over as Johnson's account executive.

Meyer, who also had no previous commodities or derivatives experience, was a registered associated person with Sterling from September 1, 2005 to May 6, 2008. There were two brief gaps in Meyer's registration with Sterling: first, from October 9 to 13, 2006; and second, from December 26, 2006 to January 22, 2007. The general unreliability of Sterling's record-keeping and supervisory systems, coupled with Meyer's faded recollection, precludes presuming that the dates that Todd Marshall notified the NFA of Meyer's change in employment status corresponded precisely to the actual dates that Meyer was present or absent at Sterling. In any

[38] Redding affidavits, *supra*.

event, Meyer had worked at Sterling for over a year before the first contact with Johnson, and essentially would remain at Sterling during the entire life of Johnson's account. Meyer currently is registered as an associated person and principal with a southern Florida introducing broker, Vista Trading.[39]

Meyer had started earlier at Sterling than Hurwitz, and had become a fairly big producer for Sterling: in 2006, he opened 17% of the firm's new accounts and generated 8% of the firm's commissions. However, Meyer's primary responsibility remained to open new accounts that, after an initial round of trades, would be transferred to a more experienced and aggressive broker, usually Miles. In this connection, Comtrust records show that for 2006 and the first half of 2007, over half -- 23 of 42 – of accounts opened by Meyers were transferred to Miles. Like Hurwitz, Meyer was compensated by a percentage of the commissions charged to accounts that he opened, and he continued to receive a reduced percentage of commissions after an account opened by him was transferred to another broker.

When Meyer first spoke to Johnson in November or December 2006, his customers' accounts while assigned to him had also performed dismally: in 2005, not one of the ten accounts that he had opened had realized a net profit, and trading had generated $84,040 in commissions and realized $168,032 in aggregate net losses; and in 2006, just four of the 37 accounts that he had opened had realized a net profit, and trading had generated $254,063 in commissions and realized $97,308 in aggregate net losses.[40]

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[39] NFA records.

[40] NFA records; Redding affidavits *supra.*; ¶¶ 7 and 8 of Meyer's answer; Meyer's affidavits dated May 11 and June 19, 2009; and Meyer's testimony at pages 33-38, of hearing transcript.

Summary of Trading Activity

14. Johnson's account, introduced by Sterling International Commodities and carried by Comtrust, Incorporated, was opened on December 28, 2006, and essentially closed on May 29, 2007, when Todd Marshall closed out all viable option positions and returned the account balance. On June 22, 2007, the few remaining options expired worthless.

15. Johnson made a total of $34,595 in deposits: $3,000 on December 29, 2006; $3,250 on January 22; $28,000 on February 12; and $345 on April 10, 2007. For each deposit, trades were placed before Johnson's funds were received by Comtrust. Johnson received back a total of $13,346 in refunds: $8,324 on March 6; $229 on April 4; $303 on May 17; $3,490 on May 30; and $1,000 on or about August 4, 2007.[41] Thus, Johnson's account realized an aggregate net loss of $21,249. The $15,860 charged in commissions accounted for the lion's share of this loss.

16. As previously noted, each trade recommendation passed on to Johnson was generated by Todd Marshall. Over approximately five months, respondents placed a total of 21 trades for the Johnson account. Hurwitz recommended the first two trades, Todd Marshall recommended the last trade, and Miles recommended the balance of 18 trades. A majority of the trades involved options on soybean and petroleum futures.

The trades were concentrated in the first ten weeks. By March 15, 2007, 17 of 21 trades had been placed, and 90% of the total commissions had already been collected.

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[41] On this record, it cannot be conclusively determined if the check for $1,000 was drawn on Sterling's or Comtrust's bank. Since the "release" signed by Johnson in conjunction with this payment has been voided below, the $1,000 payment is treated here as no more than a partial refund.

All of the trades involved deep or substantially out-of-the-money options, and seven trades were bull call spreads.[42] Since the premiums for out-of-the-money options are cheaper than the premiums for in-the-money options, a larger number of contracts could be purchased for the same amount of money. Recommending this type of option to Johnson generated additional commissions, because Sterling charged commissions on a $240 per-contract basis.

The bull call spreads involved the simultaneous purchase of an out-of-the-money call option and the sale of a further out-of-the-money call option on the same underlying futures contract. Recommending these spreads to Johnson enabled respondents to purchase additional positions at double the commission rate -- $480 per spread position – because they charged Johnson on the buy side and the sell side at the same rate. Furthermore, since Johnson collected a premium on the sell side, respondents were able to use these funds to purchase more positions and generate more commissions.

The commission-to-premium ratios for the trades were uniformly high, averaging about 45%, and ranging from 28% to 83%. Ratios for all, but four, trades were over 35%. Ratios for eight trades were over 50%.[43]

[42] Price data provided by the Office of the CFTC Chief Economist confirmed that the trades selected by Todd Marshall and recommended by respondents involved substantially out-of-the-money, or deep-out-of-the-money, options. For example: on December 28, Hurwitz recommended a July wheat call that was eight strike prices out of the money and a bull call spread with the long option 23 strike prices out of the money and the short option 32 strike prices out of the money; on February 20, Miles recommended a June Dow Jones index call that was 20 strike prices out of the money; and on May 16 Todd Marshall recommended a cotton call that was 10 strike prices out of the money. In this connection, the non-defaulting respondents did not dispute the conclusion in the default order that all trades in Johnson's account involved out-of-the-money options. The price data also confirmed that comparable in-the-money options had been available on the date of each trade in the Johnson account.

[43] The commission-to-premium ratio indicates the rate at which an option trade must appreciate to overcome the costs of commissions and fees before it breaks even and begins to realize a profit. Thus: the higher the ratio, the lower the profit potential; and the greater the number of trades with high ratios, the more likely that the account inevitably will be wiped out by commissions.

Hurwitz's and Meyer's Tenure

17. In late November or early December 2006, Hurwitz cold-called Johnson, in the first of a series of several conversations led by Hurwitz and Meyer. The thrust of Hurwitz's message was that Sterling offered an option trading strategy with lots of upside, and virtually no downside. Hurwitz made almost no mention of risk during this, and subsequent, conversations. Hurwitz told Johnson that Sterling specialized in trading commodity options, and was offering an opportunity to reap certain, dramatic profits. Hurwitz essentially asked Johnson a question that he knew would prompt a yes answer: that is, had he seen news reports about the rising price of gasoline and had he noticed that the price of gasoline always rose during the summer driving season? Johnson, as could be expected, answered yes. Hurwitz next indicated that Sterling customers had been consistently enjoying through the years "fantastic returns" based on historically recurring and predictable seasonal price variations in the retail price of gasoline. Hurwitz stated that gasoline was certain to shoot up four dollars a gallon by the summer, and that option traders would easily make triple or quadruple profits by trading options on gasoline futures.

Hurwitz asked Johnson if he was interested in making some big money. Johnson told Hurwitz that he was a self-employed carpenter, that he knew nothing about commodities or options, that he had an IRA and that he was focused on saving for retirement. After a couple of minutes, because he had never before heard of Hurwitz, Sterling or options on gasoline futures, Johnson told Hurwitz that he was not all that interested, and terminated the conversation.

Johnson did not expect another call from Hurwitz. However, a couple of days later, Hurwitz called Johnson. Hurwitz was personable, but assertive and persistent, and overcame

Johnson's reluctance by repeatedly emphasizing the strong likelihood of tremendous profits and the suitability of Sterling's strategies for Johnson's conservative investment objectives.

Hurwitz cursorily mentioned that commodity trading generally involved risk, but undercut that minimal disclosure by stating that trading options was much less risky than trading futures and involved "limited risk" because any losses would be limited to the amount of the premium paid. Hurwitz further undercut his weak reference to risk by repeatedly emphasizing the certainty of reaping dramatic profits, which strongly suggested that Sterling had discovered the secret to defeating risk. Hurwitz otherwise said nothing that accurately reflected the reality that his and Sterling's customers typically lost most of their investments.

Hurwitz did not discuss in any meaningful detail the trading strategies favored by Sterling. For example, he did not mention that they would be recommending multi-contract out-of-the-money, and deep-out-of-the-money, option trades.[44] Hurwitz further did not clearly disclose that these trading strategies would generate substantial commissions in the hundreds and thousands of dollars per trade, since Sterling steered its customers to multi-contract trades and charged commissions on a per-contract basis.

Hurwitz also did not reveal that, after Johnson made his first deposit and approved his first set of trades, he should expect to be quickly handed off to a more experienced and aggressive broker, who in turn would pressure him to commit ever larger sums of money. As a result, when Hurwitz and Meyer did hand him over to Miles a few weeks later, Johnson would be surprised and confused, and feel "betrayed," at least until Miles won him over with his own brand of persuasion.

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[44] Not only did Hurwitz, and Meyer, Miles and Todd Marshall, never tell Johnson that their trade recommendations involved out-of-the-money options, they never once used the term "out-of-the-money." ¶ 5 of Johnson's statement filed June 16.

Hurwitz also began discussing the wheat and summer blend gasoline trades that he was recommending for his other clients. After a handful of calls, Hurwitz convinced Johnson to commit $3,000, which was a substantial amount for him.[45]

18. On or about December 19, 2006, Hurwitz expressed to Johnson the signature pages from the account-opening package, and a pre-paid, addressed return express envelope. Johnson distinctly remembers being surprised to discover Matthew Meyer's business card enclosed in the package, since Hurwitz had never mentioned Meyer. Nonetheless, when Johnson called Sterling to discuss the account-opening package, he would ask to speak to Meyer.

19. The account-opening package produced by Comtrust in response to a *sua sponte* subpoena was 23 pages long. However, when a copy of this package was served on Johnson before the hearing, he immediately noticed that the package was like a "magazine," and recalled that the package that he received from Sterling in late 2006 had been much less thick -- a clear plastic folder holding less than ten separated pages that each required his signature.

The standard Comtrust account-opening package had included: a cover page; a *New Account Instructions* (1 page); a CFTC rule 155 futures *Risk Disclosure Statement* (1 page); an *Option Disclosure Statement* (1 page); an options *Disclosure Addendum* and *Trading Record Disclosure for Introduced Accounts* (1 page); a CFTC rule 33.7 *Options Disclosure Statement* (4 pages); an options *General Information* disclosure (1 page); an *Individual Information Form* (1 page); a *Commodity Customer Agreement* (2 pages); a *Consent to Jurisdiction* and signature page for the agreement, an *Arbitration Agreement* (1 page); a *Joint Owner Information Form* (1 page); a *Privacy Policy* disclosure (1 page); a *Non-cash Margin Disclosure* (1 page); an *Additional Risk Disclosure* (1 page); and instructions regarding compliance with the federal

[45] *See* Johnson testimony, at pages 42-47, 52-53, and 61-65 of the hearing transcript.

anti-money laundering statute. In addition, the package included two documents with Sterling's letterhead: a *Notification of Fees and Charges* (1 page); and a *Welcome to Sterling International Commodities* notice (1 page).

On December 20, 2006, Johnson signed six, out of ten, pertinent Comtrust documents: the rule 155 futures *Risk Disclosure Statement;* the *Option Disclosure Statement;* the *Individual Information Form* ; the *Consent to Jurisdiction* and signature page for the agreement; the *Arbitration Agreement;* and the *Additional Risk Disclosure*. On December 28, Johnson signed the two Sterling documents: the *Notification of Fees and Charges,* and the *Welcome to Sterling International Commodities* notice. Thus, the pertinent Comtrust documents <u>not</u> enclosed in the folder expressed to Johnson were: the options *Disclosure Addendum* and *Trading Record Disclosure for Introduced Accounts;* the CFTC Rule 33.7 *Options Disclosure Statement;* the options *General Information* disclosure; and the *Commodity Customer Agreement.*

20. The documents <u>not</u> provided to Johnson would not have provided, by themselves, enough information for Johnson to make an adequately informed investment decision, principally because they did not clearly and completely explain the particular risks associated with Sterling's favored trading strategies. Nonetheless, they would have provided bits of information that could have formed a starting point for Johnson to make an adequately informed investment decision. For example, the Rule 33.7 *Options Disclosure Statement* featured: an opening warning that trading commodity options involved a "high degree of risk" and is "not suitable for many members of the public;" a warning that the chance of a deep-out-of-the-money option becoming profitable is "ordinarily remote;" an admonition that the "option customer should carefully calculate the price which the underlying futures contract or underlying physical commodity would have to reach for the option position to become profitable; " and a short

glossary of options terms. The *Trading Record Disclosure for Introduced Accounts* stated, in pertinent part:

> As with most investments that have a high profit potential, the risk of loss is equally high. Most customers who trade futures and options on futures lose money. In the industry generally, it has been estimated that 90% or more of investors lose. Our firm's independent introducing brokers are no different. . . . This statement is in no way a suggestion that the presentations offered by the IIB and its personnel are unbalanced. Rather this information, which is common knowledge to sophisticated . . . investors, is being provided to insure that you know and acknowledge that most people who trade futures and options on futures do lose.

Contrary to the title of this document, the actual dismal trading record of Sterling's customers was not disclosed. So even if this document had been provided to Johnson, it would have left wiggle room for Sterling brokers to suggest that Sterling knew how to successfully overcome the risk to which non-Sterling speculators were generally subject.

The disclosures in the options *Disclosure Addendum* included: that the options, futures and cash markets "are separate and distinct and do not necessarily respond in the same way to similar [stimuli];" that a "movement in the cash market would not necessarily move in tandem wih the related futures and options contract being offered;" and that "seasonality alone may not be enough to produce profits in any commodity . . . options contract, because price increases are already reflected in these markets." Even if Sterling had provided this written disclosure, nothing Meyer or Hurwitz said would have coherently tied this particular disclosure to the trading strategies favored by Sterling.

21. As for the documents that Sterling did provide to Johnson, the Comtrust *Additional Risk Disclosure* provided cautionary language:

> [Since you checked that you have no prior commodity options experience] you should be aware that commodity trading is a risky form of investment . . . [that] you may wish to study . . . . If you wish to continue with opening your account . . . you acknowledge that the funds you initially commit and may continue to commit . . . are purely risk capital, and any loss of investment will not adversely affect or

> jeopardize your lifestyles, nor will it endanger you from any future retirement objectives.

However, Meyer and Hurwitz had preemptively undermined this disclosure by confidently, but falsely, guaranteeing that Sterling's favored trading strategies were low-risk, consistent money makers, and suitable for his conservative investment objectives.

The two Sterling documents were models of deception through disclosure of a partial truth. The *Notification of Fees and Commissions* featured the technically correct disclosure that Sterling charged $240 in commission and fees per contract, but it did not even hint that typical commissions and fees would be substantially larger per trade, because Sterling routinely recommended multi-contract trades.[46] The *Welcome to Sterling International Commodities* notice, which was not clearly written or coherently organized, explicitly stated that its purpose was to "spell out the relationship" between the FCM and the IB and their relative responsibilities, and concluded: "In sum, we, the IB, are your Broker. We are responsible for all communications with you and the conduct of your account." However, inserted in an *ad hoc* manner between passages discussing the IB's and FCM's responsibilities was the following boilerplate discussion of commissions:

> You authorize the FCM to debit from your account all commissions and fees . . . on a per contract basis, as set forth in our IIB's fee rider. . . . You understand . . . that the commission for similar services vary within the futures industry. . . . You understand and acknowledge that these commissions may substantially affect your ability to breakeven or obtain a profit in your account. Advanced trading strategies such as spreads will result in paying additional commissions, and may further significantly, impact the likelihood of your trades or account breaking even or obtaining a profit. You further acknowledge that the significant impact of commissions charged to your account have not been minimized, misstated, distorted or downplayed by any associated person, principal, supervisor or agent at the FCM or our IIB.

[46] Out of the twenty-one trades in the Johnson account: the commissions per trade for just three trades would total around $240; the commissions per trade for fourteen trades would be about $480; the commissions for one trade would be well over $1,000; and the commissions per trade for another three trades would be over $2,000.

[Underlining added for emphasis.] This document appears to have been cobbled from different documents. For example, in the first, second, fourth and fifth paragraphs which focused on the FCM's limited responsibility and liability, Sterling is referred to in the first person as "us" and "we." In contrast, in the third paragraph which featured the inserted language quoted above, Sterling is referred to in the third person as "our IIB," *i.e.*, Comtrust's independent IB.

22. On or about December 20, Johnson called Sterling and asked for Meyer. Johnson confirmed that he was a self-employed carpenter with modest earnings and savings, conservative investment goals, and that he still lacked a basic understanding of the mechanics and risks of the trading strategies favored by Sterling, but that he was expecting to make money based on what he had learned from Hurwitz.[47] However, Meyer offered no additional explanations or disclosures to assure that Johnson could make an informed decision.

Rather, Meyer quickly showed Johnson where to sign on the signature pagers of the Comtrust documents, and downplayed any references in the documents to risk. For example, when Meyer told Johnson where to sign the futures risk disclosure statement, he suggested that the risks mentioned in that document were irrelevant because Johnson would be trading options. Most significantly, Meyer did not focus on those disclosures that were most pertinent given Johnson's conservative investment objectives and lack of experience and knowledge, and given the specific, high-risk, commission-generating trading strategies favored by Sterling. For example, Meyer did not make sure that Johnson clearly understood that Sterling would routinely be steering him into deep-out-of-the-money, and substantially out-of-the-money, options, which were extremely risky and likely to expire worthless. Meyer similarly did not make sure that

[47] For example, Johnson testified that he never grasped that price volatility required that open positions be closely monitored: "I didn't think that it was something I had to babysit." Page 76 of hearing transcript.

Johnson clearly understood that these trades would most definitely, rather than "may," quickly generate substantial commission which in turn would consume between a third and a half of the funds that Johnson invested. Finally, Meyer did not unambiguously explain that Sterling customers typically lost most or all of their funds following the same sort of strategies being promoted to Johnson. Rather, Meyer confidently re-enforced Hurwitz's false and distorted core message: that Sterling's favored trading strategies were consistent with Johnson's conservative investment objectives; that Sterling's trading strategies were essentially risk-free and consistently had generated huge profits; and that Sterling was recommending wheat and summer blend gasoline trades which were essentially guaranteed to reap dramatic profits in the near future.[48]

23. On December 28, about two days after Meyer had temporarily left Sterling, Hurwitz instructed Johnson where to quickly sign the two Sterling account-opening documents, and obtained Johnson's authorization for the two trades that he and Meyer had been touting: the first was the purchase of two out-of-the-money July wheat calls, and the second was an out-of-the-money June summer blend gasoline call spread. The commissions for these trades totaled $880, which immediately consumed almost a third of Johnson's initial deposit. The commission-to-premium ratios for the trades were 36% and 69%, respectively.

According to Johnson, Hurwitz: did not mention the specific risks associated with the trades -- for example, he did not reveal that these particular trading strategies had typically failed to make money for Sterling customers; did not clearly state the total amount of commissions; did not clearly break down the total costs for each trade (*i.e.*, total premiums, total

[48] *See* Johnson's testimony at pages 47-52, and 65-73, of hearing transcript.

commissions and total cost), which at least would have indirectly revealed the onerous commission-to-premium ratios; and did not mention that the options were out-of-the-money.[49]

During the next two weeks, Hurwitz never told Johnson that the wheat options and the gasoline spread were trading below their purchase price, and thus losing money. Near the end of the second week in January, before he took off for a few days, Hurwitz told Miles that it was time for Miles to talk to Johnson.

Miles' tenure

24. On or about Friday, January 12, 2007, Meyer told Johnson that he wanted him to talk to Stephen Miles. Meyer did not tell Johnson that Miles would be immediately taking over as his account executive. However, Meyer strongly suggested that Miles was a trustworthy and successful broker by introducing him as a "good guy" who was one of the most experienced brokers at Sterling.

Miles confidently introduced himself as "one of the best commodity brokers on the East Coast." Johnson told Miles that he had modest means, that he was concerned about saving enough for his retirement, and that he still did not remotely understand commodity options. Miles offered a cursory discussion of matters like supply and demand, the difference between puts and calls, and the effect of well known current events on the prices of various commodities.

Without saying so, over the course of this conversation, Miles effectively took over as Johnson's account executive. Miles emphasized the huge profits to be made with him at the helm, rarely if ever mentioned any risk of loss, and played to Johnson's concerns:

- "I can see you're ten years behind on your retirement."
- "One day you'll hold your head up high and be wealthy."

[49] *See* ¶ 5 of Johnson's June 16th statement.

- "You're going to help people with all of the money you are going to make."
- "You're going to make 60 to 80 thousand dollars on soybeans this year."[50]

By this date, the aggregate liquidation value of Johnson's options had further declined. However, Miles never indicated that Johnson's first set of trades had declined.

On or about Tuesday, January 16, 2007, Miles convinced Johnson to approve a new round of trades, and to fund the trades by emptying his savings account with a second deposit of $3,250 (which would be received by Comtrust a week later on January 22):

> Miles . . . said "if you send me more money. You'll have a [better] spread and have a [better] chance of making money." Miles talked about corn and wheat. How drought, flood and ice change crops from one year to the other. Miles smooth talked me right out of 3250 one night. That was the last of my savings. Miles said, "You're going to make some money now with your bigger account." That's when I started to not sleep at night and felt what I was into was not for me, it was for gamblers.[51]

The three trades (July corn calls, May soybean puts and November soybean calls) that Miles steered Johnson into generated another $1,080 in commissions and fees. At this point, Johnson had paid $1,960 in cumulative commissions and fees.

25. For Johnson, the opening of his first-ever commodity options account had coincided with the purchase of his first personal computer. Johnson focused his attention on learning how to operate the computer, so that he could read the confirmation statements that Comtrust was sending electronically. As a result, not until early March would he sufficiently master the computer that he could track the status of the account and realize the magnitude of the commissions charged to his account.

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[50] Johnson's complaint.
[51] ¶¶ 8 and 9 of Johnson's June 16th statement.

26. By Friday, February 2, 2007, the account liquidation values had declined to $2,732. Thus, Johnson's $6,250 investment had quickly lost $3,518, which Miles did not reveal to Johnson.

On Monday, February 6, the account liquidation value recovered to over $7,000 and thus was slightly profitable. This, the only time that the account would be above break-even, presented a golden opportunity for Miles to urge Johnson to quintuple his investment:

> Miles and I were getting friendly as two people can get over the phone. Talk about outside [personal] issues. Miles also told me he had more clients in the Bend area, my home town. Miles [assured] me with 6250 in my account. I was <u>doing the right thing</u>. Miles told me, "It looks like your several years behind on your retirement. If you'll <u>stick with me</u>, you will drop those nail bags in 5 years and <u>hold your head up high</u> and be <u>able to help people</u> someday, because of <u>your wealth</u>." The relationship between Miles and myself was good. I became very interested in commodities. I felt I was learning something new. But then, I was very interested in just getting my money back.
>
> On [February 6], Miles called me. Talking about "bring your account up to a <u>bigger status</u>, play some hardball, your <u>behind on your retirement, do you want true wealth</u>?" Miles said, "I'm taking a select few [customers] and we're going into soybean. A bushel of soybean is going to skyrocket. If corn ethanol takes off. Like I think it will. You, Robert, <u>could stand to make 60 to 80 thousand dollars</u>, due to the shortage of soybean being planted in the U.S.A." Miles asked me, "Do you have more money to send me?" My reply was "Absolutely NO! You have $6,250 of my money. I want to see it returned. That's all the money I had. I shouldn't have to send any more money."
>
> When Steve Miles [next] told me I should send 28,000 dollars, I was in shock. "I don't have that kind of money." Miles asked "<u>Can you borrow the money?</u>" I replied, "Absolutely no. I have a Home Equity Line of Credit. I will never use credit." Miles told me. "<u>All investors use their lines of credit.</u>" He said, "Don't you want a new car." Miles and I debated over money for a good 2 to 3 hours. Well Miles is a very good manipulator and persuader. After so much hammering back and forth, the stress and anxiety had me at tears. I caved in, and said "yes" to writing a check out of my HELOC for $28,000.
>
> Miles made a guarantee with me, "You're <u>doing the right thing</u>, You're <u>going to make 60 to 80 thousand</u>. All you're going to have to do is make 2 or 3 monthly payments on your Home Equity line of Credit and you'll <u>have your $28,000 back in two months</u>. You're <u>in the big leagues now</u>. You're <u>not going to regret this move.</u>"[52]

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[52] ¶¶ 11-13 of Johnson's June 16th statement.

[Underlining added for emphasis.] Miles then advised Johnson to approve four trades, involving a total of 33 contracts, which generated an additional $7,920 in commissions. Afterwards, Johnson wrote the check for $28,000, which Comtrust would receive a week later.

27. Between February 26 and March 2, Miles accelerated the frequency of trades, often buying and selling without first consulting Johnson. Miles closed out various positions, all at losses, and used the collected premiums to initiate six more trades. Three of these trades were bull-call spreads, and Miles in turn used the premiums collected for the short legs of the spreads to fund additional positions. During this time, Miles assuaged Johnson's anxiety about the trading activity and mounting losses by assuring him: "I guarantee you'll have your money back in two months."

28. On or about March 2, Miles had sufficiently mastered his PC, and the Comtrust account statements, to grasp that he had paid about $12,000 in cumulative commissions:

> I called and asked what that was about. Miles told me "That's the price of doing business." I replied that, "I thought that this was a retirement account." He then told me "You have to hit the bottom before you get rich."[53]

Miles also assured Johnson that he had made him a $8,300 profit on a soybean trade. However, none of the soybean trades had remotely made that profit. Only one of seven soybean trades realized a net profit, and that was for $3,750. The net losses on the six losing soybean trades totaled $6,950.[54]

[53] Sixth page, factual description to Johnson's complaint.

[54] Sterling's customers were compelled to rely on their Sterling account executives to provide fair and accurate verbal reports of the net profits or net losses for trades, because Comtrust's written, and electronic, statements only reported the gross profit or loss (*i.e.*, the "net premium" collected or paid) when the position was closed out, but did not report the net profit or loss (*i.e.*, the gross profit or loss, less the considerable costs of the commissions and fees which were charged when the position was opened).

During this time, Miles typically liquidated option positions after a week or two, often without consulting Johnson. By April 19, which was when Johnson would last speak to Miles in his capacity as a Sterling account executive, the commissions and fees had totaled $15,720.[55]

Todd Marshall's tenure

29. Sometime after April 19, Miles left Sterling, without Miles or anyone else at Sterling telling Johnson. Remarkably, even though Johnson made multiple calls to Sterling over three weeks asking to speak to Miles, no one at Sterling would offer to help Johnson or tell him that Miles was gone for good.[56]

After Miles left, Todd Marshall would essentially take over as broker for Johnson's account. However, he would not take any apparent action until on or about May 11, 2007 -- about a week after he had submitted to the NFA the form 8T terminating Miles registration as an associated person with Sterling.

By this point, Johnson had lost all patience with Miles' unexplained failure to return his calls and insisted on speaking to someone responsible. Johnson was handed to Todd Marshall, who introduced himself by name, but did not reveal that he was the owner of Sterling. Johnson complained that he had been trying unsuccessfully for almost a month to contact Miles and close his account so that he could limit his losses. Marshall merely replied "He's not here," without clearly indicating that Miles had already left Sterling or acknowledging that Sterling employees had effectively ignored and buried his requests for assistance:

> I spoke to Todd Marshall. I never was told by Miles or in the telephone conversation with Todd Marshall that Todd Marshall was the owner of Sterling. I told Todd Marshall, "I've been trying to get in contact with Steve Miles." Todd replied, "He's

[55] *See* Johnson's testimony at pages 106-130 of hearing transcript.

[56] As previously noted, the *Independent Introducing Broker Notice* encouraged customers to direct all communications to Sterling, and not to Comtrust: "[Sterling is] your broker. We are responsible for all communications with you and the conduct of your account."

> not here." I told Todd Marshall, "My account a month ago was between 5,000 and 6,000 dollars. All along I have been trying to get a hold of Miles, to get out of the market to save what I had left in the account."[57]

Johnson also complained about the excessive commissions, about the fact that Miles had convinced him to draw $28,000 from his home equity line of credit, and about the fact that Meyer, Hurwitz and Miles had guaranteed huge profits and had assured him that Sterling's option trading strategies were suitable for his conservative investment objectives. Marshall ignored these serious allegations, and convinced Johnson to try getting back some money by approving one more trade for a total cost of $409.[58] Marshall also returned to Johnson the cash balance of $303.

However, this was not exactly what Johnson had in mind when he had begun his conversation with Marshall. So, a couple of weeks later, on May 29, Johnson worked up the gumption to renew more forcefully his instruction to close the account. This time, Marshall continued to downplay and displace Johnson's complaints by telling Johnson that he should have known better than to rely on any guarantees or to use borrowed funds for speculation. However, Marshall did follow Johnson's instructions and agreed to liquidate all viable open positions.

Also, during this, his last, conversation with Johnson, Marshall promised, without any conditions, to refund an additional $1,500:

> Todd Marshall replied by saying, "Well, I will close your account out and send you your 3,500 dollars, and I will also send you 1,500 dollars out of my pocket." I thought to myself, "Todd must have some authority with Sterling to send money out of pocket." Todd and I had a verbal agreement on the 1,500 dollars. Todd also said," if you can't afford trading in the commodities market, you should never use your home equity line of credit." Todd said, "you know, 90% percent of people lose their money, on the first go around." Michael Hurwitz, Matthew Meyers and Steve Miles never told me those percentages. . . . I received my 3,500 dollars a short time

[57] ¶ 17 of Johnson's June 16th statement.
[58] This trade realized a gross profit of $130, which was wiped out by $139 in commissions and fees. Thus, this last trade served as a final refrain of Johnson's experience: a money-loser for Johnson, but a money-maker for Sterling.

later. The account was closed. I was waiting on the 1,500 dollars Todd and I agreed on.[59]

Comtrust quickly refunded the $3,490 account balance. However, Todd Marshall did not promptly pay the promised $1,500 "out of my pocket" refund. Also, he never again spoke to Johnson. Rather, Todd shifted to brother Kerry responsibility for handling Johnson's queries about the promised refund.[60]

Kerry Marshall's tenure

30. Kerry Marshall abruptly took over as Johnson's primary contact at Sterling after May 29, 2007. In that capacity, he employed a variety of empty promises, surprise conditions, shrinking offers and overt threats to delay and dilute the payment of his brother's promised rebate, and then to force Johnson to sign a one-sided release. Kerry Marshall incrementally reduced the amount of the payment over time, from the $1,500 unconditionally promised by Todd Marshall in late May, to $1,400 offered by Kerry Marshall in late June, to $1,000 offered in late July after Johnson had complained to Comtrust about the delay in the promised payment. According to Johnson:

> After a week [*i.e.*, in the first week of June 2007], I phoned Sterling International. Kerry Marshall answered the phone. I asked "Is Todd there?" Kerry Marshall said "Todd's not here." For the next three months Todd was never there. I asked Kerry "Is my 1500 on the way?" Kerry replied, "We're working on it." I called Kerry Marshall once a week for two months. [He'd tell] me, "It's on the way. It's on my desk. We're working on it." I started feeling I was getting the run-a-round. Finally, I received a document with the amount of 1400 that needed to be signed and notarized. I signed and notarized the document. I sent it back to Sterling. I was very disappointed, [because] the 100 dollar short-fall felt like the 22,000 [sic] dollars I had just lost to Sterling. I waited another two weeks.[61]

[59] ¶¶ 18 and 19 of Johnson's June 16th statement.
[60] *See* Johnson's testimony at pages 118-122, and 136-139, and Todd Marshall's testimony at pages 130-135, 139-142, of hearing transcript.
[61] ¶ 20 of Johnson's June 16th statement.

When the promised check for $1,400 did not arrive, Johnson called Comtrust to complain. Soon afterwards, he received from Sterling, not a check, but a new document which stated that Sterling agreed to pay Johnson an even smaller amount: $1,000. At the top of the document "Sterling International Commodities, Inc." was printed in extra large font. Below that in much smaller font "Settlement Agreement and General Release of Claims" was printed. The text of the document included expressions of mutuality, but its overall tenor and substance was one-sided and self-serving. For example, on one hand it stated that Sterling "denies any liability," but on the other hand did not include a corresponding statement to the effect that Johnson "denies that his claim lacked merit." Similarly, on one hand the document diminished Johnson's complaint: "Whereas client informed Sterling of a concern with the performance of account." On the other hand, it included a self-serving after-the-fact "acknowledgement" that respondents had told Johnson that "90 percent of clients can and do lose money in these markets and Sterling clients are no different." Finally, it stated that Johnson had five days to sign the document, if he wanted to get paid.

According to Johnson, when he called to complain about this second reduction, Kerry Marshall told him that he and Todd had decided to further reduce the amount because Johnson had "gotten [Comtrust] involved":[62]

> Finally I received another document, not 1400 dollars, the document was for 1000 dollars to be signed and notarized. I waited so long for my 1500 dollars. I just signed and notarized the 1000 dollar document. I just want my money and it all behind me. . . . My thinking, "they are lying to me, and I'll never see any money.[63]

After a couple more weeks, Johnson received a check for $1,000.[64]

[62] This was the first time that Johnson had ever called Comtrust. He called Comtrust this time, because Comtrust had been listed as beneficiary in the release.

[63] ¶¶ 20 and 25 of Johnson's June 16th statement.

[64] *See* Johnson testimony at pages 141-147, and Kerry Marshall's testimony at pages 147-152, of hearing transcript.

Conclusions

Accord and Satisfaction

In order to prevail on the accord and satisfaction affirmative defense, respondents must establish by a preponderance of the evidence that the settlement agreement signed by complainant and respondents was the product of valid mutual assent.[65] The record shows that the parties had contractual capacity and supported their agreement with consideration. However, by failing to produce reliable written or oral testimony on this issue, Todd and Kerry Marshall failed to rebut Johnson's plausible and believable assertions that the agreement was <u>not</u> the product of bona fide negotiations and mutual assent, but rather the product of deception, coercion and undue influence which contaminated the agreement and rendered it void.

Johnson's conversations with Todd and Kerry that preceded his signing the agreement could not reasonably be described as a negotiation as that term is commonly understood, *i.e.*, a process where two sides, actually aware that they are involved in a negotiating process, make opening offers and then make compromise counter-offers which approach and sometimes successfully reach some middle ground. In sharp contrast, the conversations between the Marshalls and Johnson followed a distinctly different pattern, with the Marshalls taking a bad-faith, one-sided, take-it-or-leave-it approach, and making increasingly smaller offers, until Johnson felt compelled to sign their one-sided, self-serving agreement. First, Todd Marshall never indicated to Johnson that they had a dispute that required resolution. Rather, Marshall advised Johnson that his grievances lacked any merit, and then out of the blue unconditionally

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[65] *See Melton v. Pasqua*, Comm. Fut. L. Rep. (CCH) ¶29,152 (CFTC 2002), *affirmed* ¶29,152 (4th Cir. 2003) (When validity of a settlement agreement is called into question, a CFTC judge may and should conduct an evidentiary inquiry); and *Chicoine v. Rosenthal & Co.*, Comm. Fut. L. Rep. (CCH) ¶ 21,075, at 24,344 (CFTC 1980), *affirmed in part and vacated in part*, 678 F.2d 727 (7th Cir. 1982) (A proper examination of the relevant circumstances around the execution of a written agreement or written acknowledgement is not strictly confined to the four corners of the document).

promised to pay Johnson $1,500 "out of my own pocket." Kerry Marshall then took over from his brother and lied several times that he was about to mail the check, and then incrementally reduced the amount of the payment, from the $1,500 unconditionally promised by Todd Marshall in late May, to the $1,400 offered in June, to the $1,000 offered in late July after Johnson had complained to Comtrust about the Marshalls' delays and runarounds. Finally, Kerry Marshall threatened to further reduce the offer below $1,000, if Johnson did not quickly sign the release prepared by Sterling.

In order to establish a finding of undue influence, the evidence must show: one, Johnson's "susceptibility" to the sort of influence employed by the Marshalls; two, an "opportunity" for the Marshalls to exercise undue influence; three, evidence of the Marshalls "disposition" to exercise undue influence; and four, evidence of the "unnatural nature" of the transaction.[66] Here, susceptibility and opportunity have been shown by the fact that the Marshalls' were obviously aware of Johnson's confusion, naiveté and lack of sophistication, aware that Johnson could be easily swayed and confused, and aware that Johnson faced an increasingly dire financial situation caused by his decision to trust respondents. Disposition has been shown by the fact that the Marshalls exclusively took the initiative, repeatedly took advantage of their stronger bargaining power, actively exploited Johnson's naïvete and lack of sophistication, falsely offered a purportedly unconditional personal payment, and then strung him along with false promises. The unnatural nature of the transaction is underscored: one, by the fact that the Marshalls used false promises, delays, diminishing offers and eventually the threat that Johnson would get nothing unless he signed the agreement; two, by the fact that Sterling paid meager consideration – less than 5% of Johnson's losses and less than 10% of the

[66] *See* Corbin on Contracts, Vol. 7, §§ 28.9-28.12 (2002); 13 Williston § 1625 (3rd edition); and Restatement (Second) of the Law of Contracts §177, comment a.

commissions collected by respondents; and three, by the fact that Johnson not long afterwards complained that the Marshall's had tricked and coerced him into the agreement. In these circumstances, it is reasonable to conclude that the agreement was not the product of mutual assent. Thus, the settlement agreement is tainted, void and unenforceable, and respondents' accord and satisfaction defense must fail.

Fraudulent solicitation and churning

Michael Hurwitz and Stephen Miles defrauded Johnson during the solicitation and the trading of his account by convincing him to commit ever increasing amounts of money and to fund these deposits from his savings and home equity line of credit, by grossly distorting the relative risks and rewards of following their trading advice, and by churning his account.

During the solicitation and trading of the account, Hurwitz and Miles created the false and misleading impression that Johnson could reasonably expect to make tremendous profits with minimal accompanying risk, at a cost of just $240 per trade. For example, respondents: falsely represented that the trading strategies favored by Sterling were suitable for Johnson's conservative investment objectives; falsely guaranteed profits by exaggerating the profit potential and downplaying the substantial risk of loss of the option trading strategies favored by Sterling; falsely suggested that Sterling customers typically enjoyed tremendous profits, when in fact the vast majority of Sterling customers had lost large portions of their investments in the two preceding years; emphasized well-known current events and seasonal tendencies deceptively suggesting that they were certain to move the market in certain directions when in fact these factors had already been factored into the market price; deceptively downplayed the importance of the account-opening documents, and failed to provide all required written risk disclosures; failed to disclose that Sterling would be recommending trading strategies – multi-contract, out-of-the-money options and option spreads – that would quickly generate excessive, profit-killing commissions; failed to clearly disclose the amount of commissions; outright lied about the commissions, suggesting that they were normal and customary and that they were justified by the purportedly guaranteed profits, when in fact they were excessive and the primary factor in the substantial losses suffered by the majority of Sterling customers; failed to warn him that they would be pressuring him to invest ever increasing amounts of money, in total disregard of his financial status and investment objectives; and used similar deceptions to lull Johnson into maintaining his account in the face of mounting losses. It is "rudimentary" that these types of misrepresentations and omissions about profit potential and risks are material.[67]

Johnson's decision to open the account, deposit additional funds and continue trading was consistent with his assertions that he relied on Hurwitz's and Miles' confident, but unrealistic, message that he would quickly realize large profits with minimal accompanying risk. The conclusion that Johnson reasonably relied on respondents' misrepresentations and omissions to his detriment is supported by the fact that he was naïve and unsophisticated, with limited investment experience, no experience trading commodity options, and no familiarity with the commodity markets.[68] Respondents' written disclosures of general risks by themselves did not cure the false impression of guaranteed large profits created by Hurwitz and Miles, where the overall effect of respondents' intentionally deceptive statements substantially outweighed and vitiated the written risk warnings,[69] where the commission disclosure itself deceptively

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[67] *In re JCC,* Comm. Fut. L. Rep. ¶ 26,080, at 41,576 n.23 (CFTC 1994).
[68] *See Ricci,* at 44,444.
[69] *Ferriola,* at 50,153. Similarly, although Sterling has not produced a recording of the account-opening compliance review for Johnson's account, nothing in the record remotely suggests that Sterling would have instituted a compliance review that was genuinely designed to detect or cure the sort of fraud practiced by Hurwitz and Miles. *See JCC, Incorporated v. CFTC,* Comm. Fut. L. Rep. (CCH) ¶ 26,492, at 43,217-43,218 (11th Cir. 1995) (A perfunctory compliance review cannot be used as "advance exoneration" of fraudulent misrepresentations omissions).

suggested that commissions would be no more than $240 per trade, and where respondents failed to provide the complete CFTC rule 33.7 disclosure statement.[70]

To establish churning, Johnson must show: one, that respondents "controlled" the level and frequency of trading in the account; two, that respondents chose an overall volume of trading that was "excessive" in light of his trading objectives; and three, that respondents acted with either "intent" to defraud, or in "reckless disregard" of his interests.[71] Since Johnson did not execute a written power of attorney, he must show that respondents exercised *de facto* control over the trading in his account. Evidence of the following factors will establish *de facto* control: (1) the customer lacks sophistication; (2) the customer lacks prior commodity option trading experience and devotes a minimum of time to trading the account; (3) the customer reposes a high degree of trust and confidence in respondents; (4) a large percentage of the transactions are based on respondents' recommendations; (5) the customer does not approve transactions in advance; and (6) the respondents do not provide full, truthful and accurate information prior to obtaining customer approval for transactions.[72] Here, the record amply demonstrates that respondents controlled the trading in the account. Todd Marshall supplied the recommendations for all of the trades in the account. Marshall, Miles and Hurwitz decided when to buy and when to sell, with Miles often buying and selling without first consulting Johnson. Johnson lacked the requisite trading knowledge or experience to select trades and or to know when to buy and sell, and remained generally overwhelmed from start to finish. Also, Johnson's acceptance of respondents' advice was tainted by their deceptions and distortions concerning the likelihood of profits, the results of trades, and the status of the account.

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[70] Even if respondents had provided the required written disclosures, along with the other written disclosures in the complete Comtrust account-opening package, the written disclosures would have been vitiated by respondents' oral deceptions. *See O'Hey v. Drexel Burnham Lambert*, Comm. Fut. L. Rep. ¶22,754, at 31,141 (CFTC 1985).
[71] *Ferriola,* at 50,154.
[72] *Id.*

Commission case law recognizes that customer objectives are one of the touchstones for an analysis of excessiveness.[73] Here, Johnson did not communicate a specific trading objective beyond an expectation that the trading strategies recommended by respondents would be consistent with his limited financial resources and his conservative retirement-oriented objectives, and that the strategies had a reasonable likelihood of profits with minimal risk of loss. It would be unreasonable to expect him to articulate much more of an objective given that: Johnson knew nothing about commodity options; respondents had cold-called him; respondents left Johnson with little understanding about the mechanics and specific risks of Sterling's trading strategies; and respondents did not attempt to ascertain a more specific or sophisticated objective. In any event, the absence of a fully articulated specific trading objective does not justify the use of a trading strategy that emphasizes account executives' and firms' interests over the interests of their customer.[74]

Here, respondents recommended trading strategies that were patently designed to generate several hundreds and thousands of dollars in commissions in a short time, by using a combination of multiple contracts, out-of-the-money or deep-out-of-the-money options and bull call spreads. The excessiveness is underscored: by the fact that the commission-to-premium ratios, or break-even rates, averaged 45% and ranged up to 83%, which meant that the likelihood of profit was extremely remote; by the fact that commissions rapidly consumed large percentages of the funds deposited by Johnson; by the fact that respondents routinely urged Johnson to initiate trades before he had added sufficient funds; and by the fact that Miles repeatedly urged him to invest ever increasing amounts of money, in total disregard of his financial status and conservative investment philosophy.

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[73] *In re Murlas Commodities, Inc.*, Comm. Fut. L. Rep. (CCH) ¶26,485, at 43,156-57 (CFTC 1985).
[74] *Ferriola,* at 50,154.

Respondent's promises of certain profits failed to reflect the detrimental effect of Sterling's burdensome commissions on profit potential. Here, the commissions and fees charged to Johnson's account consumed nearly half of his total investment and resulted in high commission-to-premium-paid ratios which represented a formidable barrier to profit potential. Thus, their 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.[75]

By principally compensating his account executives with a cut of the commissions, Todd Marshall supplied his brokers with the necessary motivation to make unrestrained profit projections and to convince Johnson to approve trading strategies that emphasized their interests over Johnson's interests. Moreover, the fact that Meyer and Hurwitz routinely transferred new customers like Johnson to more experienced brokers like Miles, and that Miles urged Johnson to invest more money and to make more trades, further substantiates the conclusion that Marshall pushed them to generate commissions.

As a crucial component of this commission-generating scheme, Todd Marshall selected for Hurwitz and Miles to recommend to Johnson trades in positions that were out of the money ("OTM"), even when comparable in-the-money ("ITM") positions were available. These trades exponentially increased respondents' commission income, because Sterling charged Johnson 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, respondents' unvarying insistence that

[75] *Johnson v. Fleck*, Comm. Fut. L. Rep. (CCH) ¶24,957, at 37,502 (CFTC 1990) (Gramm concurrence).

Johnson trade out-of-the options cannot be justified where Johnson's trading objective included, at a minimum, 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.[76] 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."[77] Thus, respondents' promises of certain profits 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.

The intentional nature of respondents' fraud is underscored by their exploitation of Johnson's naiveté and lack of trading experience, their blatant disregard of his conservative financial objectives, their reckless indifference to the source of his funds, their blatant lies that the commissions charged to Johnson were normal and customary, their failure to provide a fair and accurate disclosure of Sterling's oppressive commission structure, the fact that they rushed him into approving additional trades and investing additional funds before he understood the size of the commissions, and the fact that they disregarded and discouraged his complaints.

The proper measure of damages for churning combined with fraudulent profit guarantees and exposure to unnecessarily high levels of risk, where losses exceed commissions, is Johnson's out-of-pocket losses: $21,249. Hurwitz should be held liable for this full amount because he

[76] *See Ferriola,* at 50,154-50,155.
[77] *Id.*, at 50,155.

continued to receive a cut of the commissions after he handed off Johnson to Miles, because he gave Miles the go-ahead to take over the Johnson account, and because when he had convinced Johnson to open the account he already knew that Johnson would probably be handed off to a more aggressive broker, most likely Miles, who had almost never made money for his customers and who in turn would expose Johnson to greater risk by pressuring Johnson to commit more money and pay ever increasing commissions.

Aiding and abetting

In order to establish aiding and abetting, the weight of the evidence must show that one knowingly associated oneself with an unlawful venture, participated in it as something that he wished to bring about, and sought by his actions to make it succeed.[78] Here, Todd Marshall controlled and actively managed Sterling. In that capacity, he directly supervised Miles and Hurwitz in the small confines of Sterling's office, he established Sterling's commission-based compensation plan, he selected each of the trades that he and Miles and Hurwitz recommended to Johnson, he regularly reviewed the trading activity in all Sterling customers' accounts, including Johnson's account, and he was responsible for regulatory compliance. Thus, Marshall had assumed responsibilities regarding the awareness of certain regulatory requirements that do not attach to the public at large.

In this connection, Marshall knew, or should have known in the diligent exercise of his duties as Sterling's chief of compliance, that, since 2000, the Commission has found to be presumptively fraudulent any broker's recommendation to purchase an out-of-the-money option,

[78] *In re Richardson Securities, Inc.*, Comm. Fut. L. Rep. ¶ 21,145 (CFTC 1981); *In re Lincolnwood Commodities*, Comm. Fut. L. Rep. ¶ 21,986 (CFTC 1984); *In re Dillon-Gage*, Comm. Fut. L. Rep. ¶ 22,574 (CFTC 1984); *McGaughey v. Hogan-Orr, Inc.*, Comm. Fut. L. Rep. ¶22,479 (CFTC 1985); and *Cohen v. Manganiello*, Comm. Fut. L. Rep. ¶23,346 (CFTC 1986).

when the firm charges commissions on a per-contract basis and a comparable in-the-money option is available.[79] Nonetheless, Marshall deliberately and repeatedly selected the same sort of patently dubious trades for his brokers to pass on to Johnson. Marshall continued to do so despite the fact that he knew from his regular review of customer accounts, including the account of Johnson, that these types of trades had consistently generated significant losses and excessive commissions.

By compelling his brokers to foist presumptively fraudulent trades on all Sterling customers, including Johnson, Marshall purposefully elected to operate beyond the borderline of compliance, deliberately played a crucial role in Sterling's fraudulent load and churn scheme, and knowingly joined and promoted Miles' and Hurwitz's fraud against Johnson. The intentional nature of Marshall's violation is underscored by his blatant indifference to Miles' abandonment of Johnson's account, his deliberate disregard and dismissal of Johnson's complaints about the patently abusive conduct of Hurwitz and Miles, and his consistently deceitful dealings with Johnson.[80] Therefore, the preponderance of the evidence establishes that Marshall aided and abetted the fraud of Hurwitz and Miles. The proper measure of damages for this violation is Johnson's out-of-pocket losses: $21,249.

The evidence also establishes that Todd Marshall failed to supervise Miles by failing to promptly assign a new broker when Miles abandoned Johnson's account and by disregarding and deflecting Johnson's complaints about his mistreatment by respondents, and that Todd Marshall fraudulently lulled Johnson into one more trade with a false promise to recoup some of his

[79] *See Ferriola,* at 50,154-50,155. *See also Frye v. Ader*, Comm. Fut. L. Rep. ¶ 29,586 (Initial Decision 2003), *affirmed* 2004 WL 5239427 (CFTC 2004); and *Pakan v. Patino*, Comm. Fut. L. Rep. ¶ 30,841 (ID 2008), *affirmed* ¶ 31,376 (CFTC 2009) (decisions following *Ferriola*).

[80] To establish aiding and abetting liability, knowing assistance may be inferred from the surrounding facts and circumstances. *CFTC v. Premex*, 785 F.2d 1403 (9th Cir. 1986).

losses.[81] The proper measure of damages for these violations is $3,256, based on Johnson's losses during Marshall's tenure as Johnson's *de facto* broker. Since these damages are subsumed in Johnson's total out-of-pocket losses, the award will be capped at $21,249.

Finally, whether Kerry Marshall perpetuated respondents' fraudulent load and churn scheme with his multiple prevarications and threats is a close question. This misconduct, which took place after the account had been closed, was sufficiently duplicitous and coercive to void the release that the Marshalls foisted on Johnson. However, this same misconduct lacked sufficient factual nexus to support a conclusion that Kerry Marshall knowingly aided and abetted Miles' and Hurwitz's fraud.

ORDER

Robert Johnson has established by a preponderance of the evidence: one, that Michael Zalman Hurwitz used a combination of deceptions, misrepresentations and omissions to initiate a fraudulent load and churn scheme, and that Hurwitz churned his account, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10;[82] two, that Stephen Miles used a combination of high-pressure tactics, deceptions, misrepresentations and omissions to advance the load and churn scheme, and that Miles churned Johnson's account, in violation of Section 4c(b) of the Act and CFTC rule 33.10; three, that Todd Owen Marshall aided and abetted the

[81] *See Hinch v. Commonwealth Financial Group, Inc.*, Comm. Fut. L. Rep. (CCH) ¶27,056, at 45,021-45,022 (CFTC 1997).

[82] Section 4c(b) of the Act provides in pertinent part: "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 "option," . . . "put," "call," . . . contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing such transaction under such terms and conditions as the Commission shall prescribe." In turn, CFTC rule 33.10 provides: "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 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."

fraud of Miles and Hurwitz, in violation of Section 13(a) of the Act;[83] four, that Todd Owen Marshall fraudulently lulled Johnson into an additional trade, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10; five, that Todd Owen Marshall failed to adequately supervise Miles, in violation of CFTC rule 166.3;[84] and six, that Marshall's and Hurwitz's violations, separately and together, proximately caused $21,249 in damages.

Accordingly, Michael Zalman Hurwitz and Todd Owen Marshall are ORDERED to pay to Robert B. Johnson reparations of $21,249, plus interest on that amount at 0.37% compounded annually from December 28, 2006, to the date of payment, plus $50 in costs for the filing fee. This total award (principal, interest and costs) shall be reduced by the $5,000 that Meyer has paid to Johnson pursuant to their agreement. Hurwitz's and Marshall's liability is joint and several.

Johnson has failed to establish any violations causing damages by Kerry Marshall, and Johnson has amicably settled his dispute with Meyer and received full payment under the terms of their settlement agreement. Accordingly, the complaint against Matthew Meyer and Kerry Marshall is DISMISSED.

Dated December 30, 2009.

Philip V. McGuire,
Judgment Officer

[83] Section 13(a) of the Act provides that: "Any person who commits, or willfully aids and abets, counsels, commands, induces or procures the commission of a violation of any provisions of this Act, or any [CFTC] rule, or who acts in combination or concert with any other person in any such violation, or who willfully causes such an act to be done or omitted which if directly performed or omitted by him or another would be a violation of [the Act or CFTC rule], may be held responsible for such violation as a principal."

[84] CFTC rule 166.3 provides that: "Each Commission registrant . . . must diligently supervise the handling of its partners, officers, employees, and agents . . . of all commodity interest accounts carried, operated, advised, or introduced by the registrant and all other activities of its partners, officers, employees, and agents . . . relating to its business as a Commission registrant."