U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581

OFFICE OF PROCEEDINGS
FILED
Aug 13 1 39 PM '97

OFFICE OF PROCEEDINGS

CLARENCE P. ADAMS, Complainant, v. JOSEPH R. JAPELL, NORTHSTAR TRADING GROUP, and LFG LLC, Respondents.	*	CFTC Docket No. 96-R158

INITIAL DECISION

By complaint filed August 19, 1996, Adams alleges that Eduardo Henson Galvez, an associated person with Northstar Trading Group, defrauded him by making misrepresentations and omissions of material facts during the solicitation and trading of his account, and by churning his account.

Galvez did not file an answer, and by order dated October 28, 1996, was found in default. Respondents Japell, Northstar and LFG filed answers generally denying any violations and raising the statute of limitations affirmative defense.

The findings and conclusions below are based on the parties' documentary submissions. For the reasons set forth below it is concluded: that Adams' claim is not barred by the statute of limitations; that Galvez defrauded Adams during the account solicitation and throughout the life of the account by materially misrepresenting the profit potential of trading with Northstar and of specific trade recommendations, and by misrepresenting trade

results; that the proper measure of damages is the $23,559 in out-of-pocket losses; that Northstar is liable for Galvez's fraud pursuant to Section 2(a)(1)(A) of the Commodity Exchange Act; that LFG is liable as the guarantor of Northstar; and that Adams has failed to establish that Japell violated his duty to supervise Galvez.

Unless otherwise noted, amounts are rounded to the nearest dollar, and dates are in 1994.

Factual Findings

1. Adams is a 74-year-old retired San Francisco fireman, with no previous futures or options investment experience.

2. Northstar Trading Group is an introducing broker located in Pleasanton, California. At the relevant time, Northstar was guaranteed by Linnco Futures Group, Incorporated, which subsequently changed its name to LFG, LLC. Joseph Japell is the president of Northstar. According to Japell, he was responsible for monitoring Northstar solicitations. However, Japell has produced no evidence that he actually monitored or witnessed any of the conversations between Adams and Eduardo Henson Galvez, his account executive. [*See* Japell's replies to Adam's interrogatories 16 and 19.] Galvez was an associated person with Northstar from May 1990 to August 1995. Before that, Galvez had worked for a string of firms that have been sanctioned by the CFTC for widespread fraudulent sales practices: First Commodity Corporation of Boston, Chilmark Commodities, and Dunhill Investments.

3. Respondents have produced no evidence rebutting Adams'

showing that Galvez acted in a consistently fraudulent manner throughout the opening and the trading of the account. [*See* ¶¶ 9-11 of complaint, and ¶¶ 1-5 of Adams' final verified statement.] According to Adams, Galvez cold-called Adams in April of 1994. Galvez then made a series of deceptive statements and omissions that materially downplayed the risk of loss and overstated profits. For example, Galvez never mentioned the high risk of loss and claimed that he had a track record of successfully predicting price movements and that his other customers had been making large profits.[1/] Galvez also failed to provide a rudimentary explanation of the mechanics of trading options, and as a result, Adams incorrectly believed that the trades recommended by Galvez were for the actual physical commodities.

4. Adams would deposit a total of $23,592 ($5,000 on May 11, $4,510 on May 13, $11,000 on May 27, and $3,082 on June 13), and would receive a refund of $33 on July 13. Thus, his out-of-pocket losses totaled $23,559.

5. Throughout the life of the account, Adams received confirmation statements and monthly account statements that reported the trading activity in his account, including such information as the net premium paid or collected on a round-turn trade and the commissions paid when an option position was initiated.

1/ Respondents have not offered any evidence concerning the account performance of Galvez's Northstar customers, and in the absence of such proof, Galvez's claims are presumed to be false or without a reasonable basis.

6. Trading began with the purchase on May 11 of ten August gold options, and the purchase on May 12 of five July gold options. By the end of May, Adams had purchased additional unleaded gasoline and Treasury bond options, and had paid $5,200 in commissions.

7. Adams would pay another $3,900 in commissions in June ($2,600 on June 9, and $1,300 on June 17), for a total of $9,100, representing almost half of the funds invested by Adams. In these circumstances, the likelihood that Adams could have realized any net profits was extremely remote.

8. At first, the trading was nominally profitable, with the first four round-turn trades in June realizing an aggregate $3,463 in trading profits (*i.e.*, the net premiums collected). However, the $3,250 in commissions for these trades almost completely consumed the trading profits, leaving a mere $213 in aggregate net profits. According to Adams, Galvez grossly exaggerated the profits on these trades by orally reporting the gross profits rather than the net profits.

The remainder of the trades would all be losers; and by the end of July, the remaining open Treasury bond positions had lost over 90% of the value, with a liquidating value of $938.

9. The Treasury bond options, purchased for a total cost of $15,988 on June 9 and 17, expired worthless on August 22, 1994.[2/]

2/ Neither side produced any evidence concerning Galvez's communications with Adams between June 9 and August 22, 1994.

10. In August of 1995, Adams paid $4,000 to a California firm called Public Investors Arbitrations ("PIA") to attempt to recoup his losses. The PIA letterhead variously described its owner Louie Quijano as a "Legal Representative" and "The Last Crusader," with a Ph.D and an LL.D of unidentified provenance. On February 21, 1996, Quijano wrote a "Demand Letter" letter to LFG's attorney. Quijano's letter was a rambling, barely coherent, burlesque demand for payment of $100,000.[3/] [Respondents' discovery production, served January 15, 1997.] Not surprisingly, by letter dated April 10, 1996, Japell denied any violations and rejected the possibility of any settlement. [Exhibit B to the Amended complaint.]

11. Adams filed his complaint on August 19, 1996.[4/]

Conclusions

The statute of limitations set out in Section 14(a) of the Commodity Exchange Act requires that a reparations complaint be filed within two years after the cause of action accrues. When fraud is alleged, a cause of action "accrues" when a complainant knows, or should have known in the exercise of due diligence, that wrongful conduct has occurred resulting in monetary damages. The determination of when a cause of action accrues turns on when a customer discovers those facts enabling him to detect a general

---

3/ Adams' current attorney may wish to bring the activities of Quijano and PIA to the attention of the California state bar.

4/ Adams faxed a copy of the complaint after regular business hours on Friday, August 16, 1996; but did not perfect the filing of the complaint until Monday, August 19, 1994, when he express-delivered the check for the filing fee with the original of the complaint.

fraudulent scheme, rather than when the customer grasps the full details of the scheme or determines the available legal remedies.[5/] The record establishes that upon receipt of the confirmation statement dated August 22, 1994, the last options in the account had expired worthless. At this point, Adams knew that he had lost almost all of his investment, and the fraudulent nature of Galvez's promises of profits was thus apparent. Therefore, Adams's cause of action accrued no later than August 22, 1994. The date that Adams filed his complaint, August 19, 1996, is not past the two-year statute of limitations deadline, and thus the complaint is not time-barred.

Adams has established that Galvez, during the account solicitation and in connection with trade recommendations, made a series of false statements that materially downplayed the risk of loss and overstated profits in violation of CFTC rule 33.10 and Section 4c(b) of the Commodity Exchange Act. For example, Galvez failed to mention the high risk of loss and falsely claimed that he had a track record of successfully predicting price movements and that his other customers had been making large profits. Galvez also failed to provide a rudimentary explanation of the mechanics of trading options and exaggerated the profits on the initial

---

5/ *See, e.g., Cook v. Monex International, LTD.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. ¶22,532 (CFTC 1985), *reconsideration denied* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,078 (CFTC 1986); *Martin v. Shearson Lehman Brothers/American Express*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,354 (CFTC 1986); and *Marraccini v. Conti-Commodity Services, Inc.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,793 (CFTC 1986).

round-turn trades. The intentional nature of Galvez' fraud is underscored by, among other things, the blatant nature of his misrepresentations and omissions and his knowledge of Adams' limited investment inexperience.

Adams' receipt of a written risk disclosure does not relieve respondents of liability where Galvez made numerous material omissions and affirmative misrepresentations about risk and profit throughout the life of the account. Similarly, respondents cannot use Northstar's compliance review as an "advance exoneration of contemplated fraudulent conduct." *JCC, Incorporated v. Commodity Futures Trading Commission*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,492, at 43,217-43,218 (11th Cir. September 15, 1995).

The proper measure of damages for Galvez's fraud is Adams' out-of-pocket losses of $23,559. Northstar is liable for Galvez's fraud pursuant to Section 2(a)(1)(A) of the Commodity Exchange Act, and LFG is liable as guarantor of Northstar.

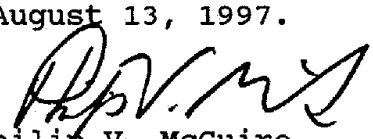
As to Adams' allegation that Japell failed to supervise adequately the activities of Galvez, the evidence produced -- Galvez's previous employment by notorious boiler room operations, Galvez's violations, and a generalized supervisory relationship -- is insufficient to establish a violation of CFTC rule 166.3. *See Lobb v. J.T. McKerr & Co.*, [1989-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,568 (CFTC 1989).

ORDER

LFG LLC, and Northstar Trading Group are ORDERED to pay to Clarence P. Adams reparations of $23,559, plus interest on that amount at 5.56%, compounded annually from May 11, 1994, to the date of payment, plus $50 in costs for the filing fee, and $268.89 in costs for Adams' reasonable expenses incurred in filing a motion to compel.[6/] Liability is joint and several.

No violations by Joseph Japell having been shown, the complaint against Joseph Japell is DISMISSED.

Dated August 13, 1997.



Philip V. McGuire,
Judgment Officer

6/ *See* Order dated August 5, 1997, and Adams' submission filed August 8, 1997.