



U.S. COMMODITY FUTURES TRADING COMMISSION

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PEJMAN HAMIDI, and
SHAHRYAR MASOUEM,
Complainants,

v.

WILLIAM MALCOMB COATES, Jr., and
AMERICAN FUTURES GROUP, INC.,
Respondents.

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* CFTC Docket No. 96-R168
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INITIAL DECISION

Complainants' principal allegation is that Coates churned their account. They also allege that Coates made an unauthorized trade, and made false and deceptive statements during the account solicitation. Coates strongly denies the allegations.

The findings and conclusions below are based on the parties' documentary submissions and oral testimony, and reflect my determination that Coates' testimony was generally more credible and plausible. All dates are in 1996, and amounts are rounded to the nearest dollar.

Factual Findings

The Parties:

1. William Coates was the branch manager of American Futures Group's Irvine, California branch office,^{1/} and acted as

^{1/} American Futures Group's registration as a futures commission merchant has been suspended by the CFTC, *In re American Futures Group, Inc., et al.*, Notice (CFTC Docket No. 95-15, Aug. 20, 1997);
(continued...)

complainants' account executive. [Page 14, Hearing Transcript.]

2. Pejman Hamidi, a resident of Irvine, California, for 15 years, opened a joint account with Shahyar Masouem on May 20, 1996. At that time, Hamidi was 22 years old, had obtained a Series 7 license to deal stocks and mutual funds, had four years' experience trading stocks and one-and-one-half years' experience trading stock options, and understood the basic mechanics of trading options. In addition, Hamidi regularly read the *Wall Street Journal* and *Business Week*, and regularly viewed CNBC. With that background, despite Hamidi's relative youth and lack of experience with commodity futures or options, he could not be considered an unsophisticated investor. At the time of the hearing, Hamidi was attending his second year of college. [Pages 6-10, and 55-56 of Hearing Transcript.]

At the time of the account opening, Shahyar Masouem, a resident of Irvine for 12 years, was 24 years old, had a bachelor of science degree in ecology, and had limited investment experience. [Pages 12-14, Hearing Transcript.]

Neither side presented particularly compelling testimony regarding Hamidi's and Masouem's financial status. Hamidi and Masouem represented on the account application that each had an annual income between \$50,000 and \$75,000, and a net worth between

¹/ (...continued)
and its membership has been suspended by the NFA, *In re American Futures Group, Inc.*, Notice and Order of Suspension (NFA Case No. 97-AWD-22, Jan. 9, 1997). See also *In re American Futures Group, Inc., et al.*, Decision (NFA Case No. 95-BCC-15, Mar. 24, 1997) (expelling AFG from NFA membership), appeal pending.

\$50,000 and \$100,000. Complainants assert that they vastly exaggerated these figures at Coates' instigation, and that they had to borrow money from a friend to open the account. However, they have produced no reliable evidence establishing their true actual incomes and net worths, and thus have failed to show that the information they put in the application was inaccurate. In contrast, Coates testified that Hamidi and Masouem held themselves out as young men with access to considerable sums of money, and that he did not suggest or urge them to supply erroneous information. I have credited Coates' testimony on this matter. [See pages 19-20, and 34-37 of hearing transcript.]

The Account Opening and the Initial Trading Strategy

3. In May of 1996, Hamidi and Masouem believed that the price of crude oil was about to drop. They based this belief on a CNBC news broadcast anticipating a United Nations decision to permit Iraq to renew oil exports, on discussions with their relatives in Iran, and on a non-AFG television advertisement. Complainants simply picked AFG out of the "Commodities" section of the local business telephone directory, and arranged a meeting with Coates at the AFG offices on May 20, 1996.

Complainants explained to Coates that they expected the United Nations to permit Iraq to increase the crude oil supply and thus drive down the price. Coates thought that complainants' assumption was reasonable, but told them that the U.N. announcement was scheduled for later that day, and that if Hamidi and Masouem intended to take advantage of the market's reaction to that

particular event, they obviously had to act quickly by opening the account and purchasing the appropriate options. Complainants concurred, reviewed and signed the various account-opening documents, and promised to bring in a check the next day to cover the option purchase. Notwithstanding these hurried circumstances, complainants understood that they could lose their entire investment.

Coates advised complainants that the nearest unleaded gasoline contract -- the July contract which expired June 21 -- would be the most sensitive to the United Nations announcement, and thus the most appropriate to implement complainants' short-term strategy. Hamidi initially insisted that they buy puts with 62 or 63 cent strike prices, because he believed that gasoline was trading between 65 and 66. However, Coates checked his screen and told them that it was currently trading lower, and thus recommended that Hamidi purchase puts with a 59 strike price. Hamidi and Masouem then authorized the purchase of 18 July unleaded gasoline puts with a 59-cent strike price. The total cost of the options was \$9,072, including about \$1,500 in commissions. [Page 1 of complaint; second page of answer; pages 9-11, 18-21, 23-29, 34-36, 41-43 of hearing transcript.]

4. Complainants assert that Coates made a variety of false statements to lure them into opening the account. First, they assert that he claimed that he had been a government witness against Ken White and Jack Carl. However, Coates convincingly denied this assertion and testified that it would have been

ludicrous for him to testify against the firm (Jack Carl) that cleared AFG's trades or against a man (Ken White) of whom neither he nor complainants had ever heard. Second, complainants assert that Coates touted the fact that AFG was the only futures commission merchant in southern California and could more efficiently execute orders than an independent introducing broker. However, complainants produced no evidence that AFG was not the only FCM operating branches in southern California or that these statements were materially misleading. Finally, complainants assert that Coates showed them charts showing profitable trading by his clients. However, complainants never sought production of these charts or described them in sufficient detail to establish that they were misleading about Coates' expertise or performance. In contrast, Coates credibly testified that the charts showed profitable and unprofitable trading and reflected actual, and representative, trading results in a variety of markets, none of which involved petroleum products. [Pages 15-17, 22-28, 34-39, 54-56 of hearing transcript.]

Trading Activity

5. On May 21, complainants deposited a total of \$9,000, all of which they ultimately lost. During the life of the account, complainants would pay a total of \$7,019 in commissions and fees.^{2/} For the option trades, the over-all commission-to-

^{2/} This calculation includes \$879 in commission credits, which AFG assessed Coates' branch office to cover the debit balance.

premium-paid ratio was 23%.^{3/}

Set out below is a summary of trading in complainants' account:

<u>In</u>	<u>Out</u>	<u>Description</u>	<u>Net Premium Collected or (Paid)</u>	<u>Commissions</u>
5-20	5-30	18 Jul. gas. 59¢ puts	\$2,646	\$(1,502)
5-30	6-04	10 Jul. crude 20¢ calls	1,600	(842)
5-31	6-12	10 Jul. corn spread	90	(1,681)
6-04	6-05	13 Jul. gas. 59¢ puts	2,184	(1,093)
6-05	6-06	10 Aug. crude 19¢ puts	900	(591)
6-07	6-17	17 Aug. crude 18¢/19¢ put spread	(4,550)	(1,700)
6-10	6-10	5 Jul. copper futures	(2,688)	(276)
6-12	6-12	5 Jul. copper futures	(1,850)	(276)

Control of Trading Activity

6. Both sides agree that Coates consulted with complainants before initiating each trade, with the exception of the crude oil trade on June 5, which complainants claim was unauthorized, and the liquidation on June 17, which was done pursuant to a power of attorney signed by complainants on June 12. [See pages 45-46, and 126-139 of hearing transcript.] Coates credibly testified that for all of the trades Hamidi first brought up information he had read or heard about the particular market and Coates then suggested a trade designed to capture a profit on the price move expected by

^{3/} For spreads, the premium paid calculation was based on the net premium paid when the spread was initiated.

Hamidi. [See pages 50-67, 86-88, 113-114, and 115 of hearing transcript.] Complainants assert that they felt "uncomfortable" and "reluctant" in connection with Coates' recommended spread transactions, because they found the spread strategy complicated. However, complainants never informed Coates about any discomfort, reluctance or inability to understand the spreads. [See pages 52-54, 60, 75-77, and 106-108 of hearing transcript.]

7. Both sides also agree that Coates spoke to complainants every day, sometimes twice a day, at least until June 17. Typically, both complainants would be present for meetings at Coates' office, but Hamidi sometimes spoke alone with Coates over the phone. Masouem received the confirmation and monthly account statements and the margin call notices, and regularly consulted with Hamidi. [Page 30 of hearing transcript.] Hamidi was not reviewing the account statements, but complainants do not allege, and have produced no evidence, that Coates was aware of this. [See pages 15, 29-34, 46-49, 57-59, 62, 65-68 of hearing transcript.] Neither complainant informed Coates of any difficulty understanding the account statements. [See pages 31-32, 46, 59, 65-68.]

Deficit Trading and Margin Calls

8. Four of the eight trades were initiated on dates when the account had a debit or zero opening cash balance: May 20 (\$0); June 4 (\$741); June 5 (\$648); and June 12 (\$3,482). And seven of the eight trades resulted in a debit closing cash balance: May 20 (\$9,073); May 31 (\$741); June 4 (\$640); June 5 (\$141); June 7

(\$519); and June 10 (\$3,482); and June 12 (\$2,096).^{4/} However, with the exception of the very first day, the account always had a positive liquidation value in support of its open option positions.

Coates credibly testified that for each trade he had slightly overspent the account after Hamidi had instructed Coates to commit as much of the funds as possible and had promised to cover any deficit. [See pages 29-34, 86-89 of hearing transcript.] Also, Hamidi testified that Coates accurately reported the net profit or loss for each completed trade, and Masouem testified that he could ascertain the account balance from the account statements. In these circumstances, Hamidi's assertions that Coates had concealed or obscured the existence of debit balances on various dates -- by failing to report the debit balances, by failing to estimate the purchase costs for the trades, or by failing to report the fill costs for the trades -- were not credible. [See pages 49, 74-77, 92, 104-114 of hearing transcript.]

Change in Trading Strategy

9. The initial trade implementing complainants' strategy based on the U.N. announcement was completed ten days later, on May

^{4/} As a result of the resulting cash deficits, AFG issued a series of margin calls, which complainants were never forced to meet until the last trade in the account. Coates' testimony that he never advised complainants to ignore the margin call notices has been credited in part because he "was on the hook" for any deficit, and is supported by the fact that AFG ultimately charged complainants' deficit to Coates' branch office. See pages 88-89 of hearing transcript. Coates has not counterclaimed for the debit balance.

30. On May 20, the U.N. had made the widely expected announcement that it was allowing Iraq to resume oil exports. Although the market did not react as dramatically as expected by Hamidi, Masouem and Coates, the value of the gasoline puts did gradually increase between May 20 and May 30. During this time, Coates spoke every day with Hamidi and Masouem. On May 30, Coates advised complainants to sell the gasoline puts, because he thought that they had peaked. Hamidi authorized the sale of the gasoline puts, and realized a net profit of approximately \$1,230.^{5/} [Pages 45-49 of the hearing transcript.]

Coates then suggested that complainants speculate in short-term price swings in other markets, using a short-term trading strategy.^{6/} At this point, Complainants were apprehensive, partly because their initial strategy of speculating on the United Nations announcement had already played out, but they decided to continue following Coates' advice because he had successfully implemented that strategy. Hamidi then authorized the purchase of crude oil calls. [See pages 49-59, 63-64 and 86 of hearing transcript.]

10. The initiation of the corn spread on May 31, resulted in a \$751 debit balance and a margin call notice. According to complainants, Coates had failed to disclose the existence of the

^{5/} The 59-cent puts had been bought at \$1.00, and were sold at \$1.35.

^{6/} The remainder of the trades recommended by Coates were consistent with this short-term strategy, involving either July or August contracts, and the five options trades held open for an average of 4.8 days, and two futures day trades.

cash deficit, and thereafter on June 4, advised them to sell the 20-cent crude oil calls merely to satisfy the margin call, and not for the reason he stated: that "their profit had maxed out." However, Coates convincingly testified that Hamidi had asked to commit as much of the account equity as possible for this trade, and assured Coates that he would deposit additional funds if the account was slightly overspent, as Coates had warned might happen. Moreover, the price history of the 20-cent crude oil call establishes that Coates was correct about the crude contract maxing out because it in fact did hit an interim high of 61 points on June 4 -- coincidentally the sale price for complainants' options -- and then dropped and mostly traded below the purchase price until the expiration date.^{7/} [See pages 71-82, and 85-89 of hearing transcript.]

Complainants' also claim that Coates misrepresented the estimated profit on this trade. According to complainants, Coates promised a "nice profit, somewhere in the neighborhood of \$900, [but that] the profit received was nowhere near [that] figure." However, the account statements establish that complainants collected a net premium of \$1,600, and realized a net profit of \$758, just \$142 under, or about 15.5% off, Coates' estimate.

In-and-Out Trading

11. Two sets of trades involved apparent in-and-out trading, i.e., the sale and re-purchase of the same contract in a short time

^{7/} Official notice is hereby taken of the price history which the undersigned obtained from the CFTC Division of Economic Analysis.

span. The first set of apparent in-and-out trades involved the sale of the 59-cent July unleaded gasoline call on May 30, and the re-purchase of the same call on June 4. The second set of apparent in-and-out trades involved the sale of the 19-cent August crude oil put on June 6, and the re-purchase of the same put the next day as part of a spread transaction. However, upon closer inspection, it is clear that neither of these trades were made to generate commissions.

For the first 59-cent gasoline put trade, the complainants bought the puts at 100 points on May 20; sold the puts at 135 points on May 30, for a 35-point profit; collected a total net premium of \$2,646; and paid \$1,416 in commissions. For the second 59-cent gasoline put trade, the complainants: bought the puts at 90 points on June 4; sold the puts at 130 points on June 5, for a 40-point profit; collected a total net premium of \$2,184; and paid \$1,093 in commissions. For these gasoline trades: complainants made an aggregate 75-point profit; collected an aggregate net premium of \$4,830; paid an aggregate total of \$2,509 in commissions; and thus realized an aggregate net profit of \$2,321. Complainants realized significantly better results with this active short-term trading, than if they had held the position straight through from May 20 to June 5. If complainants had merely held the initial 18 contracts from May 20 to June 5 (buying at 100 points and selling at 130 points), complainants would have made a single 30-point profit, rather than an aggregate 74-point profit; would have collected a total net premium of \$2,268, rather than an

aggregate net premium of \$4,830; would have paid just \$1,416 in commissions, rather than \$2,509 in commissions; and thus would have realized a hypothetical net profit of \$1,252, rather than the aggregate net profit of \$2,321. In other words, while Coates' recommendation to exit and then re-enter the same market generated an additional \$1,093 in commissions compared to this hypothetical trade, it also generated an additional \$1,061 in net profits for complainants.

For the first 19-cent crude oil put trade, the complainants bought the puts at 60 points on June 5, and sold the puts at 69 points on June 6 (for a 9-point profit). Although the second 19-cent crude oil put was initiated the next day, it cannot be fairly characterized as a fraudulent in-and-out trade, because it was initiated after a dip in the market, at 49 points.

Copper Day Trades

12. The last two trades were day trades in the copper futures contract. Hamidi's testimony about the copper trades was undermined by inconsistencies, especially where he inexplicably reversed his testimony about whether Coates had discussed using a \$2,500 loss limit. [Compare testimony at page 119, to testimony at page 124 of hearing transcript.] In contrast, Coates' testimony was more consistent, and he credibly testified that the copper trades were Hamidi's idea. [See pages 114-134 of hearing transcript.]

Allegedly Unauthorized Trade

13. Complainants claim that the purchase of ten 19-cent August crude oil puts on June 5 was unauthorized.^{8/} However, in light of the fact that complainants failed to protest this trade and continued to trade with Coates, and considering that Coates gave credible testimony explaining this trade, the unauthorized trading claim is unconvincing. [Pages 93-101 hearing transcript.]

Conclusions

To prove churning, complainants must show (1) that Coates controlled the level and frequency of trading, (2) that the overall level of trading was excessive in light of their trading objectives, and (3) that Coates acted with intent to defraud or in reckless disregard of their interests. See *Hinch v. Commonwealth Financial Group, Inc.,* [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,056 (CFTC 1997). Here, the only trade executed pursuant to the power of attorney was the final closing trade. Thus, complainants must show that Coates had *de facto* control over the trading activity. The Commission has identified the following factors tending to show *de facto* control: (1) a lack of customer sophistication; (2) a lack of prior commodity trading experience by the customer and a minimum of time devoted by the customer to the trading in the account; (3) a high degree of trust and confidence reposed in the broker by the customer; (4) a large percentage of transactions entered into based on the recommendation

^{8/} This trade, offset the next day, generated \$592 in commissions and \$308 in net profits.

of the broker; (5) an absence of prior customer approval for transactions entered into on his behalf; and (6) a customer's approval based on advice that is not full, truthful and accurate. *Id.* Here, the weight of the evidence does not establish that, by their conduct, complainants surrendered to Coates the effective control of the level and frequency of trading in their account. Although Masouem and Hamidi were both young and without any prior commodity experience, both are intelligent and well-read. Hamidi had obtained a Series 7 license, had four years experience trading stocks and one-and-a half years experience trading stock options, and understood the basic mechanics of trading options. Masouem and especially Hamidi devoted a substantial amount of their time to the account, either visiting Coates office or speaking to him every day or even twice a day. While Hamidi relied on Coates to select specific contracts and to monitor open positions, complainants suggested the markets in which they wished to speculate and failed to show that the Coates' responsive advice was incomplete, deceptive or inaccurate. In these circumstances, complainants have failed to establish that Coates controlled the trading, and thus their churning claim must fail.

Finally, complainants have failed to establish that Coates made any unauthorized trades or that he otherwise defrauded them during the opening of the account.

ORDER

No violations having been shown, the complaint in this matter is DISMISSED.

Dated February 26, 1998.

A handwritten signature in cursive script, appearing to read "Philip V. McGuire".

Philip V. McGuire,
Judgment Officer