

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

MARK A. FERRIOLA,

Complainant

v.

CFTC Docket No. 98-R114

TRANSAMERICA FIRST CORP.,
CARLO SCOTT KEARSE-MCNEIL,
and ALBERT GRAY,

Respondents.

Appearances:

For the complainant:

Mark S. Boyle, Esq.
Boyle & Leyhane, Ltd.,
9924 Walden Parkway
Chicago, Illinois 60643

For the respondents:

Lee O. Lubin, Esq.
Law Offices of Richard A. Leach
22900 Ventura Boulevard
Woodland Hills, California 91364

Before: Painter, ALJ

INITIAL DECISION

Mark A. Ferriola ("Ferriola") filed this complaint with the Commission on March 27, 1998 charging that respondents violated the Commodity Exchange Act in connection with the solicitation and handling of his account, and that the unlawful conduct of respondents resulted in direct money damages in excess of \$53,000. Ferriola requested a formal proceeding.

Respondents Carlo Scott Kearse-McNeill ("McNeill") and Albert Gray ("Gray") filed an answer on May 26, 1998 and denied any wrongdoing. McNeill and Gray also

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filed a purported counter-claim for costs and attorney fees. Respondent Transamerican First Corp. did not file an answer. Ferriola, through counsel, advised this court that a settlement had been reached with Transamerican, and by order issued July 13, 1998, the complaint as to Transamerican was dismissed. However, Transamerican failed to honor discovery requests served on it by respondents Gray and McNeill, and the dismissal as to Transamerican was vacated by order issued November 5, 1998. Post trial, counsel for Ferriola transmitted the Settlement and Release agreement to the Court, and it is concluded that judgment may not be issued against Transamerican.

The trial of this matter took place in Chicago, Illinois on February 16, 1999. Ferriola and McNeill were the only witnesses. Gray did not personally participate, but was represented by Lee O. Lubin, Esq.

FINDINGS OF FACT

1. Transamerican First Corp. was at relevant times registered with this Commission as an Introducing Broker, guaranteed by Vision L.P., a registered futures commission merchant. (Commission records; McNeill testimony Tr. 67-68) Vision L. P. was not a member of any designated futures exchange and presumably conducted its options business through an omnibus account with Lind-Waldock, a registered futures commission merchant. McNeill testified that it was his understanding that Lind-Waldock wrote the options sold to Ferriola. (Tr. 68) McNeill gave rather evasive testimony concerning ownership of Transamerican, but conceded that "I had some equity and acquired it." (Tr. 69)
2. McNeill was first registered with the Commission as an associated person with Transamerican in January 1995. (Commission records) McNeill is a high school graduate with no training in commodities other than preparation for Series 3 examination. (Tr. 82)
3. Ferriola had never traded futures or options prior to the time in question. In March 1996 he sold his business, Snap On Tools. Shortly thereafter he received a cold call from McNeill. Ferriola was surprised that a person in California would call him about investing money. (Tr. 13-15)
4. Ferriola told McNeill that he had \$20,000 to invest. (Tr. 15) McNeill assured Ferriola that he could make "tons of money" with Transamerican. (Tr. 19) However, in testimony McNeill denied saying that half his customers were money ahead on closing their accounts. (Tr. 93)
5. McNeill was unable to recall how many times he called Ferriola before Ferriola opened an account, but he was sure it was not ten times. (Tr. 77) On March 27, 1996 McNeill faxed to Ferriola the Vision L.P. customer agreement. Ferriola signed the hard-to-read fax copy where indicated, and faxed the signed document back to McNeill the following day, along with a copy of the \$20,000 check to open the account. The hard copy check was sent by Federal Express. (Tr. 19; Ex. A through D)

6. McNeill conceded that he asked for the check to be sent by facsimile in order to begin trading immediately. (Tr. 80)
7. The parties stipulated that each and every transaction on the account was recommended by McNeill with the exception of Ferriola's instructions to close out the account. (Tr. 29) McNeill admitted under oath that he managed the account. (Tr. 74)
8. On March 28, 1996, before Ferriola's check had been received, McNeill placed an order to buy 20 July unleaded gasoline call options. The premium cost was \$16,380 and commissions and fees amounted to \$3,301.00. Ferriola's account had a balance of only \$318.00 at the end of the day. (Ex. E) McNeill stressed urgency in getting into the gasoline market because it was a seasonal market. (Tr. 89-90) This court finds that McNeill claimed urgency in order to pressure Ferriola to get his money in quickly.
9. On March 29, 1996 McNeill purchased 21 July soybean call options for Ferriola's account, generating commissions of \$3,360. The purchase of the soybean options resulted in a debit balance in the account. (Ex. D) Ferriola agreed to send in a second \$20,000 check to cover the deficit, and he did so on April 1, 1996. (Tr. 25)
10. On April 8, 1996 McNeill sold 15 July soybean calls, and 15 July unleaded gas calls. At the close on April 8, Ferriola's account had a liquidating value of \$56,840. (Ex. E)
11. On April 9, 1996 McNeill purchased 20 July wheat call options, 4 June 96 T-bond calls and 20 July 96 sugar calls. Commissions and fees generated on April 9, 1996 exceeded \$7,000. (Ex. E)
12. On April 11, 1996 McNeill represented that Ferriola could double his money. (Tr. 32) Ferriola deposited an additional \$20,000, bringing his out-of-pocket investment to \$60,000. (Ex. E) On that very day McNeill racked up commissions and fees in excess of \$5,000. This court concludes that these trades were made solely for the benefit of the respondents.
13. McNeill continued to trade the account and generate commissions. On May 7, 1996 trading resulted in a debit balance of \$19,797. Both Gray and McNeill urged Ferriola to borrow the money to place his account in order.
14. McNeill testified that he recommended and purchased deep-out-of-the-money options for the Ferriola account to get lower premiums. He acknowledged that he told Ferriola "...the closer to the money you go the more you have to pay in premium so the less contracts you get..." (Tr. 91) As a matter of fact the commissions charged were the same for "cheap" and "in the money" options. This court finds that McNeill was interested in commissions, not profits for Ferriola, in making his trading decisions.
15. Account statements of record show that Ferriola deposited \$80,000 in the account at issue. Commissions generated by McNeill totaled \$56,800. The first transaction on

the account occurred on March 28, 1996, even before Ferriola had a deposit in his account. The last took place on July 8, 1996. In slightly more than three months, McNeill converted more than half the total investment into commissions. On liquidating all positions and closing the account, Ferriola receive back \$26,880.95.

16. Post trial, counsel for Ferriola filed with this Court the agreement to dismiss Transamerican from the proceeding in exchange for payment of \$6,500.

17. Transamerican was guaranteed by Vision L.P., a non-party. Under the terms of the guarantee agreement (CFTC Form 1-FR-IB [Part B] Comm. Fut. L. Rep. (CCH) paragraph 3503) Vision L.P. is liable for any judgment rendered against Transamerican or its agents and in favor of a customer.

DISCUSSION

Ferriola was induced to open and trade a commodity account with Transamerican First and Vision L. P. by reason of a cold call from McNeill. In this cold call, McNeill emphasized only the profits be made, not losses. He stressed the urgency of getting into the market immediately and placed the first series of trades on the account without any money in the account. To justify the urgency, he testified that it was the driving season, a good time to invest in gasoline. McNeill faxed the Vision account opening documents to Ferriola, and Ferriola faxed the executed copies back to McNeill, along with a facsimile of his account opening check. McNeil was stressing urgency as he did not want Ferriola to change his mind.

McNeill boasted that he primarily purchased deep-out-of-the-money options for Ferriola's account as this provided more "leverage." In truth, the commission on options is the same, whether in-the-money or deep-out-of-the-money. Thus, by purchasing the "cheap" options, often referred to as dime options, McNeill was able to generate huge commissions. Nothing in the evidentiary record suggests that McNeill had any significant insight or expertise in trading commodity options. But the record does show that he is an expert at churning accounts. In three months, he generated over \$56,000 in commissions, a commission-to-equity ratio of more than 21% per month.

McNeill's own testimony proves conclusively that he fraudulently induced Ferriola to open and trade an account with Vision L.P. He led Ferriola to believe that he had a reasonable expectation of making a large return on his investment. Yet, as a witness he virtually conceded that most clients lost money on closing accounts. The record in this case does not show that McNeill used any rational plan in trading Ferriola's account. Initially, he went into gasoline contracts, as it was the driving season. He then went into soybeans, sugar, Swiss francs, wheat, T-bonds, D-marks, and S & P options. By using every available dollar in the account to buy options, McNeill managed to convert nearly 70% of the entire investment into commissions in three short months.

There are other interesting nuances in this case. Ferriola was never told that the account would be traded by Lind-Waldock because Vision was not a member of any exchange. Vision is the only futures commission merchant that carried an account in the name of Ferriola. Vision trades through Lind-Waldock were, no doubt, traded through an omnibus account. Before Ferriola could expect to make any money, Vision L.P, Lind-Waldock, Transamerican First Corp., and McNeill had to be paid. McNeill testified that he took it for granted that Lind-Waldock wrote the options purchased for Ferriola's account. Exchange traded options should be traded competitively on the floor of the exchange. If, in fact, the options purchased for Ferriola were written by Lind-Waldock there would be a problem. McNeill is not a credible witness, and more likely than not he simply does not understand the mechanics of options trading.

There is little or no probative evidence in this record to support Ferriola's claim that he suffered damages by reason of wrongdoing on the part of Gray. It was not until the account was in deficit that Gray allegedly urged Ferriola to borrow money on his house and continue trading. In point of fact, the last \$20,000 deposited in the account was not for trading, but rather to eliminate the deficit.

This Commission has laid down the various indicia of churning, including the following: a) *de facto* control over the account; b) trading the account while under margined; c) trading the account solely to generate commissions; d) generating commission-to-equity ratios of 18% or more per month. In the case at bar McNeill conceded that he made every recommendation, and in fact managed the account. Clearly, McNeill traded the account while under margined, commencing with trades made before any money was deposited. The strategy McNeill followed was to purchase low premium, deep-out-of-the-money options as this generated more commissions than options in the money or even near the money. And, most significantly, the commission-to-ratio far exceeds 20% per month.

Damage awards in a churning case are based on the commissions generated rather than out-of-pocket losses. In the case at bar, commissions totaled \$56,800. Complainant settled with Transamerican for \$6,500, and the award will be reduced by that amount. Complainant is entitled to receive from respondent McNeill the sum of \$56,800, minus the \$6,500 paid by Transamerican, plus the \$200 filing fee, plus interest from April 1996 to the date of payment.

ORDER

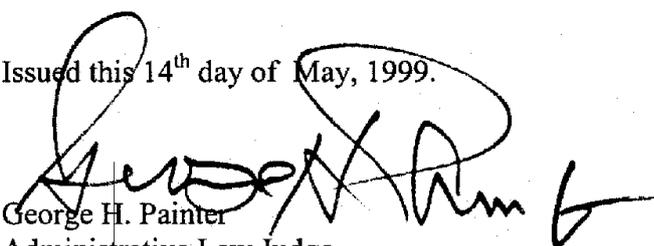
Complainant has failed to prove by a preponderance of the evidence that he suffered monetary damages by reason of wrongdoing on the part of Albert Gray. The complaint against Gray is DISMISSED.

Complainant settled his claim against Transamerican in return for payment of \$6,500. The release precludes an award against Transamerican.

The purported counterclaim filed by respondents Gray and Neill does not conform to Commission regulation 12.19, 17 C.F.R. 12.19, and it is hereby DISMISSED.

Complainant has established by the preponderance of the evidence that respondent Carlo Scott Kears-McNeill violated section 4b of the Act as described in the findings above, causing monetary damages to complainant in the amount of \$50,500 (\$56,800 less \$6,500 plus \$200) plus interest at the rate of 4.727% from April 1996 to the date of payment. Carlo Scott Kears-McNeill is **ORDERED** to pay this sum to complainant on or before the date this initial decision becomes final.

Issued this 14th day of May, 1999.


George H. Painter
Administrative Law Judge