UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

Rodney S. Modlin, **Complainant,** **v.** **Jeffrey T. Cane, American Futures Group, Inc., and Evan Tucker, III,** **Respondents.**	**CFTC Docket No.: 97-R083**

INITIAL DECISION

Appearances:

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Before: **PAINTER, ALJ.**

PROCEDURAL HISTORY

After opening two separate commodity futures accounts on the basis of Respondents' representations and sustaining losses over $70,000, Complainant brings this reparations suit under Section 14(a) of the Commodity Exchange Act ("Act"), 7 U.S.C. §18(a).

Complainant Rodney S. Modlin filed this reparations Complaint with the Office of Proceedings on May 23, 1997. The Complaint alleges that Respondents Jeffrey T. Cane, Evan Tucker, III, and American Futures Group, Inc., severally and collectively, violated provisions of both the Act and the Commodity Futures Trading Commission ("CFTC") Regulations. Specifically, Complainant charges Respondent Cane with fraudulent inducement to open and continue to trade in commodity futures accounts, misrepresentation, nondisclosure, churning, and breach of fiduciary duty in violation of Section 4b(a) of Act, 7 U.S.C. § 6b. Complainant further charges each of Respondents Tucker and AFG with aiding and abetting and failure to supervise in violation of Section 13(a) of the Act, 7 U.S.C. § 13c(a) and CFTC Regulation 166.3, 17 C.F.R. § 166.3, respectively.[1] Complainant claims $74,308.32 in monetary damages to recoup out-of-pocket losses. (Second Addendum to Complaint).

On August 12, 1997, Respondents filed a timely Answer to the Complaint denying any wrongdoing. Subsequently, on March 2, 1998, Respondents filed a Motion to Amend the Answer to the Complaint to include a counterclaim for reasonable legal expenses and attorneys' fees. By Order dated March 3, 1998, this Court denied Respondents' Motion.

This matter was heard on March 18, 1998 in Winston-Salem, North Carolina. On June 8, 1998, Complainant filed a Motion to Strike the Transcript of a purported conversation dated March 17, 1998, submitted as Respondent's Exhibit 1 ("Ex. R-1") at the hearing. The basis for Complainant's Motion was that Respondents did not submit a tape recording of such conversation. Respondents did not file any response and did not contest Complainant's Motion. By Order dated June 19, 1998, this Court granted Complainant's Motion to Strike. On July 1, 1998, this Court denied Respondent's Request for Reconsideration.

[1] Initially, Complainant alleged unauthorized trading and sought damages of unrealized loss of profits in addition to out-of-pocket losses. In the Second Addendum to the Complaint, dated July 10, 1998, Complainant dropped the

Complainant filed his post-hearing brief on June 8, 1998. Respondents filed their post-hearing brief on July 6, 1998. Complainant filed his post-hearing reply brief on July 21, 1998. This matter is now ready for disposition.

FINDINGS OF FACT

The Parties:

1. At the time of the events at issue, Complainant Rodney S. Modlin ("Modlin") was 30-years old and resided in Mebane, North Carolina. (Transcript ("Tr.") at 8.) He owned and operated a small dump truck business, "Modlin Trucking," located in Raleigh, North Carolina. (Tr. at 8.) Modlin has a high school education and limited investment experience. (Tr. at 8-9.) Modlin never traded commodity futures before his dealings with Cane. (Respondents' Answer ("Ans.") ¶ 2; Tr. at 9, 145; Ex. C-4.)
2. At the time of the events at issue, Respondent Jeffrey T. Cane ("Cane") worked at AFG as a registered Associated Person ("AP"). (Tr. at 119; Commission Records.) Respondent Cane resides in Baldwin, New York. (Tr. at 75, 117, 130; Commission Records.)
3. Respondent Evan Tucker, III ("Tucker") currently resides in both Chicago, IL and New York, NY. (Tr. at 165). At all times relevant to the Complaint, Respondent Tucker worked as a registered branch manager of AFG's New York retail sales office and as a supervisor of Mr. Cane. (Ans. ¶ 15; Tr. 166; Commission Records.) As of December 1996, Tucker was no longer employed by AFG, but has remained close with the former principals of AFG. (Tr. at 176.)
4. At the time of the events at issue, Respondent American Futures Group, Inc. ("AFG")

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charge of unauthorized trading and re-calculated his damages claim. (Tr. 57-58.)

operated as a registered Futures Commission Merchant ("FCM"), but was not a member of any exchange. (Tr. at 122, 163; Commission Records.) AFG maintained two separate offices in New York: a retail sales office and a back office, located two blocks apart. (Tr. at 125, 166.) AFG went out of business in April 1998. (Tr. at 61.)

The Solicitation:

5. In July 1995, Modlin heard infomercials aired on CNBC and on the radio that discussed commodity investments that turned "$6,000 into $24,000 in three months." (Tr. at 9.) Interested in similar returns of profit, Modlin called the advertised telephone numbers for more details. (Tr. at 9, 76.)

6. In July and August 1995, immediately following Modlin's inquiry, roughly four to six brokers solicited Modlin to open a commodity futures account. (Tr. at 10, 40.) Modlin communicated to all the brokers that he desired a commodity broker with extensive experience trading commodities. (Tr. at 10.) Modlin rejected all the brokers due to their lack of experience--three years or less--trading commodities. (Tr. at 10.)

7. Cane received a lead on Modlin from AFG. (Tr. at 76.) In August 1995, Cane solicited Modlin several times to open a commodity futures account. (Ans. ¶ 7, ¶ 9; Tr. at 11, 14, 39, 76, 77.) Cane informed Modlin that he was affiliated with AFG, but did not explain how he obtained Modlin's phone number. (Tr. at 39-40.)

8. Throughout the solicitation process, Cane represented to Modlin that he possessed fifteen years experience trading commodities. (Tr. at 12-13, 69.) Cane's fifteen years of experience, however, occurred primarily in banking and involved trading financial futures for banks. (Tr. at 84-85, 131-32.)

9. Goley Bryan Wall ("Wall") resides in Winston, North Carolina. (Tr. at 67.) At the time

of the events at issue, Wall shared a business venture with Modlin in a cattle farm. (Tr. at 67.) Interested in the commodity futures market, Wall listened via speakerphone to several conversations between Cane and Modlin. (Tr. at 68.) Cane knew Wall listened to the conversations from time to time. (Tr. at 19.)

10. Wall testified that he overheard Cane say that he, Cane, had fifteen years of experience in commodity trading. (Tr. at 69.) In fact, Cane was first registered with this Commission in 1991 as an AP. (Tr. at 119; Commission Records.) The Court finds Wall's testimony both credible and reliable.

11. Cane deliberately caused Modlin to believe that he had fifteen years experience trading commodities regulated by this Commission.

12. Prior to opening the account, Modlin informed Cane that he had "zero experience" about commodities and the minimal knowledge he did possess he obtained from the CNBC infomercials and radio advertisements during the preceding month and a half. (Tr. at 13, 16; Ex. C-4.) Modlin did not understand the complexities or technicalities of commodity trading. (Tr. at 14-17; Ex. C-4.)

13. Modlin testified that prior to opening an account at AFG, Cane asserted he "would hold [his] hand and teach [him] everything that he knew about trading commodities" and that he "would jump into the East River if [he] couldn't make [him] a profit." (Tr. at 14, 44.) Cane also represented that "[d]ay-trading was . . . his successful method of trading." (Tr. at 18, 45.)

14. No factual basis existed for Cane's assertion that Modlin would make a profit in commodity trading. To the contrary, Cane could not recall closing a single customer's

account at a profit.[2] (Tr. at 158, 178.) Modlin would not have opened the account in question had Cane disclosed that he could not recall closing a single customer's account at a profit.

15. Modlin testified that had he known Cane's actual employment history, he would not have employed him as his commodity broker. (Tr. at 12-13.)

<u>Account #1:</u>

16. On August 18, 1995, Modlin completed and signed the customer account application and risk disclosure documents that Cane forwarded to him, listing $50,000-$75,000 as his income and $100,000-$250,000 as his net worth. (Ans. ¶ 14; Tr. at 17, 77, 139; Ex. C-3.) Cane vaguely discussed the risks associated with trading in commodities, but never told Modlin that he could not recall having a single customer who made a profit. (Tr. at 17, 82, 158, 178.)

17. On August 22, 1995, Modlin opened a non-discretionary account ("Account #1") at AFG with a $10,000 initial investment. (Ans. ¶ 17; Tr. at 17; Ex. C-3.) Modlin retained Cane as a full service broker at a commission rate of $85 per round turn. (Tr. at 44.) Trading began the very day Modlin opened Account #1. (Ex. C-1.) Cane was the account executive for Modlin throughout the life of Account #1.

18. Modlin sustained losses in his accounts. (Tr. at 45; Ex. C-1.) Cane represented that the losses were not unusual and reassured Modlin that they could recoup the losses. (Tr. at 65.) Specifically, Cane told Modlin that "[t]he key to making money in commodities was sticking with the day trading . . . . to keep [him] going and going and going and going and going." (Tr. at 45.) Cane also stated "[s]tick with it and it will all come back to you,"

[2] Tucker also testified that he could not recall Cane having even one account that closed with a profit while employed with AFG. (Tr. at 178.)

leading Modlin to believe that he could recoup his losses and make a profit if he continued trading. (Tr. at 45.) Cane did not jump into the East River when Modlin sustained these losses. (Tr. at 45.)

19. On September 21, 1995, Modlin wired to Cane an additional $5,000, making his total initial investment $15,000. (Ex. C-1.)

20. The testimony and evidence shows that Modlin relied on Cane's expertise and also reposed a great deal of trust and confidence in Cane.

Account #2:

21. Stark had worked at AFG for approximately a month by mid-September 1995. (Tr. at 147, 149.) Cane and Stark spoke frequently and planned to share an office in the near future. (Tr. at 32, 89, 149.)

22. Stark composed two formal letters, dated September 11th and September 12, 1995, addressed to Cane at the company address using *personal* letterhead. (Tr. at 146, 149; Ex. C-5.) The first letter detailed Stark's methodology and the second letter delineated Stark's credentials. (Tr. at 148, 150; Ex. C-5.)

23. Modlin testified that in September 1995, "things were not going too well." (Tr. at 32.) Cane then conveyed to Modlin the contents of Stark's letters, describing Stark as a "wizard" who would assist Cane to "stay on top of the markets a lot more efficiently and make more profitable trades." (Tr. at 32, 89, 149.)

24. Induced by Cane's favorable portrayal of both Stark and the methodology, Modlin immediately flew to New York at his own expense to meet with Cane and Stark. (Tr. at 33, 65, 90.) Modlin wrote a $15,000 check to AFG before flying to New York. (Tr. at 66.) Modlin did not understand Stark's presentation of the trading methodology and

expressed the same to Stark. (Tr. at 59-60.)

25. At Cane's request, Modlin opened Account #2 to be traded based on Stark's recommendations. (Ans. ¶ 21; Tr. at 32.) On September 22, 1995, Modlin deposited $15,000 into this account. (Tr. at 31-32; Ex. C-1; Ex. C-2.) Both Stark and Cane were the trading accountants on Account #2. (Tr. at 60.) When Modlin opened Account #2, Cane did not make him aware of the balance in Account #1. (Tr. at 32.) No margin calls had been placed on Account #1 as of September 22, 1995. (Tr. at 32.)

26. No party offered into evidence or discussed any account opening documents for Account #2 during the hearing on March 18, 1998.

<u>Management of the Accounts:</u>

27. Cane and Modlin spoke on a daily basis. (Tr. 88-89, 169.) Cane initiated most of the conversations that took place. (Tr. at 134-35; Ex. R-2.)

28. Modlin directed roughly seven to eight lumber trades without Cane's recommendations, but participated minimally for the remaining trades. (Tr. at 25, 29-31.) The Court finds that Cane recommended the vast majority of the roughly 680 trades placed in the two accounts. (Tr. at 24, 25, 26.)

29. AFG used an order system that tends to obscure even a rudimentary audit trail of activity. Cane supposedly executed an order ticket at the time he initiated an order for a customer. (Tr. at 124-25.) Cane then called the order to another AFG office, located two blocks from Cane's office, where the back office allegedly created a second order ticket. (Tr. at 125-26.) No records for either set of order tickets were produced at the hearing. (Tr. at 61, 62.) On or about March 7, 1995, Respondents filed with this Court one set of order tickets, allegedly Cane's.

30. In September 1995, Stark placed very few trades in Account #2. (Tr. at 33; Ex. C-2.) In October 1995, Stark disappeared and, upon inquiry, Cane informed Modlin that Stark had left AFG. (Tr. at 33.) A higher level of trading occurred in Account #2 in both October 1995 and November 1995, compared to the trading level in September 1995. (Ex. C-2.)

31. On or about November 10, 1995 a margin call for $9500 was placed on Account #1. (Tr. at 34, 152.) Modlin met the margin call. (Tr. at 35; Ex. C-1.) Account #2 still remained open with almost a $16,000 balance. (Tr. at 34, 152-53.) Cane never suggested that Modlin use the balance in Account #2 to cover the $9,500 margin call placed on Account #1. (Tr. at 35, 153.)

32. Shortly after Modlin met the margin call, Cane closed Account #2 and transferred the balance to Account #1. (Tr. at 34.)

33. In December 1995, a second margin call was placed on Account #1 for $12,800 and held in abeyance until January 16, 1996, when Modlin deposited $20,000 with AFG. (Ex. C-1.)

34. Cane primarily used the day trading method or the short-term trading method on Account #1, which generated a high volume of trades per month. (Ex. C-1; Ex. C-2.)

35. Wall advised Modlin against trading so frequently in so many different markets. (Tr. at 19, 70.) In response, Modlin stated he would stick with Cane's recommendations because Cane had fifteen years experience trading commodities and Wall did not. (Tr. at 19, 70.)

36. Nevertheless, Modlin intermittently expressed to Cane his concern about both the frequency of trading in the account and the high level of commissions. (Tr. at 24-25.) In response, Cane recounted stories where he personally recouped losses to reassure Modlin

and persuade him to continue trading. (Tr. at 65.)

37. On March 15, 1996, Modlin met a margin call placed on Account #1 for $8925. (Ex.C-1.) On March 18, 1997, Tucker and Cane closed out Modlin's trades that resulted in a negative account value of approximately $1902. (Tr. at 112.)

38. On or about March 19, 1996, Cane called Modlin and they discussed Modlin sending more money to place a few more trades in the energies market. (Tr. at 112-13; Ex. R-3.) On March 21, 1996, Cane received $9,861 from Modlin. (Tr. at 114; Ex. C-1.) Cane adjusted Modlin's account for the deficit balance of $1902 and used the remaining funds to place trades for Modlin in April that also resulted in losses. (Tr. at 114-15.)

39. After these losses, Modlin stopped trading and closed his account. (Tr. at 116.) Cane remitted the $3,952.68 balance to Modlin. (Tr. at 116; Ex. C-1.)

40. After careful review, the Court finds that during the life of both accounts, Complainant lost a total of $74,308.32. (See Ex. C-1.)

41. In April 1996, Modlin learned about the National Futures Association ("NFA") and checked into the background and employment history of Cane. (Tr. at 36-37.) Modlin discovered that Cane had been registered as an AP for only eighteen months. (Tr. at 36, 38.)

42. In April or May 1996, Modlin confronted Tucker with this information and told him that Cane represented in August 1995 that he had fifteen years experience trading commodities. (Tr. at 37-38, 160-61.) Upon inquisition by Tucker, Cane denied the assertion and claimed that he represented fourteen years of experience to Modlin. (Tr. at 38.)

Supervision of Modlin's Accounts:

43. Tucker maintained a private office that faced the sales room. (Tr. at 166.) Cane worked merely fifteen feet away from Tucker's office. (Tr. at 166.) Tucker spent most of his time supervising roughly ten to twenty brokers on the sales floor. (Tr. at 166, 179.)

44. Tucker testified as to what time Cane arrived at work; the amount of calls Cane handled daily; what time and where Cane ate lunch; and the manner in which Cane managed phone calls when multiple clients called him simultaneously. (Tr. at 167-68.)

45. Tucker knew how Cane portrayed his prior employment experience to his clients. (Tr. at 183.) Although aware that Cane deliberately misled prospective customers to believe he possessed fifteen years trading experience, Tucker failed to take any remedial action.

46. Tucker could not recall Cane ever closing a customer's account at AFG with a profit. (Tr. at 178.)

47. Tucker signed off on Modlin's account opening documents. (Tr. at 166-67.) The Court concludes that had Tucker enlightened Modlin about Cane's limited commodity trading experience and profitless streak, Modlin would not have opened the first account.

48. Tucker frequently listened to Cane and Modlin's conversations and became familiar with their calling patterns and nature of discussions. (Tr. at 167, 168, 179.) From listening to these conversations and based on actual trades in the account, the Court concludes that Tucker was aware that Modlin relied heavily on Cane's trading advice. Consequently, the Court finds that Tucker knew Modlin was an unsophisticated investor who reposed complete trust and reliance in Cane.

49. Tucker's assistant supervisor, Marta Veliz, signed off on the customer order tickets at the end of each day. (Tr. at 167.) Tucker, as branch manager, had a duty on occasion to

review the order tickets. (Tr. at 177.) Tucker was keenly aware of the large number of trades in Modlin's account. (Tr. at 180.)

50. Neither Tucker nor anyone else at AFG ever called Modlin to inquire whether he was satisfied with Cane's services as a full service broker. (Tr. at 38, 182.) Tucker, however, spoke with Modlin "a number of times" and met him personally when he flew to New York in September 1995. (Tr. at 172.)

51. Tucker observed Modlin meeting with Stark during his visit to New York. (Tr. 172.) Tucker was aware that Modlin had opened two accounts at AFG. (Tr. 187.) The Court concludes that Tucker had knowledge of the fraudulent "letter scheme" designed by Cane and Stark to induce Modlin to open Account #2 at AFG. But for Tucker's acquiescent approach to Cane's fraudulent activity, the Court finds that Modlin would not have opened this second account.

DISCUSSION

The gravamen of Modlin's complaint is that Respondent Cane fraudulently induced him to open and continue to trade two commodity futures accounts. Modlin alleges that Cane deliberately misrepresented his trading experience, emphasized profit potential, and minimized the risks solely to induce Modlin to open a commodity futures account at AFG. Further, Modlin argues that Cane lulled him to continue trading by reassuring him that they would recoup the losses and insisting they could achieve profitability by utilizing the day trading method. In addition, Modlin alleges that Cane fabricated a fraudulent scheme with Stark with the intent to induce Modlin to open a second account at AFG and cheat him out of additional money. Modlin asserts that he would neither have opened an account at AFG nor continued to invest or trade but for Cane's continuous misrepresentations, blatant lies and deceptive schemes.

The Court finds Modlin's testimony to be straightforward, consistent with the evidence, credible and reliable. Conversely, the Court generally finds Respondents Cane and Tucker neither credible nor reliable in light of all the evidence and testimony.

The Court finds that Respondent Cane, more likely than not, fraudulently induced Modlin to open and continue to trade commodity futures accounts at AFG based on multiple misrepresentations of material facts and a deceptive scheme.

I. Fraudulent Inducement

Fraudulent inducement, misrepresentation, and lulling are violations of Section 4b of the Act, 7 U.S.C. § 6b, which states in pertinent part:

> [i]t shall be unlawful (1) for any member of a contract market, or for any correspondent, agent, or employee of any member, in or connection with any order . . . (i) to cheat or defraud or attempt to cheat or defraud such other person; . . . (iii) willfully to deceive or attempt to deceive such other person by any means whatsoever . . . ."

"The elements of a fraud action under [Section] 4b are derived from the common law action for fraud." Puckett v. Rufenacht, Bromagen & Hertz, Inc., 903 F.2d 1014, 1018 (5th Cir. 1990). Therefore, Modlin must first establish that Cane knowingly misrepresented or failed to disclose a material fact to Modlin. Waters v. Int'l Precious Metals Corp., 172 F.R.D. 479, 484 (S.D. Fla. 1996) (citing Clayton Brokerage Co. of St. Louis v. Commodity Futures Trading Comm'n, 794 F.2d 573 (11th Cir. 1986)). Second, Modlin must show that Cane made such misrepresentation or omission of a material fact with the intent to induce Modlin's reliance. Id. Third, Modlin must prove reasonable reliance on the misrepresentation or omission of a material fact and demonstrate that reliance on such misrepresentation or omission proximately caused the suffered damages. Id.

A. Misrepresentation or Omission of Material Facts

The Court finds that Cane induced Modlin, an unsophisticated investor, to open and continue to trade two commodity futures account at AFG on the basis of the following misrepresentations of material facts: 1) that he possessed fifteen years experience trading commodities for customers similar to Modlin; and 2) that achieving profitability in the commodity market was likely and the risks involved were minimal. Moreover, Cane failed to disclose to Modlin that he never closed a customer's account with a profit, which under the circumstances of the case at bar, the Court finds further compounded Cane's misrepresentations of profit and risk, and lulled Modlin.

Determination of whether a misrepresentation actually occurred requires the Court to focus on "the common understanding of the information conveyed." In re JCC, Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,080, at 41,576 (CFTC May 12, 1994) (quoting Hammond v. Smith Barney, Harris Upham & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617, at 36,657 n.12 (CFTC Mar. 1, 1990)). Consequently, one can find a representation deceptive, regardless of whether it is true or false. See In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,701, at 43,926 (CFTC June 5, 1996) (noting that a representation can be found misleading either because it is false or because no reasonable basis exists to support an assertion that the representation is true). Furthermore, an omission of a material fact qualifies as a misstatement if the Court finds that the circumstances mandated disclosure to ensure that the representations made were not misleading. Swickard v. A.G. Edwards & Sons, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,522, at 30,275 (CFTC Mar. 7, 1985).

To sustain a claim under Section 4b of the Act, however, the misrepresentation or omission must also involve a material fact. Sudol v. Shearson Loeb Rhoades Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,748, at 31,118 (CFTC Sept. 30, 1985). The determination of whether a misrepresentation or omission of fact is material entails an objective analysis. See id. at 31,119 (citing TSC Indust., Inc. v. Northway, Inc., 426 U.S. 438, 445 (1976)) (noting that it is "universally agreed" that an objective analysis applies to the materiality determination). Therefore, resolution of the materiality issue is dependent "on whether a reasonable investor would regard the fact as significantly altering the total mix of information available." Id.

Fraudulent Inducement of First Account:

1. Misrepresentation of Prior Trading Experience

Cane misled Modlin to believe that he possessed 15 years experience trading commodities for similar customers in order to induce Modlin to open a commodity futures account at AFG.

The CNBC infomercials and radio advertisements that portrayed investments in the commodity market as profitable intrigued Modlin, broadcasting stories of commodity investments that turned "$6,000 into $24,000 in three months." Enticed by the prospect of a 300% profit return on an investment, Modlin called the advertised telephone numbers in July 1995. Thereafter, numerous commodity brokers solicited Modlin at home.

Cane solicited Modlin to open an account at AFG several times in August 1995. Modlin clearly advised Cane that he had "zero experience" trading commodities and therefore, needed a full service broker upon whom he could completely rely and trust. In response, Cane boldly asserted "that he was [Modlin's] man, that he would hold [Modlin's] hand and teach [Modlin] everything that he [Cane] knew about trading commodities." Cane, however, neglected to explain to Modlin that he first became a registered commodity broker in November 1991 and had only traded commodities for a few years. Rather, Cane conveyed the false impression that he possessed fifteen years trading experience solely to inspire confidence in his abilities and convince Modlin to hire him. The fraudulent conduct does not rest primarily on Cane's affirmative statements to Modlin, but is premised on the information that Cane failed to disclose to Modlin properly. Thus, "[t]he touchstone [of the misrepresentation] here is not so much the words of the solicitation itself, but what message [was] conveyed to [the] customer[] acting reasonably under the circumstances." In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,701, at 43,924 (CFTC June 5, 1996).

Cane argues that he truthfully represented that he was a commodity broker and, therefore, no misrepresentation occurred. Even if the Court accepted that Cane represented to Modlin that he was a commodity broker, he still failed to disclose the length of time he was a commodity broker. This "'half of the truth may obviously amount to a lie if it is understood to be the whole.'" Swickard v. A.G. Edwards & Sons, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,522, at 30,275 (CFTC Mar. 7, 1985) (quoting Prosser & Keaton, The Law of Torts 738 (1984)). The overall message conveyed by Cane, and subsequently understood by Modlin, was that Cane possessed fifteen years experience trading commodities for customers similar to Modlin. See Bishop v. First Investors Group of the Palm Beaches, Inc. [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,004, at 44,840 (CFTC Mar. 26, 1997) (citation omitted) (stating that "an analysis must be made of the overall message conveyed by a solicitation" to determine if a reasonable customer would have been misled).

Moreover, the Court finds that prior experience trading commodities is information that reasonable investors attach significance to when they decide whether to open a commodity futures account. Sudol v. Shearson Loeb Rhoades Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,748, at 31,119 (CFTC Sept. 30, 1985). Modlin, an unsophisticated investor, desired a commodity broker with extensive experience trading commodities before choosing to invest in the commodity market. In fact, Modlin rejected six brokers precisely because they lacked the requisite experience trading commodities, although several had up to three years experience trading commodities. To a reasonable investor, such as Modlin, previous trading experience often correlates to expertise in the industry. In turn, a broker's expertise routinely functions as an indicator of the level of trust and reliance that a reasonable investor can repose in a particular broker.[3] Consequently, a broker's prior trading experience is a significant and material factor in the investment decision-making process. See Jakobsen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,812, at 31,392 (CFTC Nov. 21, 1985) ("Because it is substantially likely that information on trading experience and success rate would be considered important to a reasonable investor deciding whether to open an account and employ an account representative who the investor intended to depend on for trading advice, such information was material.").

2. Misrepresentation of Profit Potential

In addition, Cane misled Modlin to believe that attaining profitability in the commodity market was not only possible, but also probable, while simultaneously minimizing the risks involved in commodity futures investments.

Testimony establishes that Cane and Modlin discussed the infomercials and advertisements that initially sparked Modlin's interest in the commodity market. The Court concludes that Cane was cogently aware that Modlin's minimal understanding of both the risks

[3] Modlin testified that had he known Cane's prior employment history, he would not have retained him as his commodity account executive.

and profit potential resulted solely from listening to the dubious infomercials and advertisements. Cane testified that he received a lead on Modlin from AFG. The Respondents, however, offered no testimony or evidence that detailed how AFG obtained Modlin's name and telephone number. In the absence of any testimony or evidence, the Court makes the adverse inference that AFG obtained leads on prospective clients from inquiries generated by the infomercials and advertisements aired on CNBC and the radio, respectively.

In Scheufler v. Stuart, the respondent, cognizant of an infomercial's contents, relied on its portrayal of profit potential in the commodity market to induce potential investors to open accounts. Scheufler v. Stuart, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,171, at 45,577 (CFTC Sept. 30, 1997). The Commission attributed the infomercial's deceptive representations to the respondent. Id. Similarly, Cane took advantage of the infomercials' and advertisements' contents, the genesis of Modlin's favorable and incorrect perceptions towards profit potential in the commodity market, to secure Modlin as a client. Accordingly, the infomercials and radio advertisements' exaggerated portrayals of profit potential in the commodity market are imputed to AFG, Tucker, and Cane.

Moreover, before Modlin decided to open an account at AFG, Cane asserted that "he would jump into the East River if [he did not] make [Modlin] a profit." Obviously, Cane did not jump into the East River after sustaining losses in Modlin's account. Nevertheless, the statement poignantly suggests to a reasonable, albeit naïve, investor such as Modlin that the prospect of obtaining profits is likely, thereby increasing the expectation of profitability. This insidious statement is even more egregious in light of the fact that Cane never made Modlin privy to his profitless streak trading commodities for customers.

Cane's failure to disclose that he never closed a customer's account with a profit created a particularly deceptive impression of profitability under the circumstances of the instant case. Failure to disclose a customer track record is not by itself sufficient to support a fraud claim because disclosure is not mandated by the Act. Lehoczky v. Gerald, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,441, at 42,923 n.24 (CFTC June 12, 1995). In certain circumstances, however, where the complainant can establish that "respondents' solicitation included claims of expertise . . . a failure to disclose the track record *could* make such claims misleading." See id. (emphasis added) (citation omitted).[4]

Cane misled Modlin to believe that he possessed fifteen years experience trading commodities. Thereafter, Cane asserted that 'he would jump into the East River if he did not make Modlin a profit.' In this context, it is apparent that Cane intended to convey to Modlin the impression that he consistently achieved profitability in the commodity market for his customers. Therefore, Cane's silence as to his profitless streak further misrepresented the likelihood of profitability. See In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,701, at 43,926 n.72 (CFTC June 5, 1996) (commenting that "'certain omissions may be misleading if the respondent has failed to disclose qualifying information necessary to prevent one of his affirmative statements from being deceptive'") (quoting Swickard v. A.G. Edwards & Sons, [1984-1986 Transfer Binder] Comm. Fut. L Rep. (CCH) ¶ 22,522, at 30,275 (CFTC Mar. 7, 1985)). Furthermore, the Court finds that Cane's misrepresentations concerning the likelihood of profit and minimization of risk are material as a matter of law.[5]

[4] See also Kahn v. Int'l Trading Group, Ltd., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,345, at 35,475 (Initial Decision Oct. 6, 1988) (postulating that a broker's previous track record with customers constitutes a material fact to prospective clients; that the Act mandates disclosure of all material facts during the solicitation process; therefore, the Act mandates disclosure of a broker's previous track record with customers).

[5] See In re JCC, Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,080, at 41,576 n.23 (CFTC May 12, 1994) (noting that "futures markets are a zero-sum game" and therefore, statements that blur the line between possibility and probability of substantial profits are "likely to be materially misleading to customers"); see also In re Citadel Trading Co. of Chicago, Ltd., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,082, at 32,188

Cane's multiple misrepresentations of material facts created a misguided belief as to his expertise in the commodity market; amplified profit potential; minimized the risks and hazards associated with trading commodities; and ultimately, induced Modlin to open a non-discretionary account at AFG and retain Cane as his full service broker.

Lulling/Ongoing Misrepresentations:

Cane continued to make fraudulent representations that both minimized the effects of the risk disclosure statements and lulled Modlin to continue to trade, despite the mounting losses.

Modlin received risk disclosure documents in compliance with CFTC Regulation 1.55, 17 C.F.R. § 1.55, when he opened his first account at AFG. Cane's repeated fraudulent statements, however, compromised and diluted the effect of these documents. The Commission has uniformly held "that conduct can vitiate the effect of the risk disclosure statement mandated by [the CFTC's] rules." Hannay v. First Commodity Corp. of Boston, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,936, at 34,282 (CFTC Sept. 21, 1987); accord Kahn v. First Commodity Corp. of Boston, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,306, at 32,840 (CFTC Sept. 30, 1986) (noting that a formal disclosure of risk does not grant to a broker a license to make representations for which no factual or reasonable basis exists). Therefore, receipt of a risk disclosure statement does not always accurately represent one's understanding of the risks involved in commodity trading. See Paster v. Int'l Trading Group, Ltd., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,725, at 31, 055 (CFTC Sept. 16, 1985) (holding that the "totality of the circumstances, including all advice, oral and written," must be evaluated to determine whether the client has been aptly apprised of the risks involved).

(CFTC May 12, 1986) (finding that respondent's "major misrepresentations and omissions, especially his . . . minimizing the risks of loss, and his exaggerating his trading expertise and the possibility of profits, were material").

As noted by the court in Hannay:

> Perusal of the [Rule 1.55 disclosure] statement reveals that it would not warn a customer to disbelieve the kind of misrepresentations involved in this case. It does not warn the customer to disbelieve representations that certain trading strategies can limit losses, that the broker's scheme can overcome inherent market risks, or that certain commodities are less volatile. Those unfamiliar with the workings of markets are unlikely to understand that no broker can eliminate or diminish risk. *The customer may be led to believe that the course of trading on which he or she embarks is not susceptible to the extreme risk that the statement warns "can" or "may" accompany trading.* Further, the statement uses terms of art that require explanation, without which the significance of the warning to the particular customer may not be understood. Thus, it is not illogical to believe the warning on the risk disclosure statement while at the same time believing representations such as were made by [respondent].

Hannay v. First Commodity Corp. of Boston, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,936, at 34,282 (CFTC Sept. 21, 1987) (quoting Clayton Brokerage Co. of St. Louis v. Commodity Futures Trading Comm'n, 794 F.2d 573, at 580-81 (11th Cir. 1986) (alteration in original) (emphasis added)).

Modlin intermittently expressed concern to Cane about the high levels of trading in many different markets and the continuing losses occurring in the account. In response, Modlin received calming reassurances from Cane that such losses were not unusual, but that "the key to making money in commodities was sticking with the day trading" and "to keep . . . going and going and going . . . ." Cane expressly communicated that Modlin could recoup his losses if he abided by the day trading method. In this fashion, Cane skillfully minimized the attendant risks associated with day trading and investing in the commodity market. Moreover, Cane continued to emphasize the prospect of achieving high profit returns, although cogently aware that he never personally closed a customer's account with a profit. See Munnell v. Paine Weber Jackson & Curtis, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,313, at 32,863 (CFTC Oct. 8, 1986) (recognizing that favorable predictions of profit potential combined with comments minimizing risk exposure is tantamount to a virtual guarantee of profitability).

In response to Cane's lulling, Modlin permitted Cane to continue trading his account at high volumes, met all margin calls and even made additional investments.[6] Modlin's testimony is corroborated by Wall, who testified that he cautioned Modlin against trading so frequently in many different markets. In response to Wall's advice, Modlin retorted that Cane had fifteen years experience trading commodities, and, therefore, he would "stick" with Cane's recommendations and the day trading method.[7] Cane's conduct not only vitiated the risk disclosure statements, but also lulled Modlin to continue to invest money and meet margin calls until Respondents liquidated his account in April 1996 leaving a negative balance.

Fraudulent Inducement of Second Account:

Unfortunately, Cane's fraudulent escapade is not confined to the solicitation and looting of Modlin's first account at AFG. After gaining Modlin's complete trust and reliance, Cane cunningly planned to extract additional money from Modlin through another deceptive ploy.

Cane and Stark both worked for AFG in close proximity to each other. They spoke frequently enough that they shared trading methods and customers – even planned on sharing an office in the near future. Nevertheless, Stark felt compelled to compose two formal letters

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[6] See Kacem v. Castle Commodities Corp., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,058, at 45,032 (CFTC May 20, 1997) (finding lulling where respondent "reassured complainant that the losses would be recouped" and complainant continued to trade despite continuing losses based on these assurances).

[7] In the concurring opinion of Muniz v. Lassila, Commissioner West noted:

> Once the hook is set and the customer has surrendered possession of his money, the customer is at risk of loss from an increasing variety of sources. Obviously, the customer may suffer legitimate market losses. Customers faced with such losses often are prone to make poor decisions in a desperate attempt to recoup losses. As losses can occur with astonishing speed, disoriented customers can be receptive to lulling or unreasonable recommendations by their brokers that lead to even more losses. Further, once the customer is hooked by solicitation fraud they then are vulnerable to a host of other fraudulent activities including: unauthorized trading, churning, improper allocation of trades, and outright conversion.

Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,225, at 38,653 (CFTC Jan. 17, 1992) (Commissioner West concurring).

addressed to Cane at the company address, using personal letterhead. In addition, Stark mailed the letters, which described his trading method and credentials, to Cane. No apparent reason existed for Stark to send Cane two formal letters on *personal* letterhead *via mail* that delineated a trading methodology to be used on a *client's* account at AFG. Moreover, Respondents did not provide any reason. The adverse inference from these suspicious actions is that the letters were designed to be a protective cover for the fraudulently activity in Modlin's accounts.

Evidence and testimony makes it apparent that these letters were indeed a 'ruse'-- a 'scheme'-- a 'device'-- to obtain additional investments from Modlin by fraudulently inducing him to open yet another account at AFG. In late September 1995, Cane proposed Stark's trading methodology. Cane described Stark as a "wizard" and cleverly insinuated that Stark would make it easier for him to turn a profit in Modlin's account. Captured by Cane's deceptive web, Modlin flew to New York at his own expense to meet with both Stark and Cane. Modlin did not understand the technical aspects of the commodity market and, therefore, could not comprehend Stark's presentation of his methodology, which was based on price fluctuations of the commodity market. Modlin, however, wrote a $15,000 check before flying to New York. This action indicates that Modlin did not make an informed decision. Rather, Modlin remained completely reliant on Cane's recommendations and guidance, still under the belief that Cane was an expert commodity trader who could turn a profit for him. Thereafter, Cane convinced Modlin to open a second account at AFG to track Stark's 'unique trading method'.

Stark traded Modlin's second account at AFG minimally during the first month. Subsequently, Modlin did not hear from Stark. Nevertheless, Modlin's second account at AFG remained open for an additional two months, during which time Cane placed a large number of trades. The Court notes that no reason remained for this second account to remain open after

Stark left AFG sometime in October 1995.

On or about November 17, 1995, AFG placed a margin call for $9,500 on Modlin's Account #1. Account #2 held roughly a $16,000 balance. Without the benefit of Cane suggesting that Modlin transfer money from one account to another to meet the margin call, Modlin wired additional funds. Cane shrewdly connived Modlin out of $9,500. Afterwards, Modlin inquired into Stark's whereabouts and Cane immediately closed Account #2. Cane never suggested or offered to return the balance of the second account to Modlin. Instead, Cane simply rolled the money into the first account. Again, Cane subtly extracted another $15,000 from Modlin. This deceptive ploy to extract additional money from an unsuspecting and trusting client is clearly an egregious form of fraud.

B. Scienter

The Court finds that Cane deliberately made misrepresentations and fabricated the aforementioned scheme solely to induce Modlin to open and continue to trade two commodity futures accounts, despite mounting losses.

The Commission has held that not only must a material misrepresentation actually occur to sustain a claim under Section 4b of the Act, 7 U.S.C. § 6b, but also that the respondent make the misrepresentation or omission of material fact either intentionally or recklessly. Hammond v. Smith Barney, Harris Upham & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617, at 36,659 (CFTC Mar. 1, 1990).

Cane clearly comprehended that Modlin wanted a commodity broker with extensive experience before he opened a commodity futures account. Nevertheless, Cane deliberately remained vague and evasive about his prior experience, cognizant of the fact that by doing so he conveyed the overall impression that he possessed fifteen years experience trading commodities.

Cane was also aware of Modlin's favorable impressions towards achieving a profit in the commodity market and exploited these impressions, rather than diluting or correcting them. In fact, Cane made numerous statements that further compounded Modlin's misguided belief as to the likelihood of profitability in the futures market. Moreover, it is ludicrous to believe that Cane was unaware that his assertions and reassurances lured Modlin to continue to invest in the commodity market, despite mounting losses. Lastly, after establishing an informal "buddy" relationship, Cane fabricated the "letter scheme" and intentionally abused Modlin's trust to extract additional money.

Sufficient probative evidence exists on the record to support the conclusion that Cane intentionally conveyed false impressions or defrauded Modlin as to the following: his prior experience trading commodities for customers similar to Modlin; the likelihood of achieving substantial profits; and the underlying objective or reasons for opening the second account at AFG.

C. Justifiable Reliance and Proximate Cause

Lastly, the Court finds that Modlin reasonably relied on Cane's fraudulent representations and that reliance on such misrepresentations proximately caused his monetary losses.

Once it is established that an intentional misrepresentation or omission of a material fact occurred, the complainant still needs to demonstrate justifiable reliance. When determining whether reliance by the complainant is either reasonable or justifiable, the Commission has consistently taken the stance "that people who are exceptionally gullible, superstitious, ignorant, stupid, dim-witted, or illiterate have been allowed to recover when the defendant knew it, and deliberately took advantage of it." Phacelli v. Conticommodity Services, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,250, at 32,674 (CFTC Sept. 5, 1986) (quoting

Prosser & Keeton, The Law of Torts 751 (5th ed. 1984) (citations omitted)). In addition, both the "characteristics and the circumstances of complainants" are considered when evaluating fraudulent claims. Id.[8]

Modlin has a high-school education and had never traded commodities before his dealings with Cane. Modlin clearly expressed to Cane his lack of knowledge about commodities and indicated that he intended to rely entirely on his broker if he opened an account. Cane took advantage of Modlin's naivete and ignorance about the commodity market and deliberately misled Modlin to believe that he was an expert in trading commodities to induce Modlin to open an account with AFG. Under these circumstances, Modlin's reliance on Cane's reassurances and misrepresentations is clearly justifiable.

To recover monetary damages under a fraud claim, however, the complainant must also prove by a preponderance of the evidence that the fraud proximately caused the damages. Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,225, at 38,650 (CFTC Jan. 17, 1992); see Jakobsen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,812, at 31,392 (CFTC Nov. 21, 1985) (explaining that a justifiable reliance analysis essentially evaluates whether the misrepresentations actually caused the damages). The determination of proximate cause entails an evaluation of whether "'respondents' violative conduct was a substantial factor in bringing about [complainant's] loss' and whether 'the loss was a reasonably probable consequence of respondents' conduct.'" Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,225, at 38,650 (CFTC Jan. 17, 1992) (quoting Sansom Refining Co. v. Drexel Burnham Lambert, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,596, at

[8] See Zobrist v. Coal-x, Inc., 708 F.2d 1511, 1516 (10th Cir. 1983) (delineating governing factors to be contemplated when assessing whether complainant's reliance is justifiable).

36,562 (CFTC Feb. 16, 1990) (alteration in original)).

Modlin had limited resources (i.e. Wall Street Journal, CNBC) from which he could make an independent reliable assessment as to Cane's expertise and depiction of profitability in the commodity market. Consequently, Modlin was an easy mark for a suave, sophisticated commodity broker such as Cane. After Cane tricked Modlin into believing that he possessed 15 years experience, it is reasonable that Modlin would repose a great deal of trust and confidence in Cane's suggestions and representations. See Jakobsen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,812, at 31,393 (CFTC Nov. 21, 1985) (citation omitted) ("A customer does not have a duty to investigate the truth of the statements made to him, but may ordinarily rely on the honesty of his account representative's representations."). Moreover, it is foreseeable that Modlin would accept losses in his account and continue trading based on Cane's reassurances that if he kept with "it," i.e. day trading, he would recoup his investments and make a profit. But for Cane's multiple misrepresentations and reassurances, Modlin would not have opened and continued to trade the commodity futures accounts at AFG.

Moreover, based on Cane's representations relating to his experience and the likelihood of profit, coupled with constant reassurances that one needed to stick with it to recoup losses and make a profit, it is not remarkable that Modlin did not apprise himself of Cane's false and fraudulent representations until the spring of 1996. But for Stark's alleged trading methodology, Modlin would not have opened this second account with an additional investment of $15,000. Cane's on-going portrayal of himself and Stark as experts in the industry also played an instrumental part in convincing Modlin to open the second account at AFG with Stark.

The court finds that Cane's fraudulent solicitation, management and lulling of both accounts proximately caused Modlin's total monetary loss of $74,308.32.

II. Failure to Supervise

Modlin also alleges that Respondents Tucker and AFG are individually and collectively liable for his out-of-pocket losses for failure to supervise Cane's dealings adequately. Inadequate supervision is a violation of CFTC Regulation 166.3, 17 C.F.R. § 166.3, which provides in part:

> Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by 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.

The objective of Regulation 166.3 is to protect customers from fraudulent or manipulative activities of Commission registrants. In re Paragon Futures Assoc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266, at 38,850 (CFTC April 1, 1992) (citing 43 Fed. Reg. 31,886, at 31,889 (July 24, 1978)). A broad supervisory system accomplishes the goals of both detection and deterrence of fraudulent activities by ensuring that employees of Commission registrants handle customer accounts and transactions in accordance with the Act. Id. Therefore, the touchstone of whether Tucker and AFG violated CFTC Regulation 166.3, 17 C.F.R. §166.3 is the determination of whether respondents adequately and diligently reviewed Cane's dealings with Modlin. In re Paragon Assoc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266, at 38,850 (CFTC April 1, 1992).

To establish a violation of Regulation 166.3 in a reparations proceeding, the complainant must first demonstrate either that (1) "respondent had knowledge of wrongdoing and failed to take reasonable steps to correct the problem," or [(2)] that "respondent failed to discharge specific responsibilities of supervision." Bunch v. First Commodity Corp. of Boston, [1990-

1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,352, at 39,169 (CFTC Aug. 5, 1992).[9] The complainant must then demonstrate that such failure to supervise proximately caused the suffered damages. Id.

Probative evidence exists to support that Tucker was aware, or should have been aware, that Cane fraudulently induced Modlin to open two separate accounts at AFG, with the second account opened on the basis of a ruse. Nevertheless, Tucker failed to intervene and remedy the problem.

Tucker did not "macro-manage" from afar. Rather, Tucker's supervisor duties involved continuous and daily contact with the brokers on the sales floor. Consequently, Tucker retained responsibility for the day-to-day activities (i.e. solicitations, opening and management of accounts, etc.) and compliance enforcement. Tucker stated that he was most familiar with Cane's handling of customer accounts and frequently listened to Cane and Modlin's conversations. By his own admission, Tucker testified that he had knowledge of how Cane portrayed his trading experience to prospective customers. The Court finds it illogical that Tucker would have very specific knowledge of Cane's activities throughout the workday, but would not have knowledge of the deceptive misrepresentations and schemes Cane used to induce Modlin.

Moreover, Tucker understood that Modlin possessed minimal knowledge about the commodity market and relied heavily on Cane's recommendations. Tucker was also cognizant of the heavy trading in Modlin's account and spoke with Modlin "a number of times." Furthermore, Tucker testified that he observed Modlin meet with Stark during his visit to New

[9] Accord In re Collins, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,981, at 44,747 n.114 (CFTC Mar. 5, 1997) (citation omitted) (noting that determination of whether a violation of CFTC Regulation 166.3 occurred involves evaluation of the Commission registrant's operative supervisory system and the supervisor's ability to perform relevant duties diligently).

York and was aware that thereafter, Modlin opened a second account at AFG.[10] In light of Modlin's inexperience, the Court finds that Tucker's failure simply to ask Modlin whether he was satisfied with Cane's handling of his account constitutes recklessness. The Court also concludes that Tucker's failure to investigate as to why Modlin, an unsophisticated investor, opened two commodity futures account at AFG is tantamount to willful ignorance.

Although not always necessary to support a claim under Regulation 166.3,[11] Modlin has already established that Respondent Cane committed flagrant forms of fraud and violated Section 4b of the Act, 7 U.S.C. § 6b. The Commission has stated that "proof of substantive violations may play a role in establishing a breach of Rule 166.3 if the violations at issue are the type that should be detected by a diligent system of supervision." In re First Nat'l Trading Corp., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,142, at 41,786 (CFTC July 20, 1994) (citation omitted).[12] The Court finds that the fraudulent activity in Modlin's accounts was so egregious that it would have been detected by diligent supervision. Nevertheless, Tucker failed to intervene to prevent the fraudulent activity in Modlin's accounts.

Probative evidence also demonstrates that but for Tucker's failure to supervise diligently and take remedial action, Modlin would have neither retained Cane nor opened and traded the two commodity futures accounts at AFG. Therefore, the Court finds both Tucker and AFG, individually and collectively, liable for Modlin's out-of-pocket loss of $74,308.32.

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[10] No party offered account-opening documents for the second account into evidence. The Court makes the adverse inference that Modlin never received nor signed account opening documents or risk disclosure statements for this second account.

[11] In "appropriate circumstances," it is not essential to establish an underlying violation of the Act to support a claim of failure to supervise. Proof by the complainant that the Commission registrant's supervisory system is inadequate may be sufficient by itself. In re First Nat'l Trading Corp., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,142, at 41,786 (CFTC July 20, 1994).

[12] See In re Paragon Assoc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266, at 38,850 (CFTC April 1, 1992) (proving a violation of the Act is probative evidence which supports a finding of failure to supervise).

III. Other Claims

Complainant Modlin also charges Respondent Cane with churning and breach of fiduciary duty in violation of Section 4b of the Act, 7 U.S.C. § 6b, and Respondents Tucker and AFG with aiding and abetting in violation of Section 13(a) of the Act, 7 U.S.C. § 13c(a).

The Court has found Respondent Cane liable for fraudulent inducement under Section 4b of the Act, 7 U.S.C. § 6b and Respondents Tucker and AFG liable for failure to supervise under CFTC Regulation 166.3, 17 C.F.R. § 166.3. Accordingly, Complainant is awarded monetary losses resulting from such violations. Therefore, the Court does not find it necessary to address the Complainant's claims of churning and breach of fiduciary duty.

CONCLUSIONS OF LAW

1. Complainant has established by the preponderance of the evidence that Respondent Cane deceived and fraudulently induced Modlin to open and continue to trade two commodity futures accounts in violation of Section 4b of the Act, 7 U.S.C. § 6b.
2. Complainant has established by the preponderance of the evidence that Respondents Tucker and AFG did not diligently supervise the handling by Cane of Modlin's commodity futures accounts in violation of CFTC Regulation 166.3, 17 C.F.R. § 166.3.

ORDER

Complainant sustained monetary damages totaling $74,308.32 by reason of Respondents' unlawful conduct. Accordingly, Respondents are ordered to pay $74,308.32 plus interest at the rate of 5.375% accruing from the date of Complainant Modlin's initial investment, August 22, 1995, plus the filing fee of $250 within 30 days of the date this decision becomes final. Respondents are jointly and severally liable for payment of this judgement.

Dated this 30th day of July, 1998

George H. Painter
Administrative Law Judge

Legal Intern: Nikita Malhotra