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

NEAL and MARY WEBSTER,

Complainants,

v.

JOHN JOSEPH AIELLO, JOHN FREDERICK MILES, DEARBORN CAPITAL MANAGEMENT LTD., and REFCO, INC.,

Respondents.

CFTC Docket No. 98-R005

LAWRENCE L. SOMMERFELD,

Complainant,

v.

JOHN JOSEPH AIELLO, DEARBORN CAPITAL MANAGEMENT LTD., and REFCO, INC.,

Respondents.

CFTC Docket No. 98-R009

DAVID L.M. KRUBINSKI, Individually, and as General Partner of K-R Partnership

Complainant,

v.

JOHN JOSEPH AIELLO, DEARBORN CAPITAL MANAGEMENT LTD., and REFCO, INC.,

Respondents.

CFTC Docket No. 98-R010

HANS and LISA SCHNEIDER, Complainants, v. JOHN JOSEPH AIELLO, JOHN FREDERICK MILES, DEARBORN CAPITAL MANAGEMENT LTD., and REFCO, INC., Respondents.	CFTC Docket No. 98-R075

INITIAL DECISION

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Before: Bruce C. Levine
Administrative Law Judge

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Overview

Q. "Did you ever talk to Judy Johnson about the lawsuits."

A. "I – I believe I did."

Q. "And did you contact Judy Johnson before the lawsuit was filed to see if she might be interested in joining it?"

A. "Uh-huh."

Q. "Yes?"

A. "Yes."

Q. "And did you tell her why you and the others were suing Refco?"

A. "Yes."

Q. "And weren't your words that 'We're suing Refco because they have deep pockets?'"

A. "I – that was one of the – one of the things that I was told."[1]

This consolidated proceeding involves a former floor trader, the investment club he created and his dream of a nation-wide chain of clubs. The dream shattered, however, as its members

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[1] Transcript of Oral Hearing, May 18, 1998 through May 22, 1998 ("Tr."), at 181-82 (colloquy between respondents' counsel and Debra Michel, complainants' witness and a complainant in the pending reparations case Michel v. Refco, Inc., CFTC Docket Number 98-R012, allegedly arising from the same core facts and employing the same counsel as complainants in this proceeding); see id. at 626-27 ("[Debra Michel] said, well, I've been told Refco has deep pockets. They'll pay. Exact words").

suffered trading losses and the losses, in turn, led to recriminations, skullduggery, litigation, the Bull's and Bears Club's insolvency and the inevitable search for deep pockets. Complainants seek to hold respondents vicariously liable for misrepresentations alleged to have been made by the Bulls and Bears Club and the Club's failure to register as an introducing broker ("IB"). In addition, they seek recovery from respondents based on respondents' failure to provide required risk disclosure and alleged unauthorized trading.

In an oral hearing, complainants succeeded in proving that one director of the Bulls and Bears Club, Stanley Rhea, made representations about the risks of selling options on futures that were most likely false. However, they did not establish that respondents should be held vicariously liable for this fraud. Likewise, complainants proved that respondents Refco, Incorporated and Dearborn Capital Management, Limited violated the regulations that require them to furnish risk disclosure statements. However, complainants failed to prove that these technical violations caused their losses. In addition, complainants failed to prove that the Bulls and Bears Club was required to register as an IB or that respondents engaged in unauthorized trading. For these reasons, set out in detail below, the Court **FINDS** that complainants are not entitled to recovery in reparations and **DISMISSES** their complaints.

Procedural History

Neal and Mary Webster ("the Websters"), Lawrence Sommerfeld ("Sommerfeld") and David L. M. Krubinski ("Krubinski") filed complaints in reparations on the same day, October 14, 1997.[2]

[2] Reparations Complaint, CFTC Docket No. 98-R005, dated October 1, 1997 ("Webster Complaint"); Reparations Complaint, CFTC Docket No. 98-R009, dated October 7, 1997 ("Sommerfeld Complaint"); Reparations Complaint, CFTC Docket No. 98-R010, dated October 6, 1997 ("Krubinski Complaint"). The Websters named the following respondents in their complaint: John Aiello ("Aiello"), John Frederick Miles ("Miles"), Tone N. Grant ("Grant"), Dearborn Capital Management, Limited ("Dearborn"), and Refco, Incorporated ("Refco"). Webster Complaint. The Director of the Office of Proceedings ("Director of Proceedings") found that the Websters' complaint did "not show how Mr. Tone M. Grant, caused, or . . . [was] responsible for, their damages." Letter from Director of Proceedings to Joseph P. Pfingst, Esquire, CFTC Docket No. 98-R005, dated October 23, 1997. Accordingly, the Office of Proceedings did not forward the Webster Complaint as to Grant. Id. Sommerfeld also named Aiello, Miles, Grant, Dearborn, and Refco in his complaint. Sommerfeld Complaint. The Office of Proceedings did not forward the Sommerfeld Complaint as to Grant and, after a motion for reconsideration, also decided that the it should not proceed against Miles. Memorandum from Director of Proceedings, CFTC Docket No. 98-R009, dated December 2, 1997; Motion to Reconsider Determination to Forward Complaint Against Dearborn Capital Management, Ltd., John Aiello and John Frederick Miles, CFTC Docket No. 98-R009, dated November 24, 1997; Letter from Director of Proceedings to Joseph P. Pfingst, Esquire, CFTC Docket No. 98-R009, dated October 23, 1997. Like the Websters and Sommerfeld, Krubinski named Aiello, Miles, Grant, Dearborn, and Refco in his complaint. Krubinski Complaint. And, like the earlier cases, the Director of Proceedings decided not to forward the Krubinski Complaint as to Grant and, upon reconsideration, dropped Miles from the case as well. Memorandum from Director of Proceedings, CFTC Docket No. 98-R010, dated December 2, 1997; Motion to Reconsider Determination to Forward Complaint Against Dearborn Capital Management, Ltd., John Aiello and John Frederick Miles, CFTC Docket No. 98-R010, dated November 24, 1997; Letter

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Hans and Lisa Schneider ("the Schneiders") filed a reparations complaint on January 30, 1998.[3] These complaints charge respondents Aiello, Miles, Refco and Dearborn with vicarious liability for the alleged fraud of certain individuals involved in the Bulls and Bears Club ("the Club") based on a claim of agency.[4] In addition, they also allege that respondents: (1) fraudulently induced their trading, (2) engaged in recklessly unsuitable trading, (3) engaged in unauthorized trading, (4) failed to comply with Rules 1.55, 32.4 and 33.7,[5] (5) violated their fiduciary duties, (6) associated with unregistered associated persons ("APs"), (7) aided and abetted the Club's failure to register as a commodity trading advisor ("CTA"), (8) aided and abetted the Club's failure to register as an IB, and

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from Director of Proceedings to Joseph P. Pfingst, Esquire, CFTC Docket No. 98-R010, dated October 23, 1997.

[3] Reparations Complaint, CFTC Docket No. 98-R075, dated January 21, 1998 ("Schneider Complaint"). Based on their attorney's experience, the Schneiders did not name Grant in their Complaint. Rather, they complained against Aiello, Miles, Dearborn and Refco. Id. The Office of Proceedings decided to forward the Schneider Complaint as to all four. Notice and Order, CFTC Docket No. 98-R075, dated March 18, 1998.

[4] Webster Complaint at 3; Sommerfeld Complaint at 3; Krubinski Complaint at 3; Schneider Complaint at 3.

[5] See 17 C.F.R. §§1.55, 32.4 and 33.7.

(9) aided and abetted frauds within the Club.[6] The Websters claimed damages of $150,996.41,[7] Sommerfeld claimed $73,581.54 in damages,[8] Krubinski sued for $73,296.36,[9] and the Schneiders claimed damages of $346,088.12.[10]

Respondents filed timely answers, denying the allegations.[11] The parties engaged in discovery and respondents filed a joint prehearing memorandum.[12] From May 18, 1998 through May 22, 1998, the Court, with the consent of all parties, presided over a consolidated hearing in San Diego, California and Palm Desert,

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[6] Webster Complaint at 3-4; Sommerfeld Complaint at 3-4; Krubinski Complaint at 3-4; Schneider Complaint at 3-4.

[7] Webster Complaint at 13.

[8] Sommerfeld Complaint at 12.

[9] Krubinski Complaint at 15.

[10] Schneider Complaint at 14.

[11] Answer of Refco, Inc., Dearborn Capital Management, Ltd., John Aiello and John Frederick Miles, CFTC Docket No. 98-R005, dated November 24, 1997; Answer of Refco, Inc., Dearborn Capital Management, Ltd., John Aiello and John Frederick Miles, CFTC Docket No. 98-R009, dated November 24, 1997; Answer of Refco, Inc., Dearborn Capital Management, Ltd., John Aiello and John Frederick Miles, CFTC Docket No. 98-R010, dated November 24, 1997; Answer of Refco, Inc., Dearborn Capital Management, Ltd., John Aiello and John Frederick Miles, CFTC Docket No. 98-R075, dated March 9, 1998. As noted above, the Sommerfelds and Krubinski named Miles as a respondent and, at a time after answers were filed, the Director of Proceedings dropped Miles from their respective cases.

[12] Respondents' Prehearing Memorandum, dated April 21, 1998.

California.[13] Following the hearing, the parties filed briefs and post-hearing motions.[14]

Between the time they filed their complaints and when they filed their joint, post-hearing brief, complainants simplified the case by abandoning most of their claims.[15] In their post-hearing brief, complainants maintained two theories of fraudulent inducement. They argue that respondents induced their trading

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[13] Due to the recent illness of Sommerfeld, the Court heard his testimony at his residence on May 22, 1998. Tr. at 1015-23.

At the hearing, the Court admitted certain enumerated exhibits into evidence as well as all material produced during the discovery process. Id. at 7-8, 771-78, 814-19, 878.

[14] Complaints' Post Hearing Brief, dated June 29, 1998 ("Complainants Brief"); Respondents' Post-Hearing Brief, dated June 30, 1998 ("Respondents Brief"); Complainants Reply Brief, dated July 13, 1998 ("Complainants Reply Brief"); Respondents' Post-Hearing Reply Brief, dated July 15, 1998; Order Amending Transcript, dated July 22, 1998.

Months after the completion of the hearing, and shortly after the submission of post-hearing briefs and reply briefs, complainants sought to reopen the record for the purpose of inserting testimonial evidence they claim was adduced in an similar proceeding involving the same respondents conducted before a different court. Order Denying Motion for Leave to Reopen the Record, dated August 12, 1998, at 1. The Court denied the request due to complainants' failure to demonstrate reasonable grounds for their failure to adduce the testimony in this proceeding. Id. at 4-5.

[15] Morris v. Stolter & Co., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,080 at 38,049 n.28 (CFTC June 27, 1991); cf. In re Rosenthal & Co., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,221 at 29,169 (CFTC June 6, 1984).

through fraudulent omissions.[16] They also continue to claim that respondents are vicariously liable for affirmative, fraudulent statements made by Sy Gaiber ("Gaiber"), Stanley Rhea ("Rhea"), and Judy Johnson ("Johnson").[17] Similarly, complainants continue to assert that respondents failed to comply with Rules 1.55 and 33.7.[18] The Websters also continue to charge that respondents engaged in the unauthorized trading of their account.[19] Finally, complainants claim that respondents aided and abetted the Club's failure to register as an IB.[20] Having considered the record, as developed before and during the hearing, the Court makes the following findings of fact.

The Club

The Bulls and Bears Clubs, Incorporated ("B&B Inc."), a California corporation, owned and operated the Bulls and Bears Club ("Club").[21] Both were located in Rancho Mirage,

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[16] Complainants Brief at 12-24, 34-35, 40-41.

[17] Id. at 12-14, 34, 40.

[18] Id. at 14-15, 40.

[19] Id. at 32-34.

[20] Id. at 16-20.

[21] Complainants' Exhibit ("CX-") 4, Bulls and Bears Clubs Inc. Prospectus, dated January 1997 ("Prospectus"), at 1

California.[22] B&B Inc. described the Club as "[a] prestigious, members-only club,"[23] the "central theme" of which was "to provide a conducive atmosphere for members to monitor their investments and exchange investment ideas with peers in a relaxed, elegant environment."[24] It combined aspects of a social club with a trader's office. Club facilities included computer stations for members' use with access to real-time market data, direct telephone lines to brokers, a main lounge, a card room, a cigar room, dining facilities and an outdoor patio.[25] The Club sponsored seminars on trading, computer classes and social events

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[22] Id.

[23] HS000101.

[24] Prospectus at 1 (emphasis omitted). B&B Inc. marketed the Club, in part, by stating,

> "What country clubs are to golfers, and racquet clubs are to tennis players, the Bulls and Bears Club is to investors in stocks, bonds, commodities and options.
>
> . . . .
>
> Join us. The Bulls and Bears Club is your opportunity to trade, monitor your investments, and share information and ideas with your peers in a private environment which is both highly functional and remarkably luxurious."

HS000103.

[25] Id.; Tr. at 576-77.

such as monthly mixers, special event parties and card tournaments.[26]

A Governing Board ("Board") oversaw the Club's operations.[27] The Club membership elected four of its seven members, B&B Inc. named two of them and the Club's full-time manager served as the seventh member.[28] Day-to-day management fell primarily to the Club's full-time manager.[29] However, Gaiber was the driving force behind the enterprise. He was a Club member, member of the Board, beneficial owner of a substantial portion of B&B Inc. stock and the apparent source of the Club's decision to focus on commodity futures and options trading.[30] While establishing the

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[26] Prospectus at 2; CX-4, The Bull-etin that Bears Good News, April 1997 ("Bull-etin"), at 2 (the Club's newsletter, advertising computer classes, "alternative trading" seminars, an April 15th "Poor Man's Tax Dinner," and a "Palate Pleasing Pasta Plate Party" on April 29th); Tr. at 576.

[27] Prospectus at 2.

[28] Id.; Tr. at 952; see Bull-etin at 1-2 (containing a message from the Club's manager, Thomas Dullien).

[29] Prospectus at 3.

[30] Tr. at 913, 951-52. When asked whether he provided services to the club, Gaiber replied "As much as I could to benefit my own stockholding positions." Id. at 913. Not all Club members traded in commodity contracts. Id. at 576. Indeed, little more than a majority of members did so. However, commodity contract traders seem to have comprised the most active members and commodity trading soon became (or always was) the central focus of the Club.

Club was a substantial undertaking, it was just the first step of a greater plan that Gaiber and others had formulated.

As the name "Bulls and Bears Clubs, Inc." implies, the Rancho Mirage club was not the only club that B&B Inc. intended to open. B&B Inc. hoped to expand regionally and then nationally, targeting 50 locations around the country as future club sites.[31] The Club in Rancho Mirage was "[t]he [p]rototype"[32] for the planned, nation-wide chain. As the prototype, it served both as a model for future clubs and as a gauge for the prospects of expansion.

The Club officially opened its doors and began operations on November 11, 1996.[33] Three months before opening, B&B Inc. began a "[m]arketing [p]rogram," soliciting memberships in the Club.[34] The program included television, radio, newspaper and direct-mail

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[31] Tr. at 670; Prospectus at 4, 8. B&B Inc. selected prospective locations based on three criteria: (1) the concentration of affluent retirees, (2) the concentration of high-technology businesses and (3) the concentration of professionals. Id. at 4. It reasoned that these criteria indicated "a concentration of wealth with a common interest in the stock market and a need for social contacts." Id.

[32] Id. at 1.

[33] Id. at 3.

[34] Id.

advertising.[35] This marketing effort continued throughout the relevant period.[36]

The Wednesday Night Seminars

Once the Club opened, it began conducting social events and, at a date that is not clear in the record, began offering Wednesday night seminars.[37] The seminars covered a variety of

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[35] Id.; Tr. at 577, 836, 1027.

[36] Id. at 1027. B&B Inc. was forced to continue its marketing effort because the Club never achieved a self-sustaining membership base. B&B Inc. estimated club operating expenses at $50,000 per month. Prospectus at 4. The Club collected monthly dues of $225 from each paying member. Id. Thus, the Club needed about 222 paying members to cover monthly expenses. B&B Inc. estimated that each club would require a minimum of 250 members "to ensure an adequate return on the investment." Id. The Club's membership never exceeded 87. CX-4, Members List ("Members List").

[37] Bull-etin at 2; Tr. at 25-26, 296, 578-79. The record is ambiguous on whether the seminars began as a marketing tool for the Club or as a member service that was incidentally used to attract prospective members who were invited to attend them. Id. at 25-26. However, the seminars were offered to the Club's members and members regularly attended. Id. at 296, 578-79; Bull-etin at 2.

The evidence indicates that no named respondent directed Gaiber to provide the seminars nor were they aware of the content of the seminars during the relevant period. Tr. at 928. Some time after Club members began suffering significant trading losses, respondents began receiving complaints about the seminars and Gaiber's advocacy of his strangles strategy. See Respondents' Exhibit ("Ex.") 89 at 5. Complainants maintain that the complaints occurred in June of 1997, months after the seminars that they base their claims on and weeks after

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topics,[38] but primarily focused on trading options on commodity futures contracts.[39] More specifically, the seminars emphasized the trading strategy of selling (or writing) strangles.[40] As a trader, Gaiber preferred strangles and recommended them as a method of speculation.[41]

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complainants testify they learned of the losses in their accounts. Complainants Brief at 4. Krubinski's telephone conversation confirms this since it mentions Gaiber's effort to move Club members' trading accounts from Refco to LIT Division of First Options, Incorporated ("LIT"), an event that occurred in May 1997, and the fact that Club members who had moved their accounts to LIT had already returned to Refco. Ex. 89 at 3-4; see infra text accompanying notes 109-116.

[38] Tr. at 841-42.

[39] The seminar topics included trading equities but, as mentioned above, emphasized commodities trading. Id. at 579, 841-43. Topics included such basics as the types of contracts that could be traded. Id. at 916. The seminars also included various strategies, including covered spreads, offsetting spreads and butterfly spreads. Id. at 842-43, 917.

[40] Traders establish strangle positions in order to speculate as to the volatility in the price of an underlying asset. Simply stated, strangles involve simultaneously taking a call and a put position at strike prices that are, respectively, above and below the current price for the underlying asset. M. Desmond Fitzgerald, Financial Options 64 (1987). A trader would buy a strangle position if the trader expected the price of the underlying asset to be volatile. On the other hand, a trader would sell a strangle position if the trader expected the price of the asset to be relatively stable. The seller collects the premiums from the two sales up front and the premiums reflect the maximum profit possibly resulting from the trade.

[41] Tr. at 579, 925.

Gaiber's presentations covered the mechanics of trading strangles, the advantages he viewed them to have, the risks involved, and what was required to limit those risks.[42] He explained that trading strangles involved selling a call and a put in the same contract month for the same underlying commodity, at strike prices above and below the current price in the commodity.[43] He stated that strangles provided some room for the price to move (in either direction) before the profitability of the position began to fall and that the premium received for selling the strangle provided a "hedge" against market movement.[44]

In describing the potential risk and rewards of selling strangles, Gaiber explained that the premiums received, when opening the positions, represented the maximum potential profit of the trade.[45] He did not tell the members that profits were assured or that writing strangles was risk-free.[46] Indeed,

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[42] Id. at 579-80, 843-44, 989-91.

[43] Id. at 990.

[44] Id. at 918, 926-27.

[45] Id. at 844, 990.

[46] Id. at 581, 844-45, 990.

These issues are hotly contested. Complainants claim and testified that Gaiber assured them that writing strangles was riskless and that profits were assured because profitable trades (continued..)

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would vastly outnumber unprofitable trades and that the potential loss on each unprofitable trade would not exceed $1,000. Complainants Brief at 9, 10, 29; Tr. at 27, 64, 362, 1036. Respondents presented the testimony of Gaiber and other non-party Club members that Gaiber explained to the members that the potential risk of writing strangles was unlimited and that profits were not assured. Id. at 579-81, 844-45, 919, 990-91. Thus, the Court's factual finding rests largely on credibility assessments.

It should be noted that complainants' burden of proof extends to issues of credibility. See Guiberson v. United States, Case No. 76-34-C2, 1978 WL 1250, at *5 (D. Kan. Dec. 13, 1978) (unreported op.); Ackerman v. Medical College of Ohio Hosp., 680 N.E.2d 1309, 1311 (Ohio Ct. App. 1996). In addition, the Court is not obligated to find one side or the other to be more credible. Indeed, there may be occasions when two witnesses, or groups of witnesses, may be equally credible or incredible. Under those circumstances, the Court need only find that complainants have failed to establish their version of the facts with requisite certainty. Guiberson, 1978 WL 1250, at *5; Ackerman, 680 N.E.2d at 1311. In other words, a tie in credibility goes against complainants.

On this point, the Court finds the testimony of respondents' witnesses, on the whole, more credible than that of the complainants' witnesses. See infra notes 126, 176, 206, 259. Indeed, complainants are undermined by the testimony of one of their co-complainants, Lisa Schneider ("Lisa"). She did not testify that Gaiber told the members that selling strangles was a low risk strategy, involving no substantial risk of loss under any circumstances. Tr. at 162-63, 1035-36. Rather, she testified that Gaiber told the members they could limit the losses by "getting out" of positions "when the market goes against you." Id. at 163.

The complainants' relative incredibility is pronounced when compared to that of Doug Wall ("Wall"). Like respondents' other eye witnesses, Wall testified that Gaiber did not tout strangles as a low risk trading strategy. Rather, he testified that Gaiber told the members that the risk of loss inherent in selling strangles could be unlimited. Id. at 990-91. Virtually every witness in this proceeding had some interest in its outcome that

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was aligned with the parties that the witness' testimony tended (or was intended) to support. See United States v. Cole, 41 F.3d 303, 309 (7th Cir. 1994), cert. denied, 516 U.S. 826 (1995); United States v. Dees, 34 F.3d 838, 844 (9th Cir. 1994) (noting that an interest in the outcome of a court proceeding could result from a pecuniary interest in the subject matter as well as a reputational interest in how factual issues are resolved). Wall was the exception. Like the complainants, the respondents and Debra Michel ("Michel"), he had a financial stake in the outcome of the litigation (either directly or by the possible use of the doctrine of offensive, non-mutual collateral estoppel). However, his interest rose from the possible use of collateral estoppel against respondents. In other words, when he testified in support of respondents, he testified against his own pecuniary interest. In addition, unlike some other witnesses in this proceeding, he did not face potential litigation in a civil suit or an enforcement proceeding arising from the events underlying this case. Moreover, he has no apparent interest in the reputation of an investment club that is distinct from the Club, but uses the names "Bulls and Bears" and has Gaiber as a member. Tr. at 667-68. Finally, he has no reputational interest in the resolution of the factual issues of this proceeding other than findings related to his credibility as a witness.

Because Wall had no reputational interest, other than being viewed as credible, in this litigation, faced no potential liability arising from the underlying events and had no financial incentive to fabricate testimony favoring respondents, complainants have been forced to ask the Court to conjure some other motivating interest. On cross-examination, complainants elicited testimony that Wall lost $15,000 in commodity option trading, an amount significantly less than the complainants. Id. at 1006. At most, this would tend to prove that Wall might have less animus toward the Club and respondents. However, $15,000 is a substantial amount of money, it is not clear whether Wall was nearly as wealthy as complainants, and he would stand to benefit if complainants prevail in this case by use of collateral estoppel. Thus, the fact that Wall lost a relatively modest sum has no independent probative value in establishing that he was motivated to fabricate testimony for the respondents' benefit.

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In their reply brief, complainants seek to impugn Wall's credibility based on the fact that he appeared voluntarily and seemed to testified effectively. Complainants argue,

> "[The respondents' nonparty] witnesses went to considerable trouble to come to the hearing for the express purpose of doing damage to complainants' cases. These were not people who were subpoenaed to testify and who then told what they know in a detached way. They came to do the complainants an injury. They did not come out of any altruism or lofty notions about justice. It would be easier to believe in the tooth fairy. Their testimony leaves no doubt about their 'interestedness.'"

Complainants Reply Brief at 5 (emphasis added). The Court takes judicial notice that competent adults tend not to believe in the tooth fairy. However, this does not assist complainants' cause.

By their hyperbolic rhetoric, but with no reference to evidence or authority, complainants wish the Court to presume that any non-party witness, who testifies voluntarily and effectively, must have had an ax to grind with the parties whose case the witness tends to undermine such that the witness would tend to commit perjury. The Court will not presume that testimony undermining a party's case proves animus toward that party, inferentially supporting the conclusion that the testimony was false. This argument not only results from a logical fallacy and lacks a factual basis, it would create a paradox. All substantially effective testimony, unless made squarely against a witness' interest, would become automatically suspect.

Complainants' argument also fails to recognize that whether a witness is under subpoena is not a reliable indication of whether the witness' appearance is actually voluntary. Complainants overlook the fact that, when asked to appear voluntarily, a witness is not necessarily given the choice of appearing or not appearing. Rather the party may give the witness the choice of appearing voluntarily or appearing under a subpoena. Likewise, voluntary witnesses may be subpoenaed as a matter of course. In re Reuter, 670 F.2d 1015, 1023 (C.C.P.A.

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1981). The issue of whether to subpoena a witness often boils down to a tactical question. See Betts v. State, 876 S.W.2d 802, 804 (Mo. Ct. App. 1994).

Even proof that an appearance was absolutely voluntary does not, without proof of additional facts, undermine a witness' credibility. Although the fact that a witness appeared voluntarily may reveal a reason to doubt the witnesses' credibility, Wabash R.R. Co. v. Ferris, 32 N.E. 112, 113 (Ind. App. 1892), proof of such an appearance, standing alone, "is . . . insufficient to discredit" the witness on grounds of credibility. State v. Keys, 37 P. 167, 168 (Kan. 1894); accord Nashville, C. & St. L. Ry. v. Crosby, 62 So. 889, 893 (Ala. 1913); Sylvester v. State, 35 So. 142, 145 (Fla. 1903). Any argument that Wall was biased in favor of respondents, such that he would fabricate testimony, is based on nothing more than speculation and is, therefore, unpersuasive.

Not only is there no evidence that Wall was motivated to testify untruthfully, there is no indication he did so. His testimony was consistent. Wall was apparently frank as to the extent and, more importantly, the limits of his knowledge. Moreover, his demeanor on the stand reinforced his credibility. See In re Staryk, CFTC Docket No. 95-5, 1998 WL 834656, at *12 n.35 (CFTC Dec. 4, 1998) (discussing demeanor and demeanor evidence). Accordingly, the Court finds that, on matters of fact that are disputed and of which Wall claimed a first-hand recollection, Wall's testimony is the most credible in this proceeding. Therefore, contradictory testimony, if not otherwise reliably supported, is found to be incredible.

For the reasons set out above, complainants have failed to establish, by a preponderance of the evidence, that Gaiber told them trading strangles was risk-free or that profits from trading strangles were assured. If the Court were to completely disregard Wall's testimony, the respondents case, on this point, would have been less compelling. However, complainants still would not have been deemed to have won the battle of witness credibility. At best, the Court would have viewed the testimony of their witnesses as equal in terms of credibility with respondents' witnesses. As noted above, such a tie amounts to a failure to prove the disputed fact.

Gaiber told the members that the potential losses, resulting from selling strangles, were unlimited and then explained how the potential and degree of loss might be reduced.[47]

Gaiber also explained that, while potentially unlimited, members could provide themselves some level of protection through vigilance and discipline. He told them that they should decide how much they were willing to lose on a particular trade and as the market moved to and through one leg of the strangle, rather than keeping the losing leg open in hope of a rebound, they should offset their positions.[48] While Gaiber believed that open positions could be offset with some level of precision,[49] there

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[47] Tr. at 579-80, 623-24, 990. As Gaiber colorfully put it, he told the members if losing positions were left open, "[t]hey'd get killed . . . financially." Tr. at 919. In private conversations with members, Gaiber described selling strangles and the inherent risk in essentially the same manner. Tr. at 654-56.

[48] Gaiber often told the members that they should limit their losses to $1,000 per contract and, as the market moves that far against one leg of their strangles, they "should liquidate the position." Tr. at 921. As noted above, complainants testified, incredibly, that Gaiber told them losses could not exceed $1,000 on any given trade. Thus, it is possible that their testimony on this point resulted from a misunderstanding or incomplete memory rather than a conscious decision to lie on the stand. <u>See</u>, <u>e.g.</u>, Tr. at 159.

[49] Gaiber explained his opinion, stating,

> "There are ways to limit risk, however, by following the rules as prescribed by either the Board of Trade or the Merc. And you can set a limit on how much you're

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is no credible evidence that he stated this to any Club member and, particularly, to any complainant.[50] The Wednesday night seminars piqued the interest of members (and prospective members) sufficiently that they wanted to begin trading.

The Referrals To Refco

The Club did not require new members to trade.[51] If they chose to trade, the Club did not require them to trade through a particular broker. Likewise, from its inception through the Spring of 1997, the Club took no official position on a preferred futures commissions merchant ("FCM").[52] Unofficially, however,

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> willing to lose on a given trade. And if you follow your own directives, you get out at that risk factor and you limit it to that risk. Agreeably, sometimes it will go through that number by a little bit, but that will be a minor amount of money."

Tr. at 919-20.

[50] Moreover, complainants who claim to have relied on Gaiber's alleged misrepresentations do not claim to have relied on a statement that open option positions could be offset with ease and certainty. Rather, they decided to swing for the fences, claiming reliance on the alleged statements that writing strangles was virtually riskless and assuredly profitable.

[51] As discussed below, Neal Webster ("Webster") was a Club member for about two months before he opened an account.

[52] Tr. at 583.

when members asked Gaiber for the name of an FCM through which to trade, he referred them to Refco.[53] Respondents did not request the referrals, did not compensate the Club for referrals and were unaware that Gaiber was referring customers.[54] In addition, it appears that the referrals did not occur until solicited by a member who expressed a desire to begin trading.[55] Moreover, they

[53] Refco is a registered FCM, headquartered in Chicago, Illinois. Club members generally communicated directly with Refco's AP and IB, Dearborn Capital Management, Limited ("Dearborn"). Dearborn incorporated in Illinois on July 1, 1988. R001083. David M. Kavanaugh was Dearborn's President, Secretary, sole director and sole shareholder. R001086-87; R001091. In January of 1997, Dearborn became a registered, exclusive and guaranteed IB and registered AP of Refco. R001053-55; Tr. at 417. John Miles ("Miles"), John Aiello ("Aiello") and Emil Van Essen ("Van Essen") were, prior to January 1997, APs of Refco. Id. at 417-18. In January of 1997, they became registered APs of Dearborn and retained their status as APs of Refco. Id. at 416-28, 730. Donna Grygus ("Grygus"), another Dearborn employee, also came from Refco. Id. at 417-18. In August of 1997, Miles became a principal of Dearborn. Id. at 416. There is no evidence that Miles, prior to his elevation to principal status, was a Dearborn officer or had the authority to hire Dearborn employees or other agents. Likewise, the record contains no evidence that Aiello, Van Essen or Grygus had such authority. Moreover, there is no evidence that the duties of Miles, Aiello, Van Essen or Grygus included reporting activity of the Club, as it related to referring customers or acting as an intermediary between Dearborn and the Club, to their superiors at Dearborn or Refco.

Gaiber denied having made referrals. Id. at 929. However, the Court finds his testimony on this point unpersuasive.

[54] Id. at 425-26, 460-61.

[55] Id. at 298.

were not proven to have been systematic.[56]

Gaiber was not the only person referring members to Refco.[57] Rhea, a Club member, director and experienced trader,[58] also

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[56] Other than Gaiber, Krubinski, who was referred by Rhea, and Lisa, who was referred by her husband, six Club members testified. Three of them testified, credibly, that they opened Refco accounts after joining the Club but were not referred to Refco by Gaiber. Id. at 582-84, 837, 991-92. Thus, even if complainants' testimony as to their personal referrals were deemed credible, it fails to prove that Gaiber systematically referred members to Refco.

Webster testified to having heard Gaiber refer members, other than himself, to Refco. Id. at 299. However, when asked if this was a regular occurrence, Webster did not directly address the question. Rather, he described the Club distributing account-opening forms to members who wanted to open accounts with Refco. Id. Webster did not state who, if anyone, referred these members to Refco. In addition, it does not logically follow that, if Gaiber provided some referrals and many members traded with Refco, that all of the new customers resulted from his referrals. This is so because a referral from Gaiber was not the only possible method of deciding to trade with Refco. In fact, there is evidence that a number of Club members found Refco for reasons other than referrals from Club officers or directors. See infra note 57.

[57] At least one other member opened a Refco account after a referral from members who held no Club office (formal or informal) and whose relationship with the member predated the Club. See infra note 60. In addition, one Club member was referred to Refco, after he joined the Club, by someone with no connection to the Club at all. Tr. at 837. Finally, at least one member decided to trade with Refco, not as the result of any referrals, but as the result of independent fact-finding. Id. at 582-84. Accordingly, the Court could only speculate as to how often, in addition to those specific referrals established by the evidence, Gaiber (or any other Club officer) referred customers to Refco, something that it will not do.

[58] Id. at 835-36, 898. While Rhea was active in the Club, he does not appear to have been an insider with B&B, Inc. This (continued..)

provided referrals or simply answered questions.[59] Likewise, members who held no official position in the Club also referred members to Refco when asked.[60] At no time did respondents

(..continued)

seems to be the case because, unlike Gaiber, Sandra Teckenbrock and others, Rhea paid the full initiation fee and dues in order to be a member of the Club. Members List at 1-2.

[59] Tr. at 469, 839. These referrals often were not express referrals at all. Rather, when asked who his broker was, Rhea would simply answer the question. Id. at 839.

[60] Id. at 423, 585-86. Wall testified to the following.

> "[N]obody influenced my decision [to open an account with Refco] except for . . . the friends I had in the Club [, none of whom were Club officers]. They were telling me . . . our account is with Refco . . . .
>
> Basically they said you can open with anybody you want . . . but Refco charges X amount for a trade . . . and they thought it was pretty reasonable compared to . . . other brokers."

Id. at 992. He later testified that Gaiber never pressured him to trade through Refco. Id. Likewise, members were not instructed or encouraged to recommend Refco as a matter of Club policy. Id. at 586.

The evidence that rank-and-file Club members recommended Refco is especially credible given the fact that even complainants in this case were satisfied with the level of service they received from the firm. For example, as discussed below, Gaiber recommended that Club members move from Refco to LIT. Krubinski, like the vast majority of Club members who traded through respondents, did not. Id. at 282-83. The Schneiders traded with other firms, after they experienced the losses complained of, but eventually returned to Refco. Id. at 42. Krubinski and the Schneiders expressed their pleasure with
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compensate these other referrals.[61] As members made the decision to trade through Refco, the Club became an intermediary between members and the firm.

<u>**The Club Obtained Refco Forms For Its Members To Use**</u>

At a time after the Club began operating and after Webster opened his Refco account,[62] the Club, through the actions

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the way their account was handled to Refco. Id. at 473-74. Likewise, some time after the Websters suffered significant trading losses, they sent a fax to Refco that stated, in part, "*LIFE IS GOOD - I HOPE!* REFCO IS GREAT - SO FAR!" NW000003 (italics and capitalization in original).

61 Tr. at 587, 839. These other referrals did not occur at Refco's direction either. Id..

62 Johnson moved her account to Refco after she joined the Club and after the Club began operating. Id. at 582-84. When she made the decision to trade through Refco, Johnson called Refco for the forms. Id. at 584. Given Johnson's experience and role in distributing Refco forms to others, if the Club had Refco account-opening documents on hand when Johnson opened her Refco account, there is every reason to believe Johnson would have availed herself of them, avoiding delay, rather than requesting a set of forms from respondents.

As discussed below, Webster did not receive his account-opening documents from the Club. Rather he received them from respondents directly. In addition, he did not testify as to actually observing a stockpile of Refco forms when he joined the Club or opened his account. Rather he testified that, "after [Club members] started trading [strangles] and it looked like . . . [Gaiber's] methods were productive, people were joining by the droves. And they were all passed a Refco kit to fill out so they could open accounts. There was a frenzy almost." Id. at 299.

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of Johnson[63] and others,[64] began obtaining account-opening forms

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There is good reason not to credit this testimony. See infra note 126. However, even if taken as credible, it would place the time, at which the Club began to stockpile forms, some time after Webster began trading.

If taken as credible, Webster ties the time when the Club served as a conduit for forms at a point after the Club began operating and at a time in which members were "joining by the droves." Tr. at 299. In the six-week period before Webster first sought to open his Refco account, only two new members joined the Club. Members List at 2-3. Between the time the Club officially opened, on November 11, 1996, and the time Webster executed his first set of Refco account-opening documents, January 31, 1997, a total of eight new members joined and only two of the eight joined in the same calendar week. Id. An 11-week period in which eight new members joined the Club would hardly qualify as a time in which members were joining "by the droves." Thus the Court may safely conclude that the time period Webster described was not the time he decided to begin trading or a time prior to that.

[63] Johnson was a Club member who had some trading experience before joining the Club. Tr. at 582. She was not an employee of the Club or a Club officer. Id. at 589. She received no compensation from the Club and paid regular dues and fees to be a member. Id. Sommerfeld described her as a woman who helped other members "out of the kindness of her heart." Id. at 1079. His lawyer put a different spin on it, describing her as "a woman obsessed with the notion of her own self-importance" and who "likes . . . to be the center of attention." Complainants Reply Brief at 4.

As she described how this practice evolved, members approached her and asked how to open an account with Refco. Tr. at 587. She would tell them to call Refco but began to make the calls for them. Id. at 587-88.

[64] Id. at 180.

for newer members from Dearborn as well as other firms.[65] When approached by a member, Johnson would call Dearborn,[66] tell a Dearborn AP that there were new members who wished to open Refco accounts and specify the number of account forms that were needed.[67] She did not specify, by name, the members for whom the forms were requested.[68] In addition to obtaining forms for individuals, she also requested forms for members who wished to open a partnership account.[69] Dearborn responded by sending the forms to the Club by next-day delivery and directed them to Johnson's attention.[70] Johnson, and other members, would then distribute the forms to the members who wished to open Refco accounts.[71] In addition, she answered questions posed by members

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[65] Id. at 160-61, 426-27.

[66] Id. at 588.

[67] Id.

[68] Id. at 588, 593.

[69] Id. at 590. Three partnerships, with about 15 members each, formed among Club members. Theses Clubs were named the B & B partnership, the C & C partnership and the T & T partnership. Id. at 261-65, 328, 1087; Ex. 101. Complainants Webster and Sommerfeld were members of the B & B partnership. Tr. at 328, 1087. Complainant Krubinski was a member of the C & C partnership. Tr. at 261-65. Complainants Hans Schneider ("Hans") and Lisa were members of the T & T partnership. Ex. 101.

[70] Tr. at 588.

[71] Id. at 191, 593.

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with regard to completing the forms.[72] However, respondents did not direct or authorize her to do this.[73] When Club members submitted incorrect or incomplete account-opening forms, respondents contacted the customer to resolve the matter and did not rely on the Club to do so.[74]

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Hans testified that, when he received the Refco forms from Johnson, she told them that completing the forms was merely a formality. Id. at 30. Johnson denies telling anyone that completing the forms was a mere formality. Id. at 599. As discussed below, the Court finds Hans' testimony generally incredible and, on this point, the Court finds him less credible than Johnson. Thus, the Court declines to find that Johnson suggested to Schneider (or anyone else) that completing the account-opening documents was just a formality.

[72] Id. at 594.

[73] By early March, Miles may have had reason to believe that Johnson was helping some Club members fill out the forms. On March 6, 1997, Rhea sent him a fax that listed the Refco customers at the Club in anticipation of the Refco-sponsored dinner. HS000526. The letter indicated Johnson "has been helping a couple more new members fill out your account papers." HS000526. However, it is unclear whether Miles actually read that portion of the letter (since no one asked him). Likewise, there is no evidence that Miles, not yet a Dearborn principal, reported the information to his superiors or had a duty to do so. Accordingly, knowledge of that fact is not attributable to Dearborn or Refco. See infra text accompanying notes 321-25. In addition, there is no evidence that any other Refco or Dearborn employee was aware of this practice during the relevant period.

[74] Tr. at 182-84, 434. Indeed, Michel testified that Dearborn employees "pretty frequently" left messages at the Club for the purpose of speaking directly to members who were trying to open new accounts with Refco but had problems with their account-opening paperwork. Id. at 183.

As the number of members who wanted to open Refco accounts increased, Johnson began requesting more forms than were necessary to meet the current demand and started to accumulate an inventory.[75] However, she did not tell respondents that she was requesting excess forms, nor does it appear that they were aware of this practice.[76] On two or three occasions, Debra Michel, the Club receptionist, requested account forms at the direction of Gaiber and Johnson.[77] In doing so, Michel did not indicate that she was requesting the forms for Club members who had a present interest in opening a Refco account.[78] Refco responded by sending the requested number of forms.[79] By December 1997, the

[75] When asked whether there was a time when she asked Refco for more account-opening kits than was necessary to meet the current demands of Club members, Johnson replied "Yes. New members would join and I'd call and ask for new applications, and I'd say, send me five applications. And I may have had one or two because I was - there were so many people; this was getting very . . . busy." Id. at 590.

[76] Id. at 429, 590-91, 592. There is no indication that respondents kept track of the number of account-opening kits issued relative to the number of account applications and agreements received from prospective customers.

[77] Id. at 178-80.

[78] Id. at 180-81.

[79] Id. at 476.

Club had accumulated an inventory of about 11 forms.[80] With the exception of about five account-opening kits, Refco was unaware that the Club had accumulated such an inventory.[81]

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[80] Id. at 151. Lisa testified that the Club had 22 kits on hand in December of 1997. For reasons discussed below, the Court does not credit this testimony.

[81] Id. at 429, 476. Rhea had once requested account-opening forms for his daughters. It appears that, in April 1997, he requested an additional set of applications for them. Ex. 55. In the letter making this request, he indicated that the original account-opening documents had been donated to the Club. Id. Thus, respondents were aware that the Club had accumulated approximately five excess account-opening kits as a result of Rhea's unsolicited action.

Complainants have produced no direct evidence that any respondent was aware of the Club's practice of stockpiling forms (beyond Rhea's one-time donation). Rather, complainants would have the Court infer actual knowledge from the fact that a stockpile accumulated, the failure of Club members who requested the forms to specify the members for which they ostensibly requested forms, and from the testimony of Michel that, when she requested forms, she did not say that she was requesting them to meet a current demand. This is an insufficient basis upon which to rebut respondents' testimony.

The complainants have not established, with any level of precision, when the inventory began accumulating or how fast it accumulated. The fact that 11 or so extra forms accumulated over the course of 13 months (five of which Rhea donated) in a club of 87 members, 45 of which were Refco customers, is not a sufficient basis upon which to conclude that Refco had actual knowledge of the Club's stockpiling. Refco did not compute and was not aware of the number of documents sets it sent to the Club. Id. at 476. Of the 45 with Refco accounts, a significant number held partnership accounts in addition to individual accounts. This increased the number of blank Refco account-opening kits flowing through the Club at any point in time. In general, a certain number of possible customers are likely to request forms and, upon consideration, refrain from trading or trade through someone else. This, in light of the fact that Refco did not compare the

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The Trading Of Club Members

As it was intended to be, the Club became the location from which a significant portion of members traded. The proximity of

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number of account-opening kits to accounts opened, precludes the Court from concluding that the mere existence of an inventory makes the knowledge of stockpiling more likely than not.

Likewise, the fact that Michel requested forms on two or three occasions, without reference to current demand, does not inevitably lead to the conclusion that respondents were aware that the Club was maintaining an inventory of forms. The apparent course of dealing was to request a specific number of forms, ostensibly for members and to meet a current demand. The fact that on two or three occasions the Club receptionist requested a specific number of forms but did not say that the forms were to meet a current demand, does not, in the context of the course of dealing between the Club, its members and respondents, signal a departure from the ostensible course of conduct Johnson established. Respondents could have reasonably concluded that Michel was also requesting forms to meet a current demand of members when she initiated the contact and specified the number needed and the number was relatively small, eight to 10.

The volume of the requests and the manner in which Refco responded also undermines the notion that respondents were aware of the stockpiling of forms and either authorized or ratified it. Michel testified that, when she requested forms, she requested a relatively small number. Id. at 180. In addition, she testified the Dearborn responded by sending the requested number of forms by a next-day delivery service. Id. at 181. If the Club were stockpiling forms, it is relatively unlikely that would only order them in such small lots. To do so would incur the risk of running out and would necessitate a repeated cycle of request and delivery. Likewise, if respondents were aware of the stockpiling, it is unlikely they would send them in small lots by next-day delivery. It would be much more efficient to send the kits in large lots and by less expensive means.

the Club's commodity trading members to each other and their relative inexperience combined to produce a group trading mentality. This pack-like (or herd-like) trading guaranteed that that they would tend to win together or lose together.[82] This feature eventually led to the Club's demise.

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[82] The parties disagree about the decision-making process at the Club. Complainants charge that Gaiber controlled the trading of most of the Club members who traded commodity futures and options, completely bypassing the members in his decision-making process. Id. at 1035. Respondents claim that Gaiber did not make the trading decisions during the relevant period. Their witnesses testified that the Club members often traded with a collective mentality. They claim that members gathered around the computers that transmitted real-time data and through discussion reached a consensus on what trade to place. Id. at 599-01, 660-61, 994-96. Having reached a consensus, they regularly ran their ideas by Gaiber who would offer comments, criticism and advice. Id. at 932-33. Respondents and their witnesses testified that, while he provided advice, Gaiber left the ultimate decisions to the members. Id. at 600. If they still felt favorably about a contemplated trade, members would then have the orders called in for them. Id. at 600, 995. In determining which story to credit, the Court has two conflicting bodies of evidence upon which it may base a decision. Thus, the Court must make a credibility assessment of the conflicting testimony. Complainants' trading records aid the Court in making this determination.

As discussed briefly above and in detail below, the Court has found the complainants' testimony generally incredible. On this point, it finds complainants less credible than respondents' witnesses. This conclusion is buttressed by the trading that occurred in complainants' accounts.

A rough analysis of the members' accounts provides some insight into the question of who controlled the accounts. Although the parties have not directed the Court to any authority on the topic, certain facts permit the Court to draw inferences, albeit with less than complete certainty, that resolve this disputed issue of fact. There is no evidence that, in his

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advisory activities, Gaiber had brokers or clerical staff to help him. Accordingly, if he exercised discretion over 12 accounts (as Sommerfeld claimed in his testimony) or more than 30 accounts, (as Sommerfeld claimed in his response to interrogatories), Gaiber would have had to monitor markets, make trading decisions and keep track of the various Club members' positions while overseeing the Club, recruiting members and conducting seminars. These requirements, in light of Gaiber's resources, support the reasonable expectation that, if Gaiber controlled the trading of a large number of accounts, he would have traded the accounts in a block fashion. In other words, he would have traded the accounts identically in terms of commodity, type of contract and, when trading options, strike price. The only anticipated difference would be in the volume attributed to each customer. However, even in terms of the size of trades, it would be reasonable to expect a uniform proportionality over time.

If Gaiber were to customize the trading of any customer, he would incur substantial additional costs in terms of keeping track of open positions and monitoring markets for meaningful changes. For one person, these costs would quickly become prohibitive as the number of customized trading plans increased. The only resources Gaiber had at his disposal, reflected in the evidentiary record, were the Club's real-time terminals. Thus, it is unlikely that, if he managed a dozen or more accounts, he would have traded them in other than a block fashion.

Centrally controlled and consensus-driven trading have some similarities, but also some reasonably expected differences. If the Club members traded, in large part, by reaching agreement, then it is to be expected that they would often place trades that are identical in terms of contract, commodity and, in options, strike price. However, it is reasonable to expect that the trades would not resemble block trading in several respects. First, there might be some rough, uniformity in the relative size of positions members of the group were willing to assume. However, the proportions would tend to be less uniform from trade to trade, reflecting the degree to which each member viewed the merits of that trade. In addition, members would likely make some trades independent of the rest of the members and, sometimes, would not follow the group in making consensus trades. Thus, if some but not all of the inexperienced Club members made

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certain trades that others did not, that fact would tend to show that the inexperienced members often traded as a group, but controlled their accounts.

In this case, the Court considers the trading of the Websters, Sommerfeld and the Schneiders, each of whom claims that Gaiber controlled their account. There were a substantial number of trades in which the Websters, Sommerfeld and the Schneiders traded in unison. However, trading in the three accounts often diverged. For example, by mid-March 1997, both the Websters and Sommerfeld were trading. On March 17, 1997, Sommerfeld sold one S&P strangle. LS000049. The Websters did not place that trade. NW000100-07. The next day, Sommerfeld sold two S&P strangles and, again, the Websters did not. LS000050; NW000105. On March 25, 1997, the Websters sold 12 S&P strangles while Sommerfeld assumed no positions. NW000109; LS000053.

By early April, 1997, Sommerfeld, the Websters and the Schneiders were trading. On April 3, 1997, the Websters sold four S&P futures contracts while the Schneiders and Sommerfeld placed no trades. NW000113; HS000067; LS000056. On April 8, 1997, the Websters sold one S&P put while the Schneiders and Sommerfeld made no trades. NW000116; LS000057-59; HS000067. The Websters sold another S&P put on April 9, 1997 and, again, neither the Schneiders nor Sommerfeld traded. NW000117; LS000058-59; HS000067. On April 16, 1997, the Schneiders sold 5 S&P strangles but neither the Websters nor the Sommerfeld opened a position. HS000119; NW000122; LS000060-61. Thus, there were days when the trading of these members converged and days when it diverged. On this basis, it is difficult to conclude that complainants' testimony is more credible on the issue of how members traded. The more likely conclusion is that Gaiber taught them a method of trading and provided advice, but that the members reached their own decisions, following the pack on some days while not following it on others.

There is yet another reason to doubt complainants' version of how Club members' trading occurred. As discussed below, Gaiber exercised formal discretion over a number of accounts after members experienced severe losses. If Gaiber had <u>de facto</u> control over the accounts before he ever had formal discretion and generally entered trades without the authorization of the account owners, then he would seem to have had no motive to seek

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As mentioned above, a significant number of members pooled funds in partnership accounts. In addition, a core of members who traded at the Club tended to reach their decisions as a group. They would use the Club's real-time data screens to follow the markets, consult historical charts and, by discussion leading to consensus, formulate a trading strategy.[83] Often, as part of this process, they would consult with Gaiber who would offer criticism, comment and advice.[84] Other members, not directly involved in the deliberations, would follow the them or simply follow the outcome.[85] In doing so, the Club's more inexperienced traders gained the benefit the other members' experience and, quite likely, a degree of perceived security.

This group-oriented trading made it inevitable that Club members would decide to trade identical contracts at the same time.[86] As a result, they tended to rely on one or a few members

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and accept formal, written disclosure. If complainants' version was true, Gaiber would gain virtually no authority that he did not already exercise. Without more compelling evidence, the Court will not presume that members' grant of discretion was an empty formality.

[83] Tr. at 599-01; 660-61; 994-96.

[84] Id. at 599-02.

[85] Id. at 605, 661.

[86] Id. at 600, 661, 995.

to actually place the orders.[87] At a time before Sommerfeld and Schneider opened their accounts, the Club began arranging for

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[87] Johnson described the process in the following testimony.

> "[A]s we'd start putting these trades on, my husband and I and a few others, the people would be standing around my station, and the minute we started putting these trades on, it would be a me-too syndrome.
>
> . . . .
>
> It was a regular outcry. I'm on the phone to Refco trying to place an order, and I'm getting 'me, too' and adding them on. And I'd say, 'instead of a block of 10, make it 20. Instead of a block of 30, change it to 50.'"

Id. at 600. She later described how the process evolved, stating

> "After the initial outcry of - the outcry of me-toos, I decided that this could not continue because it's too difficult for me on the phone trying to make calls and . . . listen to the broker and get calls across and listen to the people around me.
>
> I took the . . . buy-sell sheets that I had and we cut them in half. And the people [who wanted to place orders] would write on there their . . . name and account number . . . . And they would give it to me.
>
> If they wanted to buy it, it was on the buy [side].
>
> If it was a sell, they put in the sell. And they wrote on there what they wanted, how many contracts they wanted and what it was. And - they would give it to me."

Id. at 606-07.

members to name other members as third party advisors, granting them authority to place trades on their behalf.[88] This practice, however, did not quell respondents' concerns about the blocking of orders. As a result, in late April of 1997, respondents developed a form on which members could confirm, in writing, their order when block orders were called in.[89] In addition, respondents faxed confirmations to the members who placed trades.

The group-oriented trading of members and the Club's goal of providing a forum for investors to share information created other phenomena. First, members who tended to trade identically, won or lost together. In addition, Club members tended to discuss the outcome of their trading, both when they traded successfully and when they lost on trades.[90] Beginning in early April 1997, Club members began to experience significant losses and those losses, as well as how to trade in a volatile market, became topics of discussion among Club members.[91] Thus, any member who spent time at the Club during that period could not help but learn that trading in commodity futures and options could result in significant losses. As traumatic and dislocating

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[88] Id. at 602-03, 661-62.

[89] R001096-97.

[90] Tr. at 88, 275-76, 396, 617, 662-63, 997-98.

[91] Id. at 276, 997-1000.

as the losses were, the trading losses of April were not the first time (outside of reading their risk disclosure statements and attending Gaiber's seminars) that a number of Club members were made aware of the risks of selling strangles.

<u>The Refco Dinner And Breakfast Provided A Forum For Discussing The Risks Of Trading Strangles</u>

By March 5, 1997, approximately one-third of the Club's members had accounts with Refco.[92] Later that month, Aiello and Van Essen flew out to Rancho Mirage and met with Club members who held Refco accounts.[93] Refco hosted a dinner for customers and their spouses (or companions).[94] The dinner was primarily a social affair at which respondents sought to cement their relationship with their current customers.[95] Although there was

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[92] HS000526; Members List at 1-3. At that time, the other 43 members (Michel was not yet a member) either traded with another broker or did not trade commodity contracts at all.

[93] HS000526; Tr. at 440-41, 680-81.

[94] <u>Id.</u> at 365; Ex. 49.

[95] Tr. at 681, 723. Complainants claim that respondents hosted the dinner for "members and prospective members" of the Club and their counsel, in his conduct of cross-examination and in complainants' post-hearing brief, insinuated that the dinner was an effort to solicit new customers. Complainants Brief at 2; Tr. at 722. The clear implication of this questioning and argument is that respondents hosted the dinner in order to solicit new customers for itself or to solicit new members for the Club. Either version, if proved, would have evidenced a closer (continued..)

some discussion of trading at the dinner, most of the trading-oriented discussions occurred the next morning.

The next morning, Aiello and Van Essen shared breakfast with about nine of their customers at the Club.[96] Webster and Sommerfeld attended.[97] At the breakfast, the Refco representatives discussed the trading that had occurred at the Club and the risks involved in selling options.[98] Aiello and Van Essen explained that selling strangles involved significant risk.[99] To illustrate the point, Van Essen discussed a historical instance (the October 1987 stock market crash) when the extreme market drop would have led to astronomical losses for

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relationship between the Club and respondents. The theory has several problems. First, complainants refer to the dinner as a forum for delivering a "pitch job." Complainants Brief at 2. The reference to a pitch came from Rhea and not a Refco or Dearborn AP. HS000526. Likewise, the reference indicates that Rhea lacked actual knowledge that Refco intended to make a "pitch." Rather, it demonstrates that Rhea simply recognized the possibility. Id. ("Also, it'll be our own private dinner meeting so you can do a little 'pitch job' if there's something you want to share with us."). Finally, there is no evidence that anyone attended the dinner other than Refco APs, Club members who were Refco customers (at the time) and the spouses or companions of those Club members. See id.; Tr. at 1092.

[96] Ex. 50.

[97] Id.; Tr. at 368, 615, 1094-95.

[98] Id. at 614-15.

[99] Id. at 613-14, 686, 728, 748-49.

those who sold strangles.[100] Thus, if the Club members who attended the breakfast had never been informed that selling strangles involved considerable risk, they were informed at that time. Likewise, if they subsequently took large losses on their S&P Option trading, they would know that such losses were not unprecedented or a "once in a lifetime" event.[101]

The Club Members' Losses And Gaiber's Response

As its members began to lose, the long-term prospects of the Club dimmed. The Club had yet to reach a self-sufficient level of membership.[102] Margin calls and trading losses stood a good chance of driving members away and making the Club less attractive to prospective members. Gaiber reacted in two ways. First, he dissuaded members from meeting margin calls. In

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[100] Id. at 686, 748.

[101] After the visit, Refco presented its customers at the Club with a humidor (for use in the cigar room) that was valued at about $1,000. Tr. at 477, 691. Complainants initially claimed that the humidor was compensation provided to the Club from respondents. Webster Complaint at 6. It appears they dropped that theory after the hearing. See Complainants Brief at 16-17 ("Respondents furnished the club with a handsome humidor"). Both Miles and Van Essen denied that the humidor was a gift to Gaiber and there was no evidence that the humidor was ever treated other than as the collective property of Refco customers at the Club. Tr. at 478, 691-92.

[102] See supra note 36.

addition, as the losses mounted, he took more direct control over certain members' trading.

Respondents did not delegate enforcement of margin policy to the Club and it was a good thing that they did not.[103] The Club tended to impede rather than aid respondents' efforts to enforce Refco margin policy. Gaiber apparently assumed that respondents, if faced with a wealthy customer who was not meeting margin calls, would carry the customers positions rather than force liquidate them.[104] As a result, when members received margin calls and sought Gaiber's advice, he told them to ignore the margin call.[105] Actually, Gaiber's advice was more colorful than that. He instructed the members to tell respondents to "go pound salt."[106] The members, on a significant number of occasions, seemed to have taken Gaiber's advice. As a result, respondents

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[103] Tr. at 454, 697.

[104] As it turns out, respondents were hesitant to force liquidate under-margined accounts. Id. at 698-99, 715, 727-28.

[105] Id. at 378-79, 727.

[106] Id. at 378-79.

At about the same time Gaiber was telling the members to ignore Refco's margin policy, he was trying to draw into a closer relationship with the firm. Through March and April of 1997, Gaiber discussed the possibility of Refco placing an AP on-site at the Club. Id. at 457-58. Refco considered the opportunity but ultimately declined to enter into a closer relationship with the Club. Id. at 443-44.

experienced problems in its margin calls to Club members.[107] In addition to trying to shield the members from the unpleasantness of posting additional margin, Gaiber took a more direct role in the members' trading.

When members complained of their trading losses, Gaiber offered his services to trade the account. He eventually exercised discretion over about nine accounts that were traded with Refco.[108] However, Gaiber's personal efforts failed to recover the losses.

Gaiber Convinces Some Club Members To Leave Refco And Respondents Sever Their Ties With Gaiber

A number of factors combined to chill the relationship between respondents and the Club. Gaiber's interference with margin calls was a source of aggravation. This became a mutual sensation. As noted above, Gaiber sought a closer relationship between the Club and Refco by asking respondents to place an AP

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[107] Id. at 454-55, 698. Refco contacted the Club, with regard to margin calls, for two reasons. First, it left messages at the Club for customers who were on margin call to contact Refco. Id. at 696-97. In addition, Van Essen learned of Gaiber's interference and called him in an effort to end it. Id. at 697-98, 726-27.

[108] Id. at 561.

at the Club.[109] Respondents declined to do so at the time.[110] However, they saw potential in Gaiber's plans for nationwide expansion and were interested in drawing closer to the Club.[111] Before this occurred, they decided to have the Club checked out and asked the National Futures Association ("NFA") Compliance

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[109] Id. at 938-39.

[110] Id.

[111] Complainants argue "[t]here is evidence that Respondents were aware of Gaiber's intention to open clubs in other cities, and desired to procure the commodity business generated by such clubs." Complainants Brief at 2. In support of that statement, they cite to a letter from Rhea to Miles in which Rhea states the following.

> "I have also come up with an unique way you can become involved more deeply with Bulls and Bears which will practically guarantee your being the broker of choice for ALL of the clubs and at the same time let you enjoy the clime out here regularly. Please call me here tomorrow and I'll go over it with you. OK?"

R001173; see Complainants Brief at 2. This letter corroborates testimony of the Club's request that Refco place a broker on-site and indicates an interest on the part of Rhea (personally or on behalf of the Club). However, the letter does not provide a basis upon which to infer the mind-set of the addressee since it appears to raise the issue for the first time without reference to similar, prior communication. In short, the letter does not support the proposition that complainants cite it for. However, there is documentary evidence that respondents considered a closer relationship with the Club, but abstained pending the resolution of apparent reservations. See R001096 (Memorandum from Emil Van Essen to Greg Firtik, undated) ("We also intend to keep our relationship with the club at arm's length until they receive confirmation from the CFTC permitting shared expenses or excusing the club from registration.").

Department to investigate the Club.[112] As respondents waited for the NFA investigation to conclude, Gaiber tried to cut them out of the picture. Gaiber found LIT willing to place an AP at the Club. In order to make it worth LIT's while, Gaiber recommended that Club members move their accounts from Refco to LIT.[113]

About nine accounts, owned by Club members, moved to LIT.[114] However, most members stayed with Refco. In addition, some of the members who moved their accounts from Refco to LIT, after a short period of time, switched back.[115] Those that did so returned to a grateful, if more cautious, firm.[116]

While the LIT situation was unfolding, the NFA investigated the Club.[117] The investigation uncovered evidence that Gaiber was

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112 Refco made the request in a letter, stating, "Per BNB and NFA, the [Club] is not registered in any capacity. In order to ensure compliance with Bylaw 1101.1. [sic] I would appreciate it if you would review the brochure and further investigate this company." Ex. 87.

113 Tr. at 939-40, 1071. Gaiber explained his action, stating "I wanted [Refco] to do more for the Bulls and Bears than they were willing to do. And, therefore, if they weren't willing to . . . [place an AP at the Club] then I was really more inclined to find somebody who would." Id. at 941.

114 Id. at 462; see, e.g., id. at 1071.

115 Ex. 79; HS000489.

116 HS000109; HS000489.

117 See HS000110 ("We briefly spoke over the phone sometime in early May of this year, when I was still General Manager at the Bulls and Bears Club in Rancho Mirage.").

receiving incentive fees for advising the partnership accounts owned by Club members.[118] The NFA reported its suspicions to respondents.[119] In response, they distanced themselves from Gaiber.

On July 31, 1997, respondents informed Gaiber that he could not exercise discretion over accounts at Refco.[120] In order to

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[118] Tr. at 466. In a letter written to the NFA, Thomas Dullien, the Club's General Manager, stated, "Sy Gaiber along with President Sandra Teckenbrock are giving investment advice on how to trade S&Ps. I have now received word from a reliable source that members of a so-called player pool are paying him 20% of the gains." HS000110.

[119] Id. at 466.

[120] The letter stated the following:

> "The National Futures Association has recently contacted Refco, Inc. concerning allegations that you have been receiving incentive or management fees on commodity trading accounts at the Bulls and Bears Club . . . . Since you [are] currently not registered with the NFA as a Commodity Trading Advisor this practice may be deemed improper and against NFA rules. As such, Refco's management deems it prudent that you stop directing accounts at this firm until this situation is resolved . . . . Likewise, we must impose that the accounts you have discretion over be traded on a liquidation only basis. With this in mind, the five accounts you have discretion over have the following options:
>
> 1. Revoke your discretion and trade the accounts as individuals.

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force the account owners to make a timely choice between Gaiber and Refco, they also placed the accounts he had discretion over on liquidation-only status until his third party discretion was revoked.[121] Gaiber told those members, who owned the accounts he

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> 2. Revoke your discretion and grant discretion to another individual besides yourself who is eligible for a CTA exemption.
>
> 3. Move their accounts to another firm to conduct their trading."

Ex. 94.

[121] See supra note 120; Tr. at 465-66.

Because the letter referred to (1) Gaiber's direction of accounts and then (2) placed the account over which Gaiber had discretion on liquidation-only status, complainants' counsel sought an admission that the reference to Gaiber's direction of accounts referred to accounts over which Gaiber did not have formal discretion, all Club member accounts in other words. Id. at 560-63. Such an admission would prove that Refco knew Gaiber was directing the trading of a large number of Club members' accounts. The logic would seem to be that if, with respect to the accounts over which Gaiber had formal power of attorney, the liquidation status added nothing to the ban on Gaiber's direction, then the sentence referring to Gaiber's direction must be referring to accounts over which Gaiber had no formal discretion. There was no such admission and the letter does not compel the reading complainants asserted.

The letter clearly imposes two restrictions. First, it prevents Gaiber from directing accounts. This can be read, as respondents claim, id. at 562, to describe the formal exercise of discretion. The second restriction, liquidation only status, refers to the trading of the discretionary accounts in general. Under this provision, even the owner of the account is restricted from taking new positions so long as Gaiber retained discretion.

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had discretion over, that he could not trade the accounts through Refco and, if they wished to have him trade the accounts, they would have to change brokers.[122] Some did and Gaiber continued to exercise discretion over those accounts until the accounts owners lost interest in trading or formally terminated his authority.

Over time, as Club members failed to recoup their trading losses, they tended to stop trading and terminate their Club memberships. Members also began raising concerns about the administration of the Club and its parent corporation.[123] Disputes over these concerns led to unrelated lawsuits.[124] The loss of membership and litigation led to B&B Inc. filing for bankruptcy under Chapter 7.[125]

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The liquidation-only status not only tied the hands of the customer but, by doing so, it also forced the customer to make an immediate choice between Gaiber and Refco. Because this reading of the second restriction augments what the Court finds to be the natural reading of the first, the Court does not believe that the letter constitutes evidence that respondents were aware that Gaiber directed the trading of accounts over which he did not have written discretionary authority.

[122] Id. at 37-38, 942-43.

[123] See CX-4, Letter from Neal Webster to Bulls and Bears Club, dated June 20, 1997; Id., Letter from Sandra B. Teckenbrock to Neal Webster et al., dated July 11, 1997.

[124] Tr. at 958-60.

[125] Id. at 667, 960.

Neal Webster

Webster was one of the Club's early members, joining in October 1996.[126] At the time he joined the Club, Webster was a

[126] Id. at 294; Members List at 2. Webster's wife, Mary, is a co-complainant, but appears to have played no substantial role in the events underlying this proceeding.

Webster also testified at the hearing and, in doing so, revealed significant credibility flaws. As a complainant, Webster has a significant pecuniary stake in the outcome of this proceeding. In addition, he was involved in disputes with the Club not directly related to this litigation. See infra text accompanying notes 174-75. Thus, there is reason to believe that he has ill feelings toward Gaiber. While Gaiber is not a party to this case, the Complainants' claims, if proved, would undermine Gaiber's reputation. Accordingly, there is an inherent danger that Webster's interest and bias might color his testimony in this proceeding. John Henry Wigmore, Evidence in Trials at Common Law §§945, 948-49, 966 (James H. Chadborn rev. 1970). These facts, alone, do not make his testimony incredible per se. However, in this case, Webster's interest and bias combined with other indicia of unreliability to cast his testimony in a doubtful light.

Proof of diminished capacity, such as a faulty memory, and inconsistent statements tend to lessen a witness' believability. Id. at §§995(1), 1017. The ability of a complaining witness to reliably recall and describe events is central to this type of case. Webster claims both fraudulent inducement and a failure to make adequate disclosure. He bases his claims on statements that were not recorded. Whether a statement is true or false may sometimes turn on fine distinctions. A truthfully stated hypothetical that led to a certain outcome could, in the fog of a defective memory, become a promise that trading will achieve the result of the hypothetical under any circumstances. Likewise, a statement that the risk in buying options is limited to a specific amount (the premium) could, over time and in an emotionally charged atmosphere, be inaccurately remembered as a statement that the risk of selling options was limited to a specific amount. In addition to credibly evidencing whether

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there was a fraud, memory is essential to providing credible testimony with respect to causation.

As discussed in some detail below, complainants must also prove causation in order to recover for the alleged fraud. Causation depends on what the complainants knew and believed when they acted. Thus, a complaining witness who does not recall the information he had, when he acted, would tend not to be able to credibly establish causation. Likewise, the extent of the causal chain in a fraud case depends on what the complainant learns and when this learning takes place. A complainant's actual revelations, as opposed to the events that cause them, tend not to be recorded. Thus, first-hand recall is crucial.

Mr. Webster has significant gaps in his memory of relevant events. As part of the account-opening process, Miles wrote a letter to Webster. Ex. 2 at P-NW000002. Upon examination, Webster not only failed to recall the letter but an examination of the letter failed to refresh his memory. Tr. at 340-41. This was not his only memory lapse with regard to the account-opening process.

Webster rests a considerable part of his argument on that fact that the Club possessed Refco account-opening kits and, in his complaint, claimed that, when he expressed an interest in opening a Refco account, Gaiber told him that "he had account forms available." Webster Complaint at 10. Webster, however, obtained his account-opening forms by calling respondents. Tr. at 301. Thus, he had to explain why he called respondents when the documents he needed were on-hand. On the stand, Webster first intimated that he called because the Club was "out of the forms" but immediately backed off from that statement, claiming that he did not remember why he called Refco. Tr. at 301. In earlier statements, Webster explained why he called respondents directly and the reason had nothing to do with whether the Club had account-opening documents on hand. Complainant's Reply to Respondents' Interrogatories, CFTC Docket No. 98-R005, dated February 1, 1998 ("Webster Response to Interrogatories"), at 1 ("I decided . . . to contact Refco directly . . . because I wanted to verify for myself the relationship between Refco and B&B."). When asked whether he called in order to "verify the [Club's] relationship with Refco," Webster answered "No." Tr. at 339.

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Similarly, Webster remembers little of the account-opening process. He encountered a bit of difficulty in completing his account-opening forms to Refco's satisfaction. As a result, there was a series of facsimile transmissions between Webster and respondents. Ex. 2. Indeed, Webster expressed some frustration with the process. Id. at NW000074 ("Donna[.] Please call with any questions[.] This is getting to be a drag! Neal Webster[.]" (emphasis omitted)). On cross-examination, Webster did not recall this series of communications. Tr. at 341-42. However, his memory was later refreshed. Id. at 342-48.

While the evidentiary record refreshed Webster's recollection of certain events, there were other events as to which documents were insufficient. Webster recalls having attended the dinner respondents hosted for their customers at the Club. Id. at 365. However, he did not recall having attended the breakfast. Id. at 366. Even after examining a photograph of himself at the event, Webster was still unable to remember it. Id. at 368.

Just as Webster did not remember much of what occurred during the account-opening process, see, e.g., id. at 341-2, he did not remember major events in the trading and administration of the account. The timing of Webster's knowledge of when his account revealed the possibility of significant losses is material to the issue of causation. On cross-examination, respondents' counsel asked Webster whether April 15, 1997 was the date when he first learned "there were problems" in his account. Id. at 393. Webster replied, "I don't know about that. I don't remember." Id.

When asked whether he had received telephone calls from Aiello, informing him of margin calls, Webster replied "I don't recall." Id. at 376. When confronted with an earlier admission that he had received such telephone calls, Webster replied "Evidently I - you know, I don't recall it exactly, but I'm - it must have happened." Id. at 377. Having secured Webster's admission that he received telephone calls with regard to margin calls, respondents' counsel then asked if Webster ignored them. Webster, replied "I'm not sure about that." Id. at 378. When pressed with evidence of a contrary statement, he immediately admitted that he had ignored margin calls. Id. Similarly, when pressed on his knowledge of the need to deposit more money in

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response to a margin call, Webster claimed not to recall why he wrote a $35,000 check (that bounced) for deposit in his account. Id. at 381-82.

In addition to forgetting the circumstances under which he opened his account with Refco and forgetting significant events during the life of the account, Webster demonstrated a shaky memory (or an intent to knowingly provide false testimony) of the circumstances surrounding the account's termination. This resulted in testimony that contradicted prior statements. In his complaint, Webster provided the following description of the closing of his Refco account.

> "After we had sustained the huge loss, I made the inquiries that I would have made in the beginning had I not been deceived by the false sales pitch of the Bulls & Bears Group . . . . I discovered through my inquiries that since [w]e were short the strangles, [w]e had been exposed to unlimited liability in a highly volatile market . . . . In early June, 1997, I called Respondent Miles on the telephone and instructed him to close the account . . . ."

Webster Complaint at 12. Thus, Webster creates the impression that, stunned by his trading losses, he independently learned that selling options entailed substantial risk and, on the basis of that new-found knowledge, decided to close the account. With a great deal of reluctance, Webster revealed a different version of events in the following colloquy.

> Counsel. "There came a time when Refco terminated your account, correct?"
>
> Webster. "I believe so."
>
> Counsel. "You believe so?"
>
> Webster. "Well, I - you know, I closed - I closed -"
>
> Counsel. "I mean you know so, right?"

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> Webster. "I closed the account; I know that.
>
> . . . .
>
> I was asked to close it, I believe."
>
> Counsel. "Isn't it fair to say you were told that your account was being closed?"
>
> Webster. "No."
>
> Counsel. "That is, Refco closed your account?"
>
> Webster. "No."

Tr. at 382-83. Respondents' counsel then directed Webster's attention to Exhibit 83, a letter in which Miles informed Webster that Refco was closing the account. Confronted with this evidence, Webster recanted. Id. at 384-85.

Webster's self-interest appears to have combined with his lack of memory to produce testimony that, if left unchallenged, might have misled the Court. Respondents' counsel asked whether, when he requested account-opening documents, Refco sent them to his home. Id. at 339. Webster replied "I believe they sent them to the club." Id. When pressed on the matter and made aware of contradictory evidence, Webster immediately changed his testimony. Id. at 340. Thus, either Webster consciously lied, until confronted with contrary evidence, or he simply did not remember what occurred and filled in the blank with what he hoped the facts might be. There was at least one other instance of this conduct.

Respondents' counsel asked Webster whether, after he experienced his mid-April losses, he terminated Rhea's discretion over his account. Id. at 399. Webster replied "I believe, yeah." Id. Counsel then immediately challenged the assertion. In response, Webster chose not to defend it. Rather, he claimed "I don't recall." Id.

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Webster's testimony was not only internally inconsistent and inconsistent with his complaint. It also contradicted his statements in prehearing discovery. Webster testified that it was only after he experienced his losses that he came to regard Gaiber as an agent acting for Refco. Id. at 385. Earlier statements contradict this. In his responses to discovery requests, Webster told a different story. First, he stated that "B&B persons did verbally indicate that they had authority to act for respondents." Complainant's Reply to Respondents' Request for Admissions, CFTC Docket No. 98-R005, dated February 1, 1998 ("Webster Admissions"), at 2. He then claimed to have requested his account-opening forms directly from Refco in order to "verify . . . the relationship between Refco and B&B". Webster Response to Interrogatories at 1. He described the effect of the conversation by stating, "[t]hat conversation reinforced my belief that Gaiber and B&B acted for Refco." Id. at 2. The contradiction could not be more plain and it is not the only statement contradicted by the record.

For example, Webster claims that Gaiber formulated the trading strategy of his account prior to his mid-April losses, when Rhea called in the trades for him, and afterward, when he called in the trades himself. Tr. at 309, 317. He also testified that he "knew Sy [Gaiber] was only recommending strangles." Id. at 318. Therefore, if Gaiber was the source of his trading strategies and Gaiber was only recommending strangles, then one would expect that Webster only traded strangles during this period.

As it turns out, Webster did not trade strangles exclusively. For example, on April 28, 1997, Webster day-traded one S&P call and did the same over the next two days. NW000127-29. On May 5th, he day-traded one S&P Index future. NW000130. On May 12, 1997, he day-traded one S&P Index future and sold one S&P call. NW000131. As this sample of Webster's trading indicates, either Gaiber did not recommend only strangles or someone else made trade recommendations to Webster. In light of Webster's trading, both statements cannot be true.

In addition to an unreliable memory, patently inconsistent statements and a propensity to fill in the blanks in a self-serving, disingenuous manner, Webster tended to be evasive. See, e.g., Tr. at 355-56. Moreover, Webster's demeanor on the stand

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retiree, who previously operated his own business, with an annual income in excess of $100,000 and a net worth of about $2,000,000.[127] Webster did not begin trading at first, nor was his membership in the Club contingent on trading in any respect, trading commodity futures and options, or trading with any particular broker.[128] An attendee of virtually every Wednesday night seminar,[129] Webster joined one of the partnership accounts involving Club members,[130] and, in February 1997, opened the account at issue in this proceeding.[131]

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undermined his credibility further. Accordingly, the Court finds Webster's testimony to be generally incredible and, in particular, less credible than the testimony of Wall, Johnson, Aiello, Miles, Van Essen, Rhea and Gaiber.

127 Id. at 349-50.

128 Id. at 294-95, 298.

129 Id. at 295-96.

130 Webster does not recall when he opened the partnership account, only that it preceded his losses. Id. at 357. In order to open that account he executed a risk disclosure statement acknowledgement but claims not to have read the risk disclosure statements. Id. at 358. Webster offered no explanation as to why he failed to read the disclosures, nor does he claim that anyone discounted their importance. See id.

131 Id. at 295.

In his complaint, Webster claims Gaiber referred him to Refco. Webster Complaint at 10. Later, in a response to interrogatories, he claimed Rhea made the referral. Webster Interrogatories at 1. Finally, he testified that they both

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referred him to Refco. Tr. at 298-99. The third version has two possible explanations. First, it is possible that they both referred him to Refco, in which case the first two versions were technically correct but only partially truthful. It is also possible that the version of events testified to was merely an attempt to reconcile his previous, inconsistent statements. Unfortunately, Webster offered no explanation. Given Webster's general incredibility, and the inconsistency of his testimony on the circumstances surrounding the allegations of the express referral(s), the Court finds Webster's testimony an insufficient basis upon which to find that either Rhea or Gaiber expressly referred Webster to Refco. Likewise, the Court does not find that Webster called respondents in order to verify any relationship they may have had with the Club since Webster himself recanted this prior explanation. Id. at 339. Rather, the Court finds that Webster called respondents because the call was necessary to obtain Refco account-opening documents.

Webster also testified that Gaiber discounted the importance of the account-opening documents by telling him that filling them out was "no big deal." Id. at 300-01. In his response to respondents' interrogatories, Webster claimed that it was Rhea who told him that the documents were "nothing to concern himself with." Webster Interrogatories at 1. Both deny having made such statements to Webster. Tr. at 841, 930. The testimony of both Rhea and Gaiber revealed flaws that undermined their credibility. However, as discussed above, Webster's testimony also revealed him to be relatively incredible. In comparative terms, the Court finds that Webster's testimony, on this point, is no more credible than that of Rhea or Gaiber. Webster, as the party burdened with proving his case, is deemed not to have established that either Rhea or Gaiber made statements discounting the importance of the account-opening documents, in general, or the risk disclosure statements, specifically. See supra note 46.

Webster also testified that he had reason to believe that Rhea had arranged a "special commission structure" for Club members with Refco. Tr. at 300. This uncorroborated testimony conflicts with that of the respondents and their witnesses. Indeed, Webster does not know if it was the case or if Refco simply offered low commissions. Id. at 332. On this point the Court finds Webster's testimony, even if credible, insufficient

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Webster called Refco and had the account-opening documents sent to his home.[132] He received the account-opening forms, filled them out and returned them to Refco.[133] This included reading a risk disclosure statement and signing an acknowledgement that he had read and understood it.[134] Refco,

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to establish a special fee arrangement for Club members who traded at Refco due to his admitted lack of knowledge.

[132] Id. at 301-02, 339-40. Webster initially testified that, based on his request, Refco sent his account-opening documents to the Club rather than his home. Id. at 339. The record contradicts this and, when pressed, Webster reversed his story. Ex. 2 at P-NW000002; Tr. at 339-40.

[133] Id. at 302. On his account application, Webster stated that he had traded commodities previously. Ex. 36.

[134] Ex. 39; Ex. 40. Webster's completion of the risk disclosure statement acknowledgement creates the presumption that he did in fact read and understand the form. See infra note 420. In rebuttal, Webster offers his testimony that he did not read the statement. Tr. at 335. As noted above the Court found Webster's testimony that Rhea and (or) Gaiber minimized the form's importance to be insufficiently credible. Even if Rhea and Gaiber had minimized the importance of the account-opening documents, those statements do not appear to have been the reason Webster failed to read the risk disclosure form, assuming arguendo, his testimony on this issue was reliable.

Webster, on direct examination, explained his alleged failure to read the risk disclosure documents. He testified "I knew that most everything that was written there would be to protect them, and so they weren't going to open the account unless I signed the - unless I signed the papers. And so we wanted the account opened." Id. at 336. Accordingly, it appears that any statements, minimizing the importance of the risk disclosure statement, did not have an actual vitiating effect. Even if the Court found Webster credible as to his testimony that (continued..)

however, found the forms to have been incorrectly completed and it took a series of faxes between Webster and Refco to get it right.[135] Webster deposited $30,000 on February 12, 1997 and began trading.[136]

Webster was a regular at the Club and engaged in the group decision making.[137] He tended to follow one member in particular, Rhea. Webster and Rhea were companions at the Club and Rhea became a model of sorts for Webster.[138] Webster would mimic

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he did not read the statement because it was a form contract, that fact would not relieve him of the presumption his signature created. See Purdy v. CFTC, 968 F.2d 510, 521 (5th Cir. 1992), cert. denied, 507 U.S. 936 (1993).

[135] Ex. 2 at NW000074 -77.

[136] NW000091. While he traded, Webster received daily account statements, monthly account statements, equity runs and confirmations of his order fills. Tr. at 369-376.

[137] Webster claims that he simply followed the advice of Gaiber. Id. at 309. As discussed above, the Court found his testimony on this fact contradicted by other testimony and Webster's actual trading. The Court finds Webster insufficiently credible, in light of contradictory testimony discussed above, to credit and, therefore, declines to find this fact.

[138] As Aiello described it,

> "Well, to begin with, Neal Webster was somewhat of a sidekick to Stan Rhea. Everything Stan Rhea wanted to do Neal Webster had to be a part of it.
>
> They sat next to each other. And I know this personally, because I was there. And I

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Rhea's trades. He placed a number of his own orders,[139] but he would also have Rhea convey some of his to respondents when following Rhea. When he blocked his orders with Rhea, a Dearborn AP would speak with Webster just long enough to verify his authorization of the order Rhea attributed to him.[140] At

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(..continued)

> know this because I can hear them always chattering together on the telephone when they called to placed trades."

Id. at 742.

139 Id. at 314, 742 ("Neal Webster placed a lot of his own trades, a tremendous amount of his own trades."). When Webster placed these trades, some of which occurred before his mid-April losses, Aiello did discuss the risks inherent in trading strangles. Id. at 740-41, 742.

140 Aiello explained the process in the following colloquy.

> Counsel. "Describe how it would unfold[.]"
>
> Aiello. "Well, Stan would call up and quote the market. I would give him that quote, and he would say, you know, sell ten. And then I would say, 'Okay, Stan.' And all of a sudden he would be interrupted and you'd hear, 'Well, Neal wants to do that also.' And I --"
>
> Counsel. "What was your procedure when he did that?"
>
> Aiello. "I would ask Stan to put Neal on the phone."
>
> Counsel. "And then what would happen?"

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respondents' suggestion,[141] Webster eventually granted third party discretion over his account to Rhea.[142]

Webster's trading began inauspiciously. He sold 10 T-Bond strangles on February 12, 1997 and, one day later, offset the calls at a loss of $2,812.50, not accounting for transactions costs.[143] He reestablished the call legs that day, but at a price that guaranteed the best-case outcome for the 10-strangle trade would be a $1,306.20 loss, not counting commissions and fees.[144] Chastised by his loss, Webster continued trading, but took fewer

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> Aiello. "And Neal would get on the phone and say, 'Yeah. John, go ahead.'"

Id. at 752.

141 On April 14, 1997, Aiello faxed a letter to Webster that stated, in part,

> "Stan currently does not have discretion over your account and your orders are blocked in along with Stan[']s. Therefore[,] if you wish to continue to block your orders with Stan[']s[,] please fill out the paperwork I have sent you and fax it back to me immediately."

NW000051; see Tr. at 312-13.

142 Ex. 42; NW000021-23; Tr. at 314.

143 NW000091-92.

144 Id.

open positions.[145] As he experienced success, his risk aversion soon diminished. Webster wrote 10 T-Bond puts on February, 20, 1997.[146] He sold 10 additional T-Bond puts on February 26th and 20 T-Bond calls the next day, effectively creating 20 open T-Bond strangles.[147] These trades faired poorly. Webster liquidated them on February 28th at a net loss of $7,343.80 plus commissions and fees.[148] Thus, in the first three weeks he traded, Webster was aware, on the basis of is own trading, that he could lose substantially more than $1,000 while selling options. In addition, at this point, the value of his account was over $3,500 less than his deposits.[149] However, Webster was apparently undeterred.

Webster continued to write strangles and experienced another period of success.[150] This success was short-lived however. On

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[145] NW000092-93.

[146] NW000095. On the day before, Webster deposited an additional $15,000 in his account. NW000094.

[147] NW000097-98. Webster also day-traded 10 T-Bond calls on February 26, 1997, at a profit of $2,812.60 less commissions and fees. NW000097.

[148] NW000099.

[149] NW000091-99.

[150] NW000099-108. Webster had $20,000 in cash deposits transferred from the account on March 24, 1997. NW000108.

March 25, 1997,[151] Webster sold 12 S&P strangles.[152] Six days later, he offset the positions at a net loss (not including commissions and fees) of $25,800.[153] At this point, the value of Webster's account was over $32,000 less than its net deposits to date (29 percent of net deposits).[154] Webster was not fairing particularly well but he persisted, writing 12 S&P strangles on March 31, 1997, and depositing $75,000 into his account on April 2nd.[155]

At about this time, Webster began to diversify his trading, in a sense, by speculating on futures as well as options.[156] He also continued selling S&P puts, selling 10 on April 4th, one on April 8th, and one on April 9th.[157] While a number of these positions expired out of the money, Webster took another series

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151 As noted above, prior to placing this trade, Webster had attended the breakfast at which Van Essen and Aiello discussed the risks involved in writing strangles.

152 NW000109.

153 NW000110.

154 The account's value, at the close of March 31, 1997 was $10,263.76. NW000110. However, one of the options sales was cancelled and, in its place, Refco substituted a sale of the same number of identical contracts at a price that generated $2,700 more in total premiums. NW000111.

155 NW000110-12.

156 NW000113-119.

157 NW000114-117.

of losses on April 11, 1997. He offset the put legs of the March 31st strangles at a loss of $12,300,[158] the April 8th put at a loss of $5,950 and the April 9th put at a loss of $4,150.[159] Over the course of that day, his account declined over $43,000 in value.[160]

On April 14, 1997, Webster profitably liquidated his four S&P future short positions and, on the same day, doubled his bet, selling eight S&P futures.[161] The next day, clearly expecting a falling S&P market, Webster kept his short futures positions open and sold 16 S&P calls.[162] Over the course of April 15th, the market moved against him. By the end of the trading day, his account value had fallen from $119,062.67 to $51,239.13.[163] On April 16th, Webster liquidated his futures positions at a loss of $68,400 and his calls at a loss of $64,000.[164] Although he

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[158] NW000119. At this point, the best possible outcome of the March 31st strangle was a loss of $300, not including transaction costs. See NW000110, NW000119.

[159] NW000119.

[160] NW000118-119.

[161] NW000120-21.

[162] NW000121.

[163] NW000120-121.

[164] NW000122.

profitably offset his open puts, his account had a negative liquidating value of $8,801.31 by the end of the day.[165]

Webster continued to trade, depositing additional funds into his account on April 18, 1997 and April 25, 1998.[166] However, he never came close to recovering his losses. In fact, between April 25, 1997, the date of his final deposit in the account, and June 10, 1997, the account's value fell from $53,848.81 to $22,957.05.[167] Not once, after April 25th, did the account's value ever exceed $53,000.[168]

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165 Id.

166 NW000123-126. Webster attributes his continued trading to a combination of factors. He claims Gaiber convinced him of the following: (1) the trading losses he experienced between April 12th and April 16th were unprecedented, (2) trading was the only way he could recover his losses, and (3) Gaiber could recover the losses for him if he deposited $60,000. Webster Interrogatories at 5; Tr. at 315-16. The Court finds this explanation unconvincing. First, Webster was not a credible witness generally. In addition, Webster knew that at least one of these statements was false. As discussed above, Webster attended the breakfast at which Van Essen explained the risk inherent in selling options. This explanation included a reference to a specific, historical instance when those who were selling S&P options would have taken huge losses. Thus, it is difficult to see how Webster could not have been aware that market movements that caused his losses were not unprecedented. In other words, Webster must have known that Gaiber's alleged explanation, of why his earlier alleged misrepresentations were not willful, was at least false in part. Accordingly, the Court doubts Webster would have found Gaiber convincing on this point.

167 NW000126-152.

168 NW000216-297.

Although, by early June 1997, Webster seemed determined to keep trading and was apparently still enamored with Refco,[169] the admiration was not mutual. Webster, relying on Gaiber's advice, had systematically ignored Refco margin calls.[170] In a letter dated June 10, 1997, Miles informed Webster that he would have to close his Refco account by June 20, 1997 or Refco would force liquidate his open positions.[171] Refco based the decision on Webster's failure to meet margin calls.[172] By June 23, 1997, all of his positions were liquidated and, about three weeks later, that account was closed out.[173]

At about the time his relationship with Refco was ending, Webster also severed his relationship with the Club. Webster apparently learned that some members did not have to pay dues or initiation fees.[174] On that basis, he appears to have concluded

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[169] NW000003.

[170] Tr. at 455, 699-700.

[171] Ex. 83; Tr. at 456, 700.

[172] Ex. 83; Tr. at 456.

[173] NW000160-63.

[174] In a letter to the Club, Webster made the following demand.

> "On the grounds of misrepresentation of the number of memberships that had been sold when I joined on October 26, 1996 and the fact that I was overcharged, I hereby **DEMAND** all membership fees, initiation fees, monthly

(continued..)

that he was being overcharged for his membership. On June 16, 1997, Webster cancelled his Club membership.[175]

Lawrence Sommerfeld

Sommerfeld is a 79-year-old man with vast business experience.[176] He is the co-owner (with his wife) and chief

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> dues that were paid and that were prepaid refunded **IMMEDIATELY** or no later than three (3) days after your receipt of this **DEMAND**."

CX-4, Letter from Neal Webster to Bulls and Bears Club, dated June 20, 1997 (emphasis in original).

[175] CX-4, Letter from Thomas Dullien to Neal Webster, dated June 16, 1997.

[176] Tr. at 1024-25, 1073-75.

Sommerfeld testified at the consolidated hearing in this matter. In terms of credibility, his testimony left much to be desired. Beyond his obvious interest in the outcome of this matter, Sommerfeld exhibited an unreliable memory and provided inconsistent testimony.

Sommerfeld did not remember an number of the events underlying his case. For example, in discovery, respondents asked Sommerfeld if he had attended a dinner and breakfast in the Palm Springs area at which Aiello was present. Respondents' First Request to Admit Facts, CFTC Docket No. 98-R009, dated December 23, 1997, at 11. Sommerfeld denied having done so. Complainant's Reply to Respondents' Request for Admissions, CFTC Docket No. 98-R009, dated February 1, 1998, at 7. He claimed to have denied the request for an admission because, at the time he answered it, he did not recall having been there. Tr. at 1091. Indeed, in a supplementary response, Sommerfeld implicitly admitted that the dinner occurred. Complainant's Additional (continued..)

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Discovery Responses, CFTC Docket No. 98-R009, dated April 1, 1998 ("Sommerfeld Additional Responses"), at 2. However, as to the breakfast, he stated that it was planned, but that "Aiello and Van Essen left for Las Vegas before the meeting was ever held." Id.

At the oral hearing, Sommerfeld explained that his recollection of the dinner was based solely on seeing photographs of the event. Tr. at 1092. While the photographs refreshed his memory as to whether the event occurred, it did not appear to refresh it to any great degree. Sommerfeld did not remember if anyone from Refco had attended the dinner. Id. at 1093. As it turns out, Aiello and Van Essen both had attended it. Ex. 49 at R001156. Moreover, both sat at the same table as Sommerfeld and Aiello sat next to him. Id.

While he did eventually, if incompletely, remember the dinner, Sommerfeld still did not remember what happened the next morning. Respondents' counsel asked him if he attended the breakfast at which Aiello and Van Essen discussed the risks of writing strangles. Tr. at 1093. Sommerfeld replied "I did not." Id. Even upon seeing a photograph of the event that included himself, Sommerfeld's memory of the fact remained irretrievable. Id. at 1093-96. Sommerfeld further undermined his testimony by how he dealt with this failure of memory in a previous statement.

Sommerfeld's failed memory begs the obvious question "What else has he forgotten?" However, this is not the most serious question it raises. His earlier statements, with regard to the breakfast, significantly undermine any confidence in the accuracy (or veracity) of Sommerfeld's testimony. He not only forgot an event in which he was a direct participant and assumed that, because he did not remember it, it did not happen, he filled the blank in his memory in a self-serving manner. He did this by creating (or accepting the suggestion, of someone who did not know the facts or simply misrepresented them, of) a fiction and generating a belief that it was true. This particular misrepresentation painted respondents in the worst light possible by insinuating that Aiello and Van Essen placed a gambling trip above meeting with their customers to discuss trading. The self-serving nature of this fiction is obvious and begs the question "If Sommerfeld filled this memory gap in a false, self-serving

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manner, what other gaps did he fill in a false, self-serving manner?"

Sommerfeld's testimony also contained a number of inconsistencies. For example, Sommerfeld testified that he opened his Refco account on the basis of a private conversation with Gaiber and before he attended his first Wednesday night seminar. Id. at 1028-31. This contradicted an earlier statement. In his complaint, Sommerfeld represented that Gaiber's presentation at a Wednesday night seminar induced him to open a Refco account. Sommerfeld Complaint at 9.

In his complaint and on direct examination, Sommerfeld claimed that he was completely unaware that his account had experienced any precipitous declines in value until June of 1997. Id. at 11; Tr. at 1052. This appears to have been a disingenuous attempt to extend the alleged causal chain to all of his trading losses. When asked on cross-examination, Sommerfeld admitted that he became aware of the late-April decline in the value of his account in that same month. Id. at 1111-13; see infra note 195. Not only did Sommerfeld admit awareness, he described it as "kind of [a] hit in the head." Tr. at 1111-12.

Even when he wasn't being pressed on cross-examination, Sommerfeld's testimony was variable. For example, he claimed that, in April of 1997, he requested his trading records from Refco at Gaiber's request. Id. at 1071. He explained that Gaiber told him he would not trade his account without the records. Id. at 1068. Later, while still on direct, Sommerfeld testified that Gaiber made the request because Gaiber "was at odds with Refco, he wanted to get LIT in there." Id. at 1071. Sommerfeld's testimony also varied from statements made in the prehearing development of his case.

In his reply to interrogatories, Sommerfeld stated that Gaiber controlled the trading of "more than 30 members." Complainant's Reply to Respondents' Interrogatories, CFTC Docket No. 98-R008, dated February 1, 1998 ("Sommerfeld Interrogatories"), at 3. This account describes Gaiber controlling about the accounts of about two-thirds of the Club members who traded commodities. In his oral testimony, Sommerfeld represented that Gaiber controlled the trading of about 12 accounts. Tr. at 1045.

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Sommerfeld testified that Gaiber directed the trading of Club members in the following manner.

> "Sy [Gaiber] would call Judy [Johnson], who was doing the secretarial kind of work, and say, get so-and-so on the phone and find out - then he mentioned some numbers of what percentages he could buy certain contracts at. If the contract numbers sounded good, he would either order six contracts, eight contracts, or whatever it was.
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> . . . .
>
> Then he would say to Judy, give one to Sommerfeld, give two to someone else, give three to somebody else, and so on and so forth."

Id. at 1035. In summary, Sommerfeld stated that Gaiber decided on what trades to place without any consultation the Club membership, not even with the members present when this was going on. In his complaint, Sommerfeld provided a different description, stating,

> "Gaiber would preside virtually every trading day at the club headquarters, monitoring the computer screen. He was continually and regularly recommending trades to virtually all of the membership. Gaiber would ask who, among the members, wanted to make a given trade. A number of members would frequently agree to make the recommended trade. . . . Gaiber would then designate a member to call in the trade to Refco on that member's own behalf and on behalf of all other members who were making the trade."

Sommerfeld Complaint at 7. Thus, Sommerfeld's version of the degree to which and manner in which Gaiber influenced the trading of Club members changed over time and in a self-serving manner.

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executive officer of the Jonathan Company, a firm selling trimmings that are primarily used in the manufacturing of women's garments.[177] Sommerfeld traded stocks for 21 years but, prior to joining the Club, he had never traded commodities.[178] At the time he joined the Club, his net worth was over $1 million (excluding the value of the Jonathan Company) and his annual income was "a couple of hundred thousand" dollars.[179]

Sommerfeld became interested in the Club after seeing one of its television advertisements in early 1997.[180] He called and made an appointment with Gaiber. Gaiber took him on a tour of

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The inconsistency is troubling and its precise nature further undermines Sommerfeld's credibility.

Sommerfeld's inconsistencies, his faulty memory and his demonstrated inclination to fill the gaps of his memory in a self-serving but baseless manner combine to cast the reliability of his testimony into serious doubt. Given, Mr. Sommerfeld's health at the time he testified, the Court is hesitant to draw negative inferences from his demeanor on the stand (or, more precisely, in his living room). However, the Court will note that nothing in his demeanor weakens the conclusion that he was a generally unreliable witness in his own cause.

177 Tr. at 1024-25, 1073-74. Prior to owning his own firm, Sommerfeld was the Vice President and General Manager of another company. Id. at 1074.

178 Id. at 1026. At the time he joined the Club, his stock portfolio had a value of between $400,000 and $600,000. Id.

179 Id. at 1074-75.

180 Id. at 1027.

the Club and told Sommerfeld that, by attending the Wednesday night seminars, he would learn about commodities trading.[181] Sommerfeld joined the Club "almost immediately."[182]

At about the same time, Sommerfeld opened his account with an initial deposit of $20,000.[183] He began trading on March 17, 1997, selling one S & P strangle.[184] He sold two additional strangles the next day.[185] These trades turned out well. The first strangle expired and Sommerfeld was able to offset the two

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[181] Id. at 1028-29.

[182] Id. at 1029. In his post hearing brief, complainants' counsel argues that Sommerfeld joined the Club to "meet new people, talk about interesting things, and perhaps learn something about securities." Complainants Brief at 6-7. This claim, that Sommerfeld joined the Club for primarily social reasons, has no basis in the record. In his complaint, Sommerfeld claimed that he was interested in joining the Club to "learn more about investing." Sommerfeld Complaint at 8. On the stand, he testified that Gaiber told him he could learn about trading commodities at the Club and it was after that representation that he joined. Tr. at 1028-29. Thus, the most likely inference that can be drawn from his testimony is that Sommerfeld joined to learn about trading commodities.

[183] Ex. 32; Ex. 33; Ex. 34; Ex. 35; LS000048. Although, in his complaint, Sommerfeld claims that he was never "given a copy of any risk disclosure statement," he did, in fact, receive one and executed a risk disclosure acknowledgement. Ex. 34 at P-LS000003; Sommerfeld Complaint at 10. The Court finds Sommerfeld's testimony insufficiently credible to overcome the presumption his signature created. Accordingly, the Court finds that Sommerfeld read and understood the risk disclosure statement.

[184] LS000049.

[185] LS000050.

other strangles at a profit of $2,405.84, counting commissions and transactions fees.[186]

No doubt encouraged by his early results, Sommerfeld deposited another $30,000 into his account on March 25, 1997 and $50,000 on March 31st.[187] On March 31, 1997, Sommerfeld wrote five S&P strangles.[188] This was his first losing trade. On April 14, 1997, he offset the puts at a loss of over $4,000.[189] Although the calls expired unexercised, the trade, as a whole lost just over $1,000 including commissions and transactions fees.[190] Despite the loss from the offset of the March 31st puts, Sommerfeld's trading was generally profitable up to that point. On April 17, 1997, he deposited another $50,000 into his account.[191]

Sommerfeld avoided the mid-April losses that gripped many of the Club's members, but not for long. In late April, Sommerfeld began trading simple calls rather then strangles. He sold 10 S&P

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186 LS000051-52.

187 LS000053-56.

188 LS000055.

189 LS000060.

190 LS000055; LS000060.

191 LS000061.

calls on April 22, 1997.[192] On April 29th, Sommerfeld sold five T-Bond calls, sold three S&P calls and bought five far out of the money T-Bond calls.[193] The market then moved against Sommerfeld.

Between April 22nd and the end of April 29th, his account declined over 26 percent in value, from $149,974.78 to 110,837.28.[194] Sommerfeld was aware of this decline in his account's value and the trading losses that would occur over the April 29th and 30th.[195] On April 30th, he offset the April 29th T-Bond positions, at a net loss of $1,328.10, and the April 22nd S&P calls at a loss of $47,000.[196] The next day, Sommerfeld offset the three S&P calls, from April 29, 1997, at a loss of $7,950.[197] Sommerfeld claims to have found these losses shocking

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[192] LS000063.

[193] LS000064.

[194] LS000063-64.

[195] Tr. at 1111-13. Sommerfeld received daily and monthly account statements at his home. Id. at 1048-49. He did not claim that he was unable to read the statements. Moreover, his claim that he was unaware of the late-April losses until June 1997 was contradicted by later testimony. Id. at 1111-13. Accordingly, the Court finds that Sommerfeld failed to provide sufficient credible evidence to find that he, an experienced businessman and investor, was unable to read the statements or did not read them.

[196] LS000065.

[197] LS000066.

and he did take a short hiatus from trading.[198] However, these losses were fairly inconsequential in the context of his personal wealth and the break from trading was brief.

After two weeks without trading, Sommerfeld began to day trade S&P futures and sell S&P options.[199] On average, his trades lost money and, by June 6, 1997, the account value was $99,833.49.[200] On June 6, 1997, Sommerfeld sold four S&P calls.[201] Over the next six days, the market turn sharply against these positions. On June 12, 1997, the four contracts were offset at a loss of $22,225.[202] At the close of the trading day, the account's value was down to $77,778.93.[203]

The June 12th losses appear to have been the last straw for Sommerfeld. He initiated no more trades with Refco thereafter and, withdrew his funds from the account on June 27, 1997.[204]

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198 Tr. at 1111-13.

199 LS000069-76.

200 LS000076.

201 LS000076; LS000078.

202 LS000080.

203 Id.

204 LS000081-84. At about the same time, he opened an account at LIT based on Gaiber's recommendation. Tr. at 1071. However, it appears that the account was not open for long. Id. at 1071-72.

A short time later, Sommerfeld terminated his Club membership.[205]

The Schneiders

Hans is restaurant and club manager and his wife, Lisa, is not employed outside of their home.[206] At the time they opened

[205] Id. at 1072.

[206] Id. at 23; Ex. 27; Ex. 28.

Both Hans and Lisa testified at the oral hearing and, upon consideration of the record and their demeanor, the Court finds them relatively incredible. Obviously, both are interested in the outcome of the proceeding and, therefore, have an incentive to fabricate testimony when it would not otherwise further their interests. In addition, their testimony reveals traits that make it unreliable. Hans provided inconsistent testimony, and demonstrated both a lack of memory or a tendency to falsely claim a lack of memory (in order to avoid answering certain questions). Lisa demonstrated a propensity to fill gaps in her memory with specific, self-serving testimony and provided patently inconsistent testimony. Thus, the credibility of both suffers.

As discussed above, memory is an essential element of witness credibility in a fraud-based case. Hans has either forgotten a number of relevant facts since the beginning of this litigation, or he used a lack of memory as a defense mechanism to avoid answering certain questions. Hans was asked whether, when he and Lisa transferred money to an account at LIT, they did so at Gaiber's suggestion. Tr. at 98. An affirmative answer to this question would tend to paint the Club as acting on its own behalf (or on behalf of its members) rather than on behalf of respondents. Hans testified that he could not "recall who recommended it." Id. Respondents' counsel directed Hans' attention to an earlier statement in which he admitted that the move to LIT occurred at Gaiber's suggestion. Id. at 99-100. Hans then changed his testimony. Id. at 100. Thus, it appears that Hans either forgot relevant facts over a fairly short period of time or he feigned a lack of memory where an ostensibly truthful answer would have tended to undermine his case.

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Hans did not remember other significant events regarding his trading. For example, he did not remember whether he and Lisa granted Gaiber power of attorney over their account at Saul Stone and Company ("Saul Stone"). Id. at 96-97 Once his memory was refreshed, he admitted that they had done so. Id. at 97.

There is at least one instance in which Hans clearly used his lack of memory as a defense to questions that undermined his case. He testified that he did not know whether, after she gave Hans a Refco account-opening form, Johnson immediately went back to her trading (rather than overseeing his reading and execution of the documents). Id. at 67. Upon being impeached with a prior, inconsistent statement, Hans reversed his answer, admitting that she did in fact return to trading after providing him with the forms. Id. at 69-70.

Hans' testimony contradicted the record. In his complaint and in discovery, Hans described the process by which he received the Refco account-opening documents. In both instances, he described the roles of Gaiber and Johnson and, in both instances, he claimed it was Gaiber, and not Johnson, who told him that filling out the account-opening forms was a "formality." Complainants' Reply to Respondents' Interrogatories, CFTC Docket No. 98-R075, dated May 14, 1998 ("Schneider Interrogatories"), at 2; Schneider Complaint at 10. In the response to interrogatories, Hans described Johnson's role in detail and, attributed to her no statement indicating that filling out the forms amounted to a mere formality. Schneider Interrogatories at 2. In his testimony, Hans described the role of Gaiber and Johnson in the provision of the account-opening documents that resulted from a conversation, the context of which was not provided. Hans stated,

> "[Gaiber] advised me that I would have to open an account. He mentioned that - the firm Refco. No other firm was ever brought up. And one of the members, who I later found out was Ms. Judy Johnson, handed me an application kit, which she said was a formality. I should fill out the blanks and sign where indicated, and I did so."

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Tr. at 30. Thus, unlike his two earlier statements, Hans claimed that Johnson and not Gaiber misled him as to the importance of the account-opening documents.

Likewise, Hans provided plainly false testimony to the Court. Respondents' counsel asked Hans (a businessman with over 20 years of experience) whether, when he signed his customer agreement, he knew he was signing a document that would govern his relationship with Refco. Id. at 60. Hans replied, stating that, when he executed the customer agreement, he "really didn't understand it." Id. Respondents' counsel pressed him on the matter and simply through repeating the questions, in incredulous tone of voice, induced Hans to admit that he was aware, at the time he signed it, that the customer agreement was a contract governing his relationship with Refco. Id. at 60-61.

The failure of Hans to remember certain events, his demonstrated propensity to use his ostensibly imperfect memory defensively and his patently inconsistent testimony combine to undermine his credibility as a witness. This conclusion is reinforced by his demeanor on the stand. Lisa demonstrated a marginally more trustworthy demeanor. However, the record reveals fatal flaws in her testimony as well.

In one instance, Lisa testified unequivocally where her memory was uncertain. She stated that, between the time Hans applied to open his Refco account until May 5, 1998, no one from Refco had communicated with her in any manner. Id. at 134-35. When the Schneiders opened their account, there was a problem with the wire transfer of funds. The following colloquy took place with regard to the problem with the wire transfer.

> Counsel: "[Y]ou were involved trying to get the wire transfer to work, right?"
>
> Lisa: "Yes."
>
> Counsel: "And in doing that, you had to talk to some people at Refco, correct?"
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> Lisa: "I don't believe I did."

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> Counsel: "You talked to John Aiello at Refco in order to work out the details relating to these problems with this wire transfer; isn't that right?"
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> Lisa: "Okay. I don't recall that, but –"
>
> Counsel: "Do you now?"
>
> Lisa: "No, I don't recall that."
>
> Counsel: "But you're not saying it didn't happen; you're just saying you don't recall?"
>
> Lisa: "I don't recall it."

Id. at 158-59. Aiello did recall what happened. There was a problem with the wire transfer and, as a result, Lisa called in order to find out why there was a delay in opening the account. Id. at 734-35. This was not the only such contact. See infra note 224. Thus, if the lack of memory was genuine, Lisa appears to have filled the gap with self-serving testimony. Similarly, her testimony included important inconsistencies.

The circumstances under which she filled out the account-opening documents are important to her claims based on the alleged fraud. Having signed a risk disclosure statement, she must prove that some act vitiated the document. Her attempt to do so patently failed as a result of the circumstances under which she admitted having filled out the account-opening forms. Lisa initially testified that, before she completed the account-opening documents, she was told that filling them out was "a formality" and, as a result, she signed the forms without reading them. Tr. at 134. When her counsel asked her if Hans told her that the completing the documents was a mere formality, she responded "No," and was in the process of explaining when her counsel interrupted the answer with a question on a different subject. Id. Lisa filled out the Refco forms in her home after Hans had presented them to her. Id. at 133-34. There is no evidence that, prior to filling them out, she discussed the documents with anyone else. See id. at 155-56. Prior to that

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their account with Refco, the Schneider's net worth was $1.2 million.[207] Hans initially approached the Club seeking employment as its general manager.[208] He interviewed with Gaiber and then Rhea.[209] The second interview was less of an interview than a solicitation for the Club. Rhea asked Hans if he had any money to invest.[210] Learning that he did, Rhea told Hans he could make

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time, she had no contact with either the Club or respondents. Therefore, if Hans did not tell her that filling them out was a formality, then no one did. On cross-examination, Lisa changed her testimony. Rather than claiming she did not read the forms because she was told filling them out was a "formality," she claimed not to have read the disclosure documents because "they were in a printed form that looked to me like a lease or a standard printed form, like opening a bank account." Id. at 157-58.

Lisa's attempt to implicate the Club in her decision making also led to other patently inconsistent testimony. When asked who first interested her in commodities trading, she replied "Sy Gaiber." Id. at 155. However, she later admitted that the idea to open the joint account came to her from her husband, not Gaiber. Id. at 165. Lisa's testimony, given its obviously overreaching, raises the distinct possibility that, over the course of the litigation, she learned what facts she would have to be prove, in order to recover against respondents, and was willing to shade the truth in order to evidence those facts. Thus, she is a relatively incredible witness despite a somewhat benign demeanor on the stand.

[207] Id. at 49.

[208] Id. at 24.

[209] Id. at 24.

[210] Id. at 24-25.

more money in one month by investing than he could in one year as the Club's manager.[211] Hans did not get the job, but he did become interested in joining the Club.[212] He called Gaiber and indicated this interest.[213] In response, Gaiber invited him to attend a Wednesday seminar.[214]

Hans attended a Club seminar in March 1997.[215] Almost immediately, he decided to join the Club and, later, filled out the appropriate forms and made his membership deposit.[216] At about the same time, Hans spoke with Gaiber and expressed a desire to begin trading.[217] Gaiber told him that, to trade, he would have to open an account and he recommended Refco as a broker.[218] Hans apparently credited this recommendation because

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211 Id. at 25.

212 Id. at 25.

213 Id.

214 Id.

215 Id. at 26.

216 Id. at 30; Members List at 3.

217 Hans did not provide the context of his conversation with Gaiber. Tr. at 30. More precisely, he did not claim that Gaiber approached him in order to get him to trade immediately. Id. Accordingly, the Court makes no finding that Gaiber initiated this conversation.

218 Id. at 30.

he decided to open a Refco account and obtained one of the account-opening kits that the Club had on hand.[219]

Hans filled out the account-opening forms at the Club and took them home for his wife, Lisa, to complete.[220] At her home, Lisa filled out the account-opening documents.[221] In the process of doing this, both Hans and Lisa read Refco's risk disclosure

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[219] Id. at 635.

Hans testified that Johnson told him filling out the forms was a mere "formality." Id. at 30. As noted above, Hans' testimony on this point is inconsistent. Johnson denies ever having said that to Hans or any other Club member. Id. at 599. In order to establish his version of the facts, Hans must win a swearing contest with Johnson and, in this case, he is unable to do so. While Johnson's testimony was not without some minor flaws, the Court finds her to be generally more credible than Hans. See supra note 206. The same is true as to this issue of fact.

Hans also testified that Gaiber told him that completing the forms was a formality. Tr. at 108. Gaiber denies this. Id. at 930. While Gaiber was not the most credible witness in this proceeding, the Court cannot say he was less credible than Hans. Accordingly, the Court does not find that Hans met his burden of proving that Gaiber made statements diminishing the importance of the Refco account-opening documents. See supra note 46.

[220] Tr. at 31. Hans' testimony was a bit confused on this point. When asked, "[A]fter you signed the forms . . . what did you then do with theses forms?," Hans replied "I handed them back to Judy Johnson, and that was actually the last I did at that time with those forms." Id. "[A]ctually," that was not what happened. When his counsel reminded him that Lisa also completed the forms, Hans admitted that he took them home to her after completing them at the Club. Id.

[221] Id. at 31, 155-57.

statement and acknowledged having done so.[222] The Schneiders completed most of the forms on March 21, 1997,[223] wired $50,000 to Refco and, once the certain problems with the forms and wire

[222] Both Hans and Lisa signed the risk disclosure acknowledgement form. Ex. 30. As noted above and discussed below, this act created the presumption that they read the risk disclosure form. In order to rebut this presumption, Hans and Lisa offer their testimony. Tr. at 30, 134. The Court has found their testimony to be generally incredible and, on this point, finds it insufficiently reliable to rebut the presumption. Although the self-serving testimony of an unreliable witness, standing alone, would tend not to rebut the presumption, another outcome might result if the testimony is combined with proof of circumstances that would have prevented reading the statement. In this case, however, no such circumstances were present. Hans and Lisa each had as much time as they wanted in which to read the Refco account-opening documents. Id. at 70-72.

Hans' testimony that he did not read the risk disclosure statement is especially unconvincing in light of his past practices. He testified that it was his habit to read important documents before he signed them. Id. at 60. In particular, he testified that it was his practice to read contracts before he signed them. Id. There is no evidence in the record as to why Hans would have checked his business sense (and his common sense) at the door, particularly when his own money it at stake, he is unfamiliar with the counter party and he is unfamiliar with the business of commodity contracts trading. The Court simply will not presume that a person who is generally prudent in business matters somehow becomes less so when that person's own interests are more directly at stake.

[223] Ex. 27; Ex. 28; Ex. 30.

transfer were resolved,[224] began trading.[225]

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[224] The Schneiders encountered two problems in opening their account. First, they had neglected to sign the customer agreement. Respondents detected this and called one of them. Tr. at 433-34. The Schneiders, having been notified, signed the Customer Agreement on March 24, 1997. Ex. 29. As discussed above, there was also a problem with the wire transfer of funds into the Refco account and Lisa, impatient with the delay in the transfer, called Refco. The problem was eventually resolved. Tr. at 734-35.

[225] Hans testified that he relied on Gaiber to "trade" his account and, thus, seeks to create the impression that he played no role in making those trading decisions. Id. at 33, 37. Not only that, he claims that he lacked the capacity to follow the status of his account prior to May 5, 1997. Id. at 79. His earlier account of how Club members traded, in the Complaint, contradicts the first statement, Schneider Complaint at 7-8, and later testimony and other circumstances contradict the second.

Hans admitted that, after he joined the Club, he tried to learn "as much as possible." Tr. at 29. However, he claims that his attempts to learn about reading his account statements were rebuffed. To be more exact, he testified that, when he sought help in trying to read his account statements, Gaiber and others actually dissuaded him from doing so, telling him that no one could understand them, not even professionals in the industry. Id. at 79-80. On cross-examination, he admitted that he knew what the market value entry on account statements represented. Id. at 80-81.

Lisa testified that she was less able to derive useful information from account statements than was Hans. Id. at 166. However, Lisa also testified that she and Hans reviewed their daily account statements as they arrived. Id. at 165. If her testimony was truthful and accurate in its entirety, in the context of her husband's, the Schneiders went through the trouble of reviewing their daily and monthly statements more as a ritual than an inquiry. It would have been an empty ritual because Hans knew little about reading them and Lisa nothing at all. It also would have been a quiet ritual because Hans apparently did not, either directly or indirectly, share what little he admitted to having known about the statements with his wife.

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The Court finds this testimony incredible. As noted above and below, both Hans and Lisa testified in a generally incredible manner. As for the testimony that, when Hans sought aid in reading his account statements he was rebuffed by Gaiber and Club members publicly, the Court is unconvinced. This testimony is uncorroborated. Thus, the Court must determine whether it represents a pearl of truth among the rubble of his otherwise inconsistent and contradicted testimony. The circumstances surrounding the alleged events do not support its credibility. Gaiber's alleged statements would have amounted to a concession that he could not understand the statements either. Based on the record and the Court's first-hand impressions of him, the Court doubts Gaiber would have denied his ability to read and explain account statements. In addition, Gaiber's alleged statements were, simply, too easily verifiable. The Club's membership consisted of experienced as well as inexperienced traders and the members shared information. Id. at 50-51, 88. It is unlikely that the Club's experienced traders could not read their account statements and the testimony is virtually unanimous that Club members shared information with each other. Id. at 50-51. Thus, there were no doubt members who could read the statements and, given the interchange of information, would have shared what they knew. Finally, the Court doubts that the Schneiders' time was so lacking in value that they would have repeatedly engaged in the ritual of reviewing account statements if the statements were basically meaningless to them. It is more likely that they would have learned how to read them from someone, learned from the act of reviewing the statements in the context of information they received from other sources, or simply stopped reviewing the statements.

Hans, at first, and Lisa, later, were at the Club on virtually every trading day. Id. at 924. Hans admits that he engaged in a conscious effort to learn what he needed to know to trade his account. Accordingly, he followed the markets and discussed trading with other members who used the Club as a trading base. Id. at 88, 998-99. It is highly improbable that Hans, with his business background, would have invested so much time and effort without learning to read more of his account statement than the account's net liquidating value. Thus, the Court declines to find that both Schneiders were completely dependent upon Gaiber for knowing the status of their account.

The Schneiders placed their first trade on March 27, 1997, buying five calls on S&P futures.[226] Four days later, they began writing strangles.[227] Between April 1st and April 30th, the Schneiders primarily sold strangles, but also took simple positions in S&P puts or calls.[228] These trades included selling five S&P strangles on April 16, 1997, selling five S&P calls on April 22nd and selling five calls on April 29th.[229] During this time, they deposited an additional $430,000 into the account.[230] At the end of April, the Schneiders experienced the first significant losses in their account.

Over the course of April 29, 1997, the value of the Schneiders' open positions declined significantly. Their account fell in value from $491,187.18 to $424,062.18.[231] On April 30th the Schneiders offset the 10 calls they had sold, in lots of five, on April 22nd and April 29th at losses of $24,500 and $4,350 respectively.[232] They also offset the put legs of the

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[226] HS000113-14.

[227] HS000114.

[228] HS000115-26.

[229] HS000123-26.

[230] HS000120.

[231] HS000125-26.

[232] HS000127.

strangles, sold on April 21, 1997, at a loss of $25,250.[233] Over that day, the account fell further in value to $419,502.88,[234] over $60,000 below the total deposits in the account.[235] Fully aware of these losses, the Schneiders continued trading.

On May 1, 1997, the Schneiders offset four S&P calls, purchased on the previous day, at a profit of $5,700 (not including commissions and fees).[236] They also purchased two S&P calls and sold 20 S&P calls at a higher strike price.[237] The next day, Hans and Lisa day-traded six S&P futures contracts at a profit of $9,600, day-traded one S&P call at a profit of $1,250 and offset the calls, purchased on the previous day, at a $1,800 profit.[238]

On May 5, 1997, the S&P market soared and the Schneiders suffered more significant losses. They offset the 10 S&P calls, sold on May 1, 1997, at a loss of $50,625, and day traded an S&P

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233 Id. At this point, the best-case outcome of the April 21st strangle, as a whole, would have been a $10,250 loss. HS000122.

234 HS000127.

235 HS000066-67.

236 HS000128.

237 Id. At the conclusion of this day, the account value had rebounded slightly, to $424,839.92. Id.

238 HS000129. Over the course of this day the account value fell to $356,965.56, over $120,000 less than the net deposits to date. Id.; HS000066-70.

call at a loss of $1,375.[239] A $36,250 profit from day-trading S&P futures stanched the bleeding somewhat.[240] However, on the next day, the loses continued to mount. Hans and Lisa, significantly under-margined at the time, offset the call legs of the April 16th strangles at a loss of $108,750, offset 10 of the May 1st calls at a $66,220.80 loss and offset the five purchased calls, from the previous day, at a loss of $13,750.[241] They also offset three T-Bond futures, at a $937.50 profit, and sold seven T-Bond calls.[242]

Although they had suffered significant losses, the Schneiders continued to trade. In early May of 1997, Gaiber tried to get Club members to move their accounts to LIT so that the Club would have a broker's AP on-site.[243] The Schneiders opened and traded an account at LIT but never closed the Refco account and continued to trade it as well.[244] By the middle of

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[239] HS000130. The account's value was down to $133,911.88 at the end of this day. Id.

[240] Id.

[241] HS000131; HS000289.

[242] HS000131. By the end of the day, the account's value rebounded slightly, to $149,963.50. Id.

[243] Tr. at 100, 939-40.

[244] Id. at 98; HS000036-64; HS000072-79.

On June 9, 1997, the Schneiders invested $20,000 in the T & T partnership. Ex. 101; Partnership Agreement of T & T (continued..)

June 1997, the Schneiders were again trading in their Refco account primarily and soon closed out the LIT account.[245]

At some point after the Schneiders suffered their losses, Gaiber apparently offered his services as a trading advisor.[246] In

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Organization at 1. That same day, they transferred their open positions in the Refco account to their LIT account. HS000020. However, two days later they made it clear that they did not wish to close the Refco account. HS000021.

245 Ex. 79; Tr. at 101. When the Schneiders "returned" to Refco, respondents made them jump through some internal compliance hoops that prompted the following letter from the Schneiders.

> "Dear Emil:
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> As per your request and under threat of discontinuation of our trading account with Refco we state the following:
>
> We are fully aware of the losses in our account since we started trading . . . . We have read your letter dated June 17, 1997 regarding margin calls. We are satisfied with the manner and professionalism with which Refco has handled our account. We would like to continue dealing with Refco Inc."

HS000489.

246 The Schneiders also claim that Gaiber reassured them that they could recover their losses trading. Tr. at 37, 137-38. However, they offer contradictory versions as to when this occurred. Hans testified that Gaiber reassured them of his ability to recoup the losses well after they granted him third-party discretion, an event that occurred in late-June 1997. Id. at 37; Ex. 31 at HS000013. Lisa's testimony places the alleged reassurance in early-May 1997. Tr. at 137-38. Given their incredibility and conflicting testimony, the Court credits neither version.

late June, after they had move their trading funds back to Refco, the Schneiders granted written discretion over their account to Gaiber.[247] Later that month, respondents gave the Schneiders the choice of continuing to trade through Refco or having Gaiber manage their account.[248] They chose the latter, moving their trading funds to an account at Saul Stone.[249] The Schneiders granted Gaiber authority to trade the Saul Stone account and, to keep it open,[250] terminated his authority over the Refco account.[251] In October 1997, they closed their Saul Stone account, transferring the funds back to Refco.[252] The Schneiders never succeeded in recovering their trading losses and, on December 29, 1997, closed their account at Refco.[253]

Earlier that month, the Schneiders and complainants' counsel met with Gaiber.[254] The purpose of this meeting was to see if Gaiber would essentially fall on his own sword, impugn himself

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247 Ex. 31 at HS000013; HS000012-16; HS000491.

248 Tr. at 37-38, 941.

249 Ex. 97; Ex. 98; Ex. 99; HS000089; Tr. 139-40.

250 HS000099.

251 Ex. 98; HS000019.

252 Ex. 102.

253 HS000026; Tr. at 93.

254 Id. at 145, 961-62.

and the reputation of the Club and, thereby, help them make a case against respondents.[255] Gaiber refused to cooperate and the skullduggery began.[256] After that meeting, complainants' lawyer sent Lisa to the Club to remove every Refco account-opening kit that was stored there.[257] She went to the Club and removed 11 such kits.[258]

David Krubinski

When he opened his account with Refco, Krubinski was a novice at commodities trading, but an experienced businessman who owned several firms, had traded securities, had an annual income

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[255] Id. at 961-62.

[256] Id. at 145, 961-62.

[257] Id. at 146, 151.

[258] Although she admits that she was instructed to remove all of the Refco kits, Lisa claims she only removed one-half of the kits and left 11 behind. Id. at 151. She offers no explanation as to why she did not follow her attorney's instructions. See id. Although her assertions were not challenged by other evidence, that does not mean that the existence of the 11 copies left behind was proven. Given her instructions, lack of an explanation, and her demonstrated unreliability as a witness, the Court declines to find that she left 11 copies behind. Accordingly, the Court concludes that, in late December 1997, the Club had an inventory of 11 Refco account-opening kits. As noted above, the Club also had the forms of other brokers on hand.

of over $100,000 and had a net worth of over $500,000.[259] He was also a neighbor of Rhea and it was in the context of this

[259] Id. at 196, 239-40, 849-50. He testified that he could not determine his net worth with any level of precision without consulting his accountant. Id. at 239. Likewise, he could not remember the amount by which his annual income, at the time, exceeded $100,000 nor would he volunteer a range of possibilities. Id.

As noted above, Krubinski was a witness in this proceeding, one the Court finds to have testified in a generally incredibly manner. Obviously, although not dispositive on the issue of credibility, Krubinski has an interest in the outcome of this proceeding. In addition, his testimony was variously inconsistent in light of his earlier statements, inconsistent in light of the documentary evidence and internally inconsistent. His demeanor further undermined the Court's confidence in Krubinski's reliability as a witness.

Krubinski's complaint, with regard to his trading experience, contradicted later testimony. In his complaint, Krubinski asserted "I had no prior experience whatsoever with the trading . . . securities." Krubinski Complaint at 1. On direct, Krubinski testified that he had traded securities for "a couple of years" and had a portfolio of "[f]orty [to] fifty thousand [dollars]." Tr. at 195-96. Krubinski's description of how he began trading was also inconsistent in light of earlier statements.

In his complaint, Krubinski described the process in which he filled out his account-opening documents with Refco by stating,

> "Stan Rhea then pointed to the places where I was required to sign the account forms. I never read, nor was I given time to read the forms. The entire process, presided over by Stan Rhea, took only a couple of minutes. It was handled as though it was a matter of minor importance. Stan took the forms with him."

Krubinski Complaint at 10 (emphasis added). Thus, he described a process in which he had no time to read the account-opening forms

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and Rhea was, at least, present. His testimony described it differently. On cross-examination, respondents' counsel asked "You had as much time as you needed to fill [the account-opening forms] out, correct?" Tr. at 241. Krubinski replied "I believe so." Id. When asked if Rhea was with him when he filled out the forms, Krubinski testified "No, I don't believe he was with me." Id.

On direct examination, complainants' counsel asked Krubinski what Rhea had told him about the risk of loss inherent in trading strangles. Id. at 198. Krubinski replied, "he told me that the risk of loss would be 25 percent maximum of my account; that's all I would be risking at any given time." Id. Earlier, in his complaint, he stated that Rhea told him that the trading would "earn substantially above average investment income without risk" and "when a loss was sustained it would be a minor one, of about a thousand dollars or so." Krubinski Complaint at 9; see also id. at 1.

Krubinski also discussed the mid-April losses that occurred among Club members in his testimony. He testified that he had heard the market was down and "people" had lost. Tr. at 277. He denied that he had heard "many members" had lost, thus denying a more compelling reason to suspect he might also have lost. Id. In his complaint, Krubinski stated "On or about April 15, 1997, I heard at the Club that many members had suffered substantial losses in their accounts." Krubinski Complaint at 13; Tr. at 277-78.

Krubinski testified that he first learned of his losses "sometime after I was told I was broke in the account." Id. at 207-08. In other words, Krubinski claims he was not aware of his losses until April 16th or later, when his account had a negative net value. DK000063. In his complaint, Krubinski described the situation differently. He stated,

> "On or about April 15, 1997, I heard at the club that many members had suffered substantial losses in their accounts. I asked Stan how my account was doing. He said my account 'took a big hit.' I asked Stan 'how big'? He told me that the account had diminished in value by about $40,000. . . .

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> On the next trading day, my account had a deficit balance of $894.08."

Krubinski Complaint at 13. Thus, under the version he related before in his complaint, Krubinski was aware of the losses one day earlier. What difference would one day make? Potentially tens of thousands of dollars in proximately-caused injuries because, at the end of the earlier day, his account had a market value of $36,344.42 rather than a negative net value. DK000062.

Krubinski's testimony contradicted other prior statements as well. His testimony eventually turned to Gaiber's efforts to get members to switch FCMs, from Refco to LIT. Tr. at 282. He testified to Gaiber's effort. However, he claimed not to know if anyone actually moved their account. Id. at 283. A transcribed conversation between Krubinski and Aiello reveals that Krubinski was aware some of the members switched to LIT. Ex. 89 at 6; Tr. at 286.

Krubinski's testimony not only contradicted earlier statements. It was internally inconsistent. See infra notes 267, 290. On cross-examination, Krubinski testified that, when he received margin calls and discussed them with Gaiber, he "had no idea that [the] margin call had anything to do with money." Tr. at 267. On direct, when he was obviously more confident that the questions were intended to help him prove his case, he provided contradictory testimony. Specifically, he testified that, when he discussed a margin call with Rhea and Gaiber, he asked "What do I do? Do I have to come up with this money?" Id. at 215-16 (internal quotations omitted). This testimony reveals that Krubinski had some "idea" a margin call had something to do with money.

In an earlier attempt to prove that Rhea had forged his name to an account application, Krubinski testified that the bank references on the allegedly forged version did not correctly list "the name and address of the bank in which [he] had an account." Id. at 202-03 (referring to Ex. 11). The alleged incorrect application lists the bank as "Home Savings of America" with an address of "57297 29 Palms" and a telephone number of "(800) 933-3000." Ex. 11; Tr. at 202. The version Krubinski claims to have executed is virtually identical to the version he disclaims. It lists the bank as "Home Savings of America" with an address of

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relationship that Krubinski began trading.[260]

By early 1997, Rhea and Krubinski had developed a congenial, if not close, relationship. They discussed a number of business-related topics and Rhea lent Krubinski a number of books and tapes on subjects of business and finance from his personal library.[261] The conversations turned toward investing. Around February 1997, Krubinski indicated that he and his business partners had some cash they would like to invest and asked Rhea

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"57297, 29 Palms Hwy" and a telephone number of "(800) 933-3000." Ex. 10; Tr. at 253. Krubinski's first deposit in the account was in the form of a check, drawing on the account of "I C R Services, Davis L M Krubinski" at "Home Savings of America." Ex. 17. Thus, Krubinski's testimony as to whether the application he disavows listed, as a bank reference, a bank at which he had an account was plainly false.

When asked whether he received daily account statements at his home, Krubinski replied "No, I did not." Id. at 246. If this statement were true, then he would have had difficulty monitoring the activity in his account. Respondents' counsel pressed him on the issue, referring to his response to a request for admissions. Id. at 246-47. As a result, Krubinski reversed his testimony. Id. at 247.

In addition to being substantively inconsistent, Krubinski was evasive on the stand. See, e.g., id. at 283. Moreover, his demeanor left much to be desired. Having considered Krubinski's testimony in light of the record as a whole and his manner on the stand, the Court finds him to be generally incredible and, on most matters, less credible than respondents' witnesses.

[260] Id. at 849-51.

[261] Id. at 850.

if he could find an investment for them.[262] Rhea recommended investing in commodity options.

To be more specific, Rhea told Krubinski about selling strangles. Rhea told him that selling strangles "could" generate "large" profits and that the amount of money at risk of loss would be less than the total deposited into the account.[263] Rhea

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[262] Id. at 197, 850-51.

[263] Krubinski claims Rhea told him that profits from selling strangles "could be large." Id. at 198. Likewise, he claims Rhea told him that, depending on what version is believed (if either), only 25 percent of the account would be at risk at any one time, $1,000 would be at risk, or the maximum amount at risk would be both 25 percent and $1,000. Id. at 198, 269-70. Rhea, on the other hand, denies telling him that strangles were riskless or that profits would be generally assured. Id. at 856. Thus, the Court is once again called on to make a credibility assessment. On this point, Krubinski appears to have been the more credible.

While Rhea's testimony was generally more consistent than Krubinski's and more consistent with the documentary record, the Court finds him incredible (and more so than Krubinski) on the issue of how he described the risk of loss inherent in trading strangles. This finding is based, in part, on how Rhea described the risk inherent in selling strangles in a writing that was distributed to other members. Rhea admits he wrote CX-2, but claims that he never gave it to anyone else and that the representations it contained were merely notes to himself. Id. at 891-92 The Court finds this explanation unpersuasive for two reasons. First, Webster and Sommerfeld received the document, without any proof that they did so by taking it from Rhea. In addition, the prose of the document indicates that Rhea wrote it for an audience and not himself. See CX-2 at 1 ("Before I begin, let me caution you against listening to doomsayers and other good-meaning people with whom you might discuss this procedure with [sic].").

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also suggested that Krubinski might be interested in joining the Club and invited him to visit the Club as Rhea's guest.[264] As a result of their conversation, Krubinski decided to open an account for which Rhea would make the trading decisions. Krubinski proposed that Rhea exercise discretion and receive a commission.[265] Rhea declined this arrangement since he felt it would require him to register as a CTA, something he was hesitant to do if he could avoid it.[266] Instead, they decided to open a joint account in which the two would own the account, Rhea could control the trading and Rhea could draw on accumulated profits as

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In this paper, Rhea described the chance of losing money in any one month as "2-3%." Id. Likewise, he claimed that, for an account of "about 30 to 50,000 [dollars]," a trader who wrote five to ten strangles would incur a risk of loss to the account that "[a]t almost no time is more than 30,000 [dollars] at risk and most of the time it's much less." Id. Given his unconvincing testimony that he made these statements to no one, the Court finds Rhea incredible on a closely related topic, whether he made similar statements to Krubinski. Accordingly, the Court finds that Rhea told Krubinski that, in writing strangles, the risk of loss at any point in time would be some amount less than the amount deposited into it. Given Krubinski's inconsistent testimony on the subject, the Court lacks a reliable basis upon which to make a more exact finding.

[264] Tr. at 851.

[265] Id. at 851-52.

[266] Id. at 852.

compensation.[267] Rhea obtained Refco account-opening forms and he and Krubinski filled them out.[268] As part of this process, Krubinski read the Refco risk disclosure statement and signed the acknowledgement of having done so.[269] This idea did not work. As a matter of policy, Refco did not permit unrelated persons to

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[267] Id. Rhea claims the idea for the joint account came from Krubinski and Krubinski claims the idea from Rhea. Id. at 198-200, 852. In addition, Krubinski denies any awareness of the plan to open a joint account, claiming he thought he was opening a joint account with his wife. Id. at 199-200. After some confusion, Krubinski admitted that he executed the account application dated June 25, 1997. Id. at 202; Ex. 10. Later, he admitted that it was his intention, when he did so, to open an account of which Rhea was a joint owner. Tr. at 213. Had Krubinski testified more consistently, the Court would have been inclined to find that the idea originated with Rhea since, as the more experienced of the two, he was in a better position to know how the ownership of a trading account could be structured. The question of with whom the idea originated is not particularly probative since the Court finds that Krubinski knew he was applying to open an account in which Rhea was a joint owner and intended to open such an account.

[268] Ex. 14.

[269] Krubinski signed the risk disclosure statement's acknowledgement form. Id. at DK000014. As noted above and discussed in detail below, this act created the rebuttable presumption that he read and understood the risk disclosure statement. Krubinski testified that he did not read the risk disclosure statement. Tr. at 204. As discussed above, Krubinski's testimony has been found generally incredible and his accounts of the circumstances under which he executed the acknowledgement are inconsistent. Accordingly, the Court finds Krubinski's testimony insufficiently credible to credit or to overcome the presumption his signature created.

open joint accounts.[270] They had to open a partnership account, in order to exercise joint control, and decided to do so.[271]

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[270] Id. at 852-53.

[271] Id. at 434, 853. Krubinski initially testified that he never intended to enter into a partnership with Rhea. Id. at 205. Instead, he implied that Rhea was simply to exercise control over the trading in return for a percentage of the trading profits. Id. at 205-06. However, when asked if there was any oral agreement that supplemented or modified the written contract, he replied "No more than this Partnership Agreement." Id. at 206. The "Partnership Agreement" he referred to is the "K-R Partnership Agreement." See Ex. 12. The agreement states, in part, the following and speaks for itself.

> "This agreement is entered into this 25th Day of February 1997, by David Krubinski and Stanley H. Rhea. . . .
>
> It is herein agreed:
>
> 1. That the purpose of this partnership is to trade and speculate in the Futures Markets.
>
> 2. The parties to this agreement acknowledge that Futures trading is a high risk venture and all funds could be lost due to market action.
>
> 3. The parties further agree that funds used in this account and for this purpose are risk capital.
>
> 4. The ownership of this account shall be Krubinski 90% and Rhea 10%. Any new deposits of funds into this agreement shall be according to this ratio.
>
> 5. The parties shall open a Futures/Options trading account with Refco & Co. . . . as soon as this document is signed by both parties.

(continued..)

Rhea obtained Refco partnership account-opening forms and he and Krubinski executed them.[272] The account-opening forms were sent to Refco along with an initial deposit of $50,000, drawn on Krubinski's bank account, and Rhea began trading the account on March 5, 1997.[273]

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> 6. This Partnership agreement may be terminated by either party giving the other party written notice."

Ex. 12 (emphasis added). If this was the entire agreement between them, it is impossible to believe that Krubinski, an experienced businessman, was unaware he was entering into a partnership. The Court finds Krubinski's testimony on this issue to be less credible that Rhea's and finds that Krubinski intended to enter into a partnership with Rhea for the purpose of trading through Refco.

[272] Tr. at 243-44, 853-55; Ex. 11; Ex. 12; Ex. 13. There is no evidence as to whether Rhea obtained the account-opening forms directly from respondents or through the Club. Rhea had, at roughly the same time, requested forms directly from respondents. Ex. 55.

Krubinski claims not to have executed the application for the partnership account. Tr. at 202. As discussed above, some of Krubinski's testimony in support of this contention was found to be patently inconsistent with the record. Given Krubinski's lack of credibility, the Court does not find that Krubinski failed to execute the partnership account application. The finding on this point is unimportant, however, because Krubinski admitted executing the partnership agreement with Rhea and the Refco Customer Agreement (Partnership). Id. at 242-44; Ex. 12; Ex. 13.

[273] Ex. 17; DK000021-22; DK000045.

(continued..)

Rhea sold six S&P strangles on March 5, 1997 and 10 more on March 10th.[274] On March 24, 1997, these strangles expired and the account profited $14,750.00, less transaction costs.[275] The next day, Rhea sold 12 S&P strangles for the account.[276] This trade did not turn out so well. The open strangles were offset, on

(..continued)

Krubinski claims that not only did Rhea make the trading decisions, he was the only partner who even knew how the account was performing. In other words, Krubinski claims that he had no idea the account experienced losses until about April 15, 1997, when he was "told there was no money in the account." Tr. at 207-08. If Krubinski had provided consistent, generally believable testimony, he would have been well situated to establish this point if he had been relatively inactive with respect to the Club. Such was not the case. Krubinski received daily and monthly account statements at his home, he attended the Wednesday night seminars frequently, he regularly spent time at the Club following the market, and he kept in regular contact with Rhea. Id. at 247, 851, 867-69, 998-99. Given this level of activity, it is difficult to believe that Krubinski remained blissfully unaware of what was happening with his money. Accordingly, the Court finds that Krubinski monitored his account and was generally aware of its performance.

274 DK000045-47. On March 19, 1997, Krubinski deposited an additional $16,200 into the account and Rhea deposited $1,800. DK000050.

275 DK000051.

276 DK000052. At about the same time, he also bought 10 S&P calls that eventually expired worthless. DK000053-064.

March 31, 1997, at a net loss of $25,800.00, not including commissions and fees.[277]

Although the account had suffered significant losses, Rhea persisted.[278] However, his trading strategy changed. He wrote 12 strangles on March 31, 1997 and, on April 1, 1997, sold 12 S&P puts.[279] The next day, Rhea offset two of the March 31st strangles at a profit of $700.[280] Rhea then began trading futures contracts with the account. On April 3, 1997, Rhea sold three S&P futures contracts and offset them the next day at a profit of $2,250.[281] He also sold five S&P puts on April 4th.[282] One week later, Rhea offset the remaining 10 puts, of the March 31st trades, at a $10,250 loss.[283] That same day, he sold 10 puts and three S&P futures contracts.[284] On April 14, 1997, Rhea offset

[277] DK000054. At the end of this trading day, the account's net liquidating value was $40,231.76, nearly $28,000 less than the deposits to date. Id.

[278] Of course, persistence is easier to muster when other people's money is at risk.

[279] DK000054-55.

[280] DK000056.

[281] DK000057-58.

[282] DK000058.

[283] DK000060.

[284] Id.

his futures position, at a $6,525 profit, and sold another five S&P futures contracts.[285]

On April 15th, Rhea sold 10 S&P calls. However, over the course of that day, the value of the K-R Partnership account fell by over 50 percent, from $77,219.42 to $36,344.42.[286] The next day, Rhea offset a significant number of the open positions at a loss. He offset the five open futures contracts at a loss of $42,400 and the 10 calls he sold the previous day at a loss of $40,000.[287] These losses were partially offset by the $12,250 profit from offsetting the puts from April 11, 1997.[288] At the close of April 16, 1997, the account had a debit value of $894.08.[289]

Although no doubt stung by his losses, Krubinski gave trading one more shot. He deposited $10,000 into the partnership account on April 23rd and another $10,000 on the next day.[290] Rhea

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285 DK000061-62.

286 Id. As discussed above, Krubinski was aware of these losses on April 15, 1997.

287 DK000063.

288 Id.

289 Id.

290 DK000065-66.

Krubinski's testimony as to what occurred at about this time is not only inconsistent with prior statements, it is internally (continued..)

continued to trade the account. However, he did not do so successfully and, eventually, ceased trading in the account.[291] On June 24, 1997, Krubinski liquidated the account. At that time, there were no open positions and a cash balance of $12,940.83.[292]

The Complainants File Suit

As noted above, the Websters, Sommerfeld and Krubinski filed complaints in October of 1997 and the Schneiders filed a complaint several months later.[293] Over the course of prehearing

(..continued)

inconsistent. He testified that, after the April 16th losses, he had no intention of continuing to trade. Tr. at 210 ("I didn't want any trading"). However, he also testified that he deposited the $20,000 in order to "recoup my losses." Id. at 209-10. The Court will presume that Krubinski did not intend to recoup his losses by the generation of interest based on the $20,000 as principal. Likewise, any claim that he did not intend that his account be further traded stands in contradiction to statements he made in his complaint. Compare id. at 210 with Krubinski Complaint at 14 ("I was grasping at straws to recoup my savings. On April 23, 1997, I made a deposit of $10,000 in the account and on the next day, April 24, 1997, I deposited another $10,000.").

[291] DK000125-60.

[292] DK000071. Krubinski later received a check, for earned interest, of $25.54. DK000073.

[293] Complaints' attorney also represents parties who initiated four other reparations proceedings that were forwarded to Judge Painter and Judgment Officer McGuire. Reparations Complaint, CFTC Docket No. 98-R006, dated October 2, 1997 (naming Aiello, Miles, Grant, Dearborn and Refco as respondents); Reparations Complaint, CFTC Docket No. 98-R007, dated October 7, 1997 (same);
(continued..)

(..continued)

Reparations Complaint, CFTC Docket No. 98-R008, dated October 2, 1997 (same); Reparations Complaint, CFTC Docket No. 98-R012, dated October 9, 1997 (same).

The Club members who decided to sue in reparations (and one who never traded through Refco) recruited other members to do the same. They touted a suit against Refco as a suit against a "deep pockets" respondent who would settle. Tr. at 181-82, 626-27 ("[Debra Michel] said, well, I've been told Refco has deep pockets. They'll pay. Exact words."). This strategy doomed the possibility of settlement as respondents no doubt reasoned that settlement would lead to suits by any Club member who lost money trading through them. As the following conversation reveals, these fears would not have been groundless.

> Brian Gottlieb ("Gottlieb"). "I got a call from Shirley Oster . . . ."
>
> Aiello. "You got a call from Shirley Oster? I'm not sure I know that name."
>
> Gottlieb. "Shirley Oster was the newest member to join the Bulls & Bears."
>
> Aiello. "O.K."
>
> Gottlieb. ". . . . and she did no trading with you guys."
>
> Aiello. "O.K."
>
> Gottlieb. "and what she called me about was asking me to join the lawsuit."
>
> Aiello. "She asked you to join the lawsuit?"
>
> Gottlieb. "Yes."
>
> Aiello. "Huh! That's strange."
>
> Gottlieb. "Refco and you and John and Emil.

(continued..)

development, the oral hearing and post-hearing briefs, complainants narrowed their cases to the following issues: (1) whether respondents should be vicariously liable for the Club's alleged fraud based on an agency relationship; (2) whether respondents should be found liable in reparations based on a failure to comply with the disclosure requirements of Rules 1.55

(..continued)

> . . . .
>
> telling me that I could get my money back
>
> . . . .
>
> and also telling me that you guys made an offer."
>
> Aiello. "That is completely bogus. That came to us via Schneider's residence also. We have no intention of settling . . . ."
>
> Gottlieb. "Well, you gotta understand where I'm coming from. If you're making -- if you guys are gonna give them something back, I deserve something too."
>
> . . . .
>
> Aiello. "What is your disposition? Are you -- are you thinking of joining this lawsuit?"
>
> Gottlieb. "Only if you guys have made an offer of settlement."
>
> Aiello. "No. I can assure you that's not happening. That is not gonna happen."

Ex. 88 at 1-2.

and 33.7; (3) whether respondents induced complainants to trade by fraudulent omissions with regard to the risks inherent in trading; (4) whether respondents engaged in the unauthorized trading of Webster's account and should therefore be held liable in reparations; and (5) whether respondents aided and abetted the Club's failure to register as an IB and should therefore be held liable in reparations. The Court now turns to these arguments and, for the reasons set out below, finds that respondents have failed to prove that respondents are liable to them in reparations.

Neither The Club Nor Its Agents Were Agents Of Respondents

Neither the Club, Gaiber, Rhea nor Johnson were registered with the Commission and the Club became insolvent as its members lost money, it lost members and members sued the Club on unrelated grounds.[294] Thus, despite an apparent general satisfaction with the way respondents handled their accounts,[295] complainants seek recovery from the registrants with whom they had contact. Complainants' primary claim is that respondents should be held vicariously liable for the alleged wrongdoing at

[294] Tr. at 298, 960.

[295] Id. at 42, 282, 473-74; NW000003. See Tr. at 462; Ex. 79.

the Club based on a Section 2(a)(1)(A)(iii) agency relationship.[296] The complainants' agency case primarily rests on three facts. They argue the fact that Refco account-opening documents passed through the hands of the Club before being received by an undetermined number of Club members is virtually dispositive.[297] In addition, they emphasize that respondents and the Club benefited from each other's existence and operation.[298] Finally, they combine the percentage of Club members who traded at Refco with the fact that some referrals by Club officers occurred to create what they claim is irrefutable evidence that the Club solicited for Refco with at least implicit authorization.[299] The second fact is virtually irrelevant while the first and third, in light of the totality of the circumstances, fall short of supporting the conclusion that the Club (and its agents) were Section 2(a)(1)(A) agents of Refco.

Section 2(a)(1)(A)(iii) provides that "the act, omission, or failure of any official, agent, or other person acting for any other individual, . . . corporation, or trust within the scope of

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[296] See 7 U.S.C. §4.

[297] Complainants Reply Brief at 3; Complainants Brief at 3.

[298] Id. at 2.

[299] Id. 1-2 ("45 out of 46 is strong evidence that the club solicited business for Refco and that Refco knew such was the case.")

his employment or office shall be deemed the act, omission, or failure of such individual, . . . corporation, or trust."[300] Section 2(a) is a variant of the common law principle of respondeat superior.[301] A respondent's liability under this section depends on proving (1) that a violation of the Commodity Exchange Act ("Act") or Commission regulation actually and proximately caused the complainants injury, (2) that the person committing the violation was the agent of the respondent, and (3) that the violation occurred within the scope of that agency.[302] The Court now turns to the issue of whether the Club was an agent of the respondent firms.

Complainants bear the burden of proving the existence and scope of an agency relationship by a preponderance of the evidence.[303] In order to determine whether the complainants have

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[300] 7 U.S.C. §4.

[301] Rosenthal & Co. v. CFTC, 802 F.2d 963, 966 (7th Cir. 1986).

Section 2(a) departs from respondeat superior in two important respects. First, it serves as a quasi-criminal statute in the enforcement context. Id. In addition, it applies to agents who are not necessarily employees. Id.

[302] Id. at 966-67.

[303] Berisko v. Eastern Capital Corp., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,772 at 31,223 (CFTC Oct. 1, 1985) ("It is well-settled that agency is not 'presumed' and that the burden of showing the relationship rests upon the party asserting it.").

(continued..)

met their burden, the Court engages in a two step analysis. First, the Court must determine whether a business relationship

(..continued)

By "preponderance of the evidence," the Court means evidence indicating that the existence of an agency relationship is "more probable than its nonexistence." Edward W. Cleary _et al._, _McCormick on Evidence_ §339 (3rd ed. 1984); _accord_ _Nissho-Iwai Co., Ltd. v. M/T Stolt Lion_, 719 F.2d 34, 38 (2d Cir. 1983); _Burch v. Reading Co._, 240 F.2d 574, 579 (3rd Cir. 1957), _cert. denied_, 353 U.S. 965 (1957); _Lobb v. J.T. McKerr & Co._, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,568 at 36,443 (CFTC Dec. 14, 1989). Accordingly, upon consideration of the facts, finding for complainants on this issue will require the Court to find not only that an agency relationship between respondents and the Club was the most likely possibility, but that it is more likely than all non-agency-relationship alternatives combined. At the risk of implicating a higher degree of precision than a court can normally bring to bear in a case like this, a numerically-based example illustrates the point. Assume that the evidence indicated three possible relationships were fairly likely to have existed between respondents and the Club. Assume that the evidence indicated there was a 0.50 probability that there was an agency relationship. Assume also that there was a 0.25 probability that the Club and respondents had an arm's-length relationship and that the evidence indicated there was a 0.24 probability that the Club and respondents had an arm's-length relationship but that the Club steered all of its members to Refco in order to sell respondents on the idea of creating a closer relationship (in order to receive more services for the Club's members). Finally, assume that the probability of all other possible, non-agency alternatives, as evidenced, was 0.01. Under these circumstances, the most probable version of the facts includes an agency relationship (at least two times more likely than any other single outcome). However, the evidence does not indicate that the existence of an agency relationship is more likely than not. Accordingly, a preponderance of evidence would not establish the existence of an agency relationship.

existed between Refco and the Club.[304] Then, the Court must classify the nature of the relationship.[305] The second step of the inquiry is factually intensive and ad hoc in nature. The agency analysis involves no dispositive factors, unclear lines of demarcation, an unbounded scope of inquiry and an express, but not very useful, set of policy imperatives.

The Commission has often referred to the Seventh Circuit's maxim, in Rosenthal & Co. v. CFTC,[306] that "[t]he ascription of agency is a purposive, policy-oriented act rather than an exercise in semantics."[307] The Commission described the policies underlying the Act's vicarious liability provision in Lobb v. J.T. McKerr & Company, stating

> "Section 2(a)(1)(A)'s imposition of secondary liability on a principal for the wrongdoing of its agent protects the interest of customers by providing a source of compensation that is generally more stable and reliable

[304] Almond v. Lincolnwood, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,776 at 34,043 (CFTC July 9, 1987). This step of the analysis is almost exclusively honored in the breach and the Commission has never commented on what level of interaction rises to the level of relationship. Accordingly, the Court will proceed directly to the second step.

[305] Id.

[306] 802 F.2d at 969.

[307] Wirth v. T & S Commodities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,271 at 38,875 (CFTC Apr. 6, 1992) (citation and internal quotations omitted).

> than often judgement-proof . . . employees. Aside from providing a source of compensation for the victims of wrongdoing, the strict liability imposed by Section 2(a)(1)(A) encourages principals to take steps to limit their potential liability. As a result, principals are more likely to investigate the character and ability of agents before they are retained and to provide supervision for those activities likely to result in liability."[308]

This statement of policy advances long-held views.[309] However, it provides little insight with regard to the essential nature of a Section 2(a)(1) agency. Thus, the Court must look elsewhere for guidance.

Whether one party is the agent for another depends on an assessment of the totality of circumstances.[310] The Commission has expressly avoided definite formulas and refused to identify dispositive factors.[311] As a result, prior case law applying Section 2(a)(1) guides the resolution of the agency issue by analogy only.

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[308] ¶24,568 at 36,444 (internal quotations and citations omitted).

[309] See W. Page Keeton et al., Prosser and Keeton on the Law of Torts §69, at 500-01 (5th ed. 1984) ("Prosser and Keeton").

[310] Stolter and Co. v. CFTC, 855 F.2d 1288, 1292 (7th Cir. 1988); Reed v. Sage Group, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,943 at 34,300 (CFTC Oct. 14, 1987); Berisko, ¶22,772 at 31,223.

[311] Wirth, ¶25,271 at 38,875.

The Second Restatement of Agency defines agency as "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf . . . and consent by the other to act."[312] An agreement to act "on behalf" of another is not merely an agreement to provide some good or service. Rather, it is an agreement under which the principal authorizes the agent to act in a representative capacity and the agent accepts that authority.[313] In other words, agency is an agreement in which the principal permits the agent to bind the principal to third parties.

Whether an agency exists does not depend upon the parties' subjective understanding of the relationship. Rather, it depends upon objective manifestations.[314] These objective manifestations may take the form of an express agreement or course of conduct from which an agency agreement may be inferred. In this case,

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[312] Restatement (Second) of Agency §1(1) (1957).

The Restatement includes control by the principal of the agent as an element of an agency agreement. Id. The Commission, however, has rejected the idea that control is an essential for vicarious liability under Section 2(a)(1)(A). Wirth, ¶25,271 at 38,875 n.29.

[313] United Packinghouse Workers v. Maurer-Neuer, Inc., 272 F.2d 647, 648-49 (10th Cir. 1959), cert. denied, 362 U.S. 904 (1960); Columbia Univ. Club v. Higgins, 23 F. Supp. 572, 574 (S.D.N.Y. 1938); S.B. McMaster, Inc. v. Chevrolet Motor Co., 3 F.2d 469, 474 (E.D.S.C. 1925).

[314] Restatement (Second) of Agency §1(1) cmt. b.

there is no direct evidence of an express agreement joining the Club and Refco in an agency relationship.[315] Therefore, the Court must determine whether an express or implied agreement existed by examining the course of conduct.

Activity can evidence the existence of an agency agreement in two ways. First, certain activity may, by its very nature, indicate the existence of an operative agency agreement.[316] In addition, certain activity may be the foundation of an implied

[315] Tr. at 464.

[316] As one state court put it,

> "We recognize it as a well-settled principle of law that actual agency may be proved from the habits, course of dealing, and apparent relations; that is to say, that, where the course of dealing has been prolonged, with the knowledge and consent of the principal, actual agency can be inferred from such course of dealing."

Piedmont Operating Co. v. Cummings, 149 S.E. 814, 816 (Ga. Ct. App. 1929) (emphasis added), quoted in Crowe v. Hertz Corp., 382 F.2d 681, 688 (5th Cir. 1967).

agency agreement.[317] In both instances,[318] before the Court can draw reliable inferences from that activity, it must also consider what each party knew when the activity occurred.[319] In other words, deriving the existence and characteristics of an agency agreement from action depends on the context of the action and the information known to the actors is an essential part of that context.

In determining what Dearborn or Refco knew of an activity on the part of the Club (or its agents), it is not enough to find knowledge on the part of some Refco or Dearborn employee. In addition, the Court must find a basis upon which to conclude

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[317] Edwards v. Born, Inc., 792 F.2d 387, 391 (3rd Cir. 1986); Harold Gill Reuschlein & William A. Gregory, Handbook on the Law of Agency and Partnership 35 (1979) ("One of the most frequent ways in which authority, as well as ratification, is created . . . by acquiescence in what an agent does. . . . [F]ailure of the principal, having knowledge of the agent's conduct, to object to the continuance of that conduct constitutes a manifestation to the agent that he is authorized to continue what he has been doing." (emphasis added)).

[318] Complainants do not allege that a certain course of conduct amounted to an implied agency agreement. Rather, they assert that the facts indicate the prior initiation and existence of an agreement, pursuant to which the Club and respondents acted and interacted. Likewise, the Court does not find that complainants have established a certain course of conduct that would amount to an implied agency contract. Accordingly, the Court's analysis will be confined to whether the evidence indicates a prior agency agreement that created a relationship between the Club and respondents during all or part of the relevant period.

[319] Piedmont Operating, 149 S.E. at 816.

(really, assume) that the information was passed up the firms' chains of command. Corporations act through their officers and directors and those officers and directors can bind the corporation only by acting within the confines of their authority.[320] Accordingly, if a Dearborn or Refco officer who had the authority to bind one of the two corporations to an agency agreement, was aware of the activity upon which agency might be based, then proof of that employee's knowledge is probative evidence of an agency agreement. Knowledge of other employees might also be imputed to the corporation and, therefore, support an inference of an implied agency agreement.

Knowledge on the part of an employee, who is not a director, controlling officer or otherwise in possession of sufficient autonomy,[321] is imputed to a corporation provided four conditions

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[320] Evanston Bank v. Conticommodity Svcs., Inc., 623 F. Supp. 1014, 1030 (N.D. Ill. 1985) ("To find that the bank authorized Thomas' acts, his authority must be legally traceable, directly or indirectly, to the bank's board of directors."); Ahlgren v. Blue Goose Supermarket, Inc., 639 N.E.2d 922, 928 (Ill. App. 1994).

Complainants do not claim that the Club had apparent authority to act on behalf of Refco. Rather they limit their theory of the case to actual agency. Complainants Reply Brief at 2-3 ("Complainants have never claimed that their right to reparations rests on any theory of apparent agency, and they do not do so now.").

[321] Bates v. Merritt Seafood, Inc., 663 F. Supp. 915, 933 (D.S.C. 1987).

are met. First, the employee must receive the knowledge "while he is acting within the scope of his agency."[322] In addition, the information must "concern[] a matter within the scope of . . . [the employee's] authority."[323] Moreover, the employee must "have . . . a duty to speak to his principal about the specific item of knowledge."[324] Finally, the corporation "is only bound by knowledge which would appear to be important to the agent, in view of his duties and prior knowledge."[325] Thus, even if a Refco or Dearborn employee or agent (other than the Club and its agents if they were respondents' agents) had knowledge of Club activity, knowledge of that activity cannot be imputed to Refco or Dearborn without considering the employee's status and duties.

As noted above, the Court must consider the totality of the circumstances in its agency analysis. The Commission has discussed the probity of particular facts on a largely ad hoc basis. However, through the categorical analysis of Reed v. Sage Group, Inc.[326] and other, less wide-ranging inquiries, the

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[322] Evanston Bank, 623 F. Supp. at 1034, followed in Juarez v. Ameritech Mobile Communications, Inc., 957 F.2d 317, 321 (7th Cir. 1992).

[323] Evanston Bank, 623 F. Supp. at 1034.

[324] Id. at 1035.

[325] Id.

[326] Reed, ¶23,943.

Commission has considered each of the factors most relevant to the Court's inquiry in this case.[327]

The factors that are relevant to determining whether parties were bound by an agency relationship, during a period of time, fall into two general categories: (1) how the purported agent and principal interacted with third parties and (2) how they interacted with each other. Factors falling under the first category include whether the potential agent had an independent contractual relationship with its customers or whether its relationship with the customer flowed through an agreement between the alleged principal and customer and then the purported agents' agreement with the alleged principal.[328] Whether a

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[327] Reed sought to define the nature of a Section 2(a)(1)(A) relationship between two nominally independent firms who did business with each other as FCM and IB. Id. at 34,297-01. Looking to the legislative history of Section 2a(1)(A), Reed found that Congress commented on circumstances before the Commission and resolved the question by drawing a distinction between circumstances where an IB and FCM are independent businesses and circumstances where the IB is a "de facto branch office" of the FCM. Id. at 34,302. The Commission took this legislative history to mean that "those factors that have been present in almost every relationship" between an FCM and IB "will not be sufficient" to establish agency under Section 2(a)(1)(A). Id. Thus, the Commission examined the factual record to determine whether a nominally independent IB and FCM were "truly independent." Id. at 34,303.

[328] Id. In the context of an IB-FCM relationship, the Commission reasoned that an independent IB would more likely than not have it relationship with the customer memorialized and governed by its own contract with the customer rather than through a (continued..)

possible agent uses the materials of the alleged principal to fulfill its regulatory requirements has been found probative of agency.[329] In addition, under certain circumstances, the Commission has found the fact that the alleged agent was a conduit of substantive communication between the customer and claimed principal to be probative.[330] Finally, the Commission has considered whether the purported agent acted in an expressly representative fashion (with the alleged principals' knowledge).[331]

The analysis of the course of conduct between the purported principal and agent focuses, in large part, on control, acquiescence and support. While not dispositive, the control that one nominally independent firm exercises over another (or

(..continued)

combination of its contract with the FCM and the FCM's contract with the customer. Id.

329 Id. The Commission expressed the belief that a truly independent firm would use its own forms to fulfill disclosure requirements. Id.

330 Berisko, ¶22,772 at 31,223. However, under other circumstances, it has found the fact to be of relatively little probity. See infra note 378.

331 See In re Big Red Commodity Corp., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,623 at 30,664-65 (CFTC June 7, 1985).

does not) is probative.[332] On the other side of the same coin and similarly material, the obligations that the parties have toward each other may indicate the presence or absence of an agency relationship.[333] In addition, the Commission has considered the degree of support the claimed principal provided to the purported agent,[334] whether the possible agent dealt with the principal exclusively,[335] and whether each party was separately compensated by their common customers or whether they split commissions.[336]

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[332] For example, the Commission found it significant that the Reed FCM had "significant powers to influence" the IB's operations, including the power to obtain and inspect certain IB documents. Reed, ¶23,943 at 34,303.

[333] In Reed, the IB-agent had a number of obligations toward the FCM. These duties included: (1) compliance with the FCM's policies, (2) refraining from making statements in contradiction to the FCM's account-related documents, (3) reporting customer complaints to the FCM, (4) collecting margin calls for the FCM, (5) paying customer debit balances, and (6) indemnifying the FCM for claims arising from the accounts the IB introduced. Id.

[334] For example, part of the Reed IB's consideration for its relationship with the FCM included the provision of customer agreements, the provision of market and research reports, forms used in the FCM's day-to-day operations and customer leads. Id. at 34,303-04.

[335] Id. at 34,303.

[336] The Commission has deemed a commission-sharing agreement to be "strong evidence of a principal-agent relationship." Ho v. Dohmen-Ramirez, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,221 at 32,605 (CFTC Aug. 19, 1986); accord Berisko, ¶22,772 at 31,223.

In its assessment of respondents' relationship with the Club, the Court must not only consider relevant facts but it must also recognize that circumstances could change over time. Just as agency relationships have a scope of authority, they have a temporal scope and it is the complainants' obligation to establish the time-frame of an agency relationship. Thus, an agency relationship may have existed when one member joined the Club and began trading but not when an other member joined the Club at a later (or earlier) time.

In this case, complainants cannot point to exercises of control over the Club nor have they established any obligations Refco imposed upon the internal operation of the Club.[337] Likewise, there was no sharing of commissions. The Club and Refco each had separate contractual relationships with those Club members who were Refco customers. Moreover, the relationship between each firm and their common customers was not dependent upon the other firm's relationship with the customers contractually or practically.[338] Each of these factors weighs

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[337] Respondents placed certain conditions on the interaction between Club members and respondents. However, the Court does not consider these to be exercises of control over the Club. Likewise, the Court does not consider these to be obligations of the Club toward respondents that are relevant in an agency inquiry.

[338] Although Refco benefited from the Club's existence and, although the Club, as it evolved, became dependent upon its (continued..)

against an agency relationship and, as would be expected, complainants do not address them. Rather, they limit their argument those facts that they claim support their case, namely the mutually beneficial relationship of the two firms, the existence of referrals and the Club's accumulation of forms. The Court will address these in turn.

The Mere Fact That Refco Benefited From The Club's Activity Is Of Little Probative Value In An Agency Inquiry

Complainants attach a great deal of importance to the fact that the Club's activity stimulated an interest in trading from which respondents benefited.[339] The Court has no doubt that respondents welcomed and gained benefits from the business generated by Club members. Such benefits provide an obvious incentive for respondents to associate themselves with the Club. However, proof of benefit, itself, has little probative value.[340]

(..continued)

members trading, trading with Refco did not require Club membership and Club membership was not essentially valueless to the customer that did not trade commodity futures or options on commodity futures.

339 Complainants Brief at 2.

340 United States v. Marroso, 250 F. Supp. 27, 30 (E.D. Mich. 1966) ("The fact that one assists another or does something for his benefit does not constitute such person an agent for another."); Taylor v. Vista Futures, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,165 at 38,430 (CFTC Nov. 20, 1991) ("Taylor II") (holding that, in a case where an FCM was (continued..)

While the benefit is an incentive for firms to draw closer, this would not be a cost-free exercise. Establishing an agency relationship would impose costs related to strict, vicarious liability under Section 2a(1) and the express duty to supervise the Club under Rule 166.3.[341] Thus, there is an insufficient basis upon which to presume that mutual benefit alone would more likely than not incite an agency relationship.[342] At best, mutual benefit provides some context within which to evaluate other, more probative facts.

(..continued)

alleged to be a principal, the FCM's benefit arising from a commodity pool is "insufficient" to establish an agency relationship).

341 17 C.F.R. §166.3. ("Each Commission registrant . . . must diligently supervise the handling by its . . . agents . . . of all commodity interest accounts carried . . . by the registrant . . . ."). Given the geographical separation of respondents and the Club, the costs associated with effectively monitoring the Club's day-to-day operations would have been substantial.

342 FCMs and CTAs, IBs, and publishers of commodities market information or trading methodology complement each others' activities. Independent CTAs generally depend on their customers to trade and the FCM fills a necessary role in this trading. Likewise, FCMs benefit from the commission's generated by customers that follow an independent CTA's trade recommendations. Both FCMs and CTAs benefit from those who create a general interest in commodities trading by publicizing basic information about the markets or trading methods. However, the resulting mutual benefit does not make these nominally independent entities <u>de facto</u> representatives of the other(s) without proof of other, more probative facts. In a similar vein, the fact that respondents could and did benefit from the Club's existence did not transform the Club into an authorized Refco representative.

Proven Referrals Of Club Members To Refco Are Insufficient To Establish The Existence Of An Agency Relationship

Complainants also emphasize that the Club and its officers "steered" members to Refco.[343] They claim this fact conclusively proves that the Club solicited customers on respondents' behalf and respondents were aware this was occurring.[344] The argument runs into three problems. First, the existence of referrals, standing alone, is not particularly probative of agency. In addition, complainants failed to prove that referrals by the Club or its agents, in the scope of their authority, were any more frequent than occasional. Finally, complainants have failed to prove that either Refco or Dearborn was aware of any practice to solicit customers for Refco that was based on systematic, ostensible Refco referrals.

In general, proof of referrals does not amount to proof of an agreement of the referring party to solicit customers on behalf of the party to whom customers are referred. It is possible that referrals may result from an agreement. However, it is also possible that a "truly independent" firm might refer a customer to another "truly independent" firm that provided a complementary service. In other words, referrals

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[343] Complainants Brief at 7, 10, 17, 29-30.

[344] Id. at 4.

could result from an exercise of independent judgment in service of the customer who expressed a desire to obtain a complementary service that the referring firm did not provide. Likewise and especially in this proceeding, the referrals could have been part of a plan, on the part of the Club to develop a closer, but not current, relationship with a single broker for the purpose of gaining enhanced services for its members (thereby increasing the value of membership). The record indicates that the Club wanted to have the AP of a broker on-site and eventually persuaded LIT to place one at the Club.[345] In order to obtain this benefit from Refco, the Club may have planned to concentrate membership trading at one firm, expecting that the firm would either recognize the value of establishing a closer relationship or fear losing the members' business to another broker that was willing to do so. As explanations, the alternatives are no less plausible than the existence of an agency relationship on an abstract level and complainants have failed to dispel them by presenting evidence.[346]

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345 See supra text accompanying notes 109-13.

346 Cf. Scheufler v. Stuart, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,171 at 45,573-75 (CFTC Sept. 30, 1997) ("Scheufler II"), rev'g in part Scheufler v. Gerald, Inc., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,926 (ALJ Nov. 27, 1996) ("Scheufler I").

Not only is the existence of systematic referrals by the Club and its agents ambiguous as an inferential basis, it is unproven in this case. Complainants have established that Gaiber and Rhea engaged in referrals. However, they have not directly proven the number of members that each referred to respondents. In addition, the Court cannot infer the frequency of those referrals from the record with the requisite certainty. The percentage of Club members trading at Refco supports the inference that referrals occurred. However, Club officers were not the only people who provided those referrals. Thus, the Court is unable to determine whether the high percentage of Club members trading with Refco resulted from systematic referrals on the part of Gaiber and Rhea or was the product of some combination of the following: (1) occasional referrals by Gaiber and Rhea, (2) occasional referrals by some of the 45 members who eventually traded at Refco, (3) chance, and (4) independent fact finding on the part of prospective customers who received no express referral. Accordingly, complainants have failed to establish this part of their case.

Even if the Club (and its officers within the scope of their respective agencies to the Club) had engaged in systematic referrals to Refco and Dearborn, the probity of this fact would be reduced (and complainants' assertion of ultimate facts undermined) by the complainants' failure to prove that Refco and

Dearborn were aware of the systematic referrals.[347] Complainants presented no direct evidence of such particular knowledge. Rather, they point to the high percentage of members who opened accounts with Refco after joining the Club as proof positive that respondents charged the Club to act as its agent.[348] This argument, even if legally sound, lacks the necessary factual basis.

Respondents were aware of the number of members who traded with them. However, complainants theory requires proof of more. Knowledge that 45 member traded with Refco is not the same as knowledge that 45 of 46 members, who traded in commodity contracts, traded through Refco. There is no evidence that respondents were ever informed of the percentage of Club members who traded with them. Likewise, there is no proof that, during the relevant period, they were aware of the total number of members or the total number of members who traded commodity futures and options. Without proof of this knowledge, there is an insufficient basis upon which to impute knowledge of the concentration of members' trading to Refco or Dearborn.[349] Because

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[347] See supra notes 320-25.

[348] Complainants Brief at 3-4.

[349] Not only is there an insufficient basis upon which to impute knowledge of systematic referrals to Refco or Dearborn, there is no basis upon which to impute any knowledge of the referrals to (continued..)

that Court cannot conclude awareness on the part of the respondent firms of systematic referrals and because such systematic referrals were not proven to have occurred, the Court cannot, without proof of other facts, make inferences sufficient to find respondent firms' authorization from the fact that virtually all Club members who traded commodities contracts traded through Refco.

The Fact That The Club Distributed Refco Forms To Its Members Does Not Compel The Conclusion That The Club Was Respondents' Agent Under The Circumstances Of This Case

The central fact to complainants' agency case is the Club's request for, stockpiling and distribution of Refco account-opening documents to members who wished to open Refco accounts.[350] Complainants rely on Knight v. First Commercial Financial Group,

(..continued)

Refco and Dearborn. As discussed above, knowledge of an employee is not imputed to the employer unless the employee is obligated to report the information up the corporate chain. Miles was aware that Rhea (and others at the Club) referred Club members to Refco. However, there is no evidence that Miles, prior to his elevation to firm principal, had an obligation to convey this information to Dearborn's or Refco's principals, officers, director(s) or any other employee who had the authority to enter into an agency relationship on behalf of Dearborn or Refco. Therefore, Miles' knowledge of the referrals that occurred at the Club is not properly imputed to Dearborn or Refco.

[350] See Complainants Reply Brief at 3-4.

Incorporated[351] for the notion that any time the account-opening forms pass through the hands of a third party on its way to a customer, the third party acts as the broker's agent.[352] If this were the Commission's rule, then the agency determination in this case would be a simple matter with respect to the time period when Sommerfeld, the Schneiders and Krubinski opened their accounts.[353] However, as noted above, the Commission has not identified this (or any other) fact as dispositive and Commission case law reveals that even when the distribution of an FCM's forms occur, the surrounding facts must be considered.

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[351] [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,942 (CFTC Jan. 14, 1997) ("Knight II"), aff'g on other grounds [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,515 (ALJ Oct. 5, 1995) ("Knight I").

[352] Complainants Reply Brief at 3 ("Knight speaks in perfectly plain English, and its message is not to be ignored.")

[353] As discussed below, there is less evidence that there was an agency agreement when Webster joined the Club because there is no evidence that the Club was yet engaged in the practice of stockpiling account-opening kits. Complainants' only evidence on this point was Webster's testimony. As discussed above, this testimony was generally unreliable and his testimony, as to whether forms were stockpiled when he joined the Club and opened his Refco account, was vague at best. In addition, the fact that he called respondents to obtain account-opening documents, given his failure to explain why he did so if such documents were on hand, undermines any of his testimony that would support the inference that the Club had already collected a stockpile of forms when he decided to begin trading.

In Knight, an unregistered third party was a "conduit" for the FCM's forms.[354] However, he was significantly more than that. The FCM admitted having relied on the third party to "fulfill any responsibilities that went along with getting [the] . . . account[-opening] documents signed."[355] In addition, the FCM referred the customer's questions about account statements and margin calls to the third party.[356] These and other factors led the Commission to conclude that there was an agency relationship between the two.[357]

In Ho v. Dohmen-Ramirez,[358] the Commission considered whether the agent of an FCM was also an agent of a CTA. In that case, the CTA conducted a commodity trading seminar in which the FCM's agent spoke.[359] The seminar was promotional in nature in that attendees were invited to open an account with the CTA.[360] Ho, the complainant in that case, attended the seminar and later met

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354 Knight II, ¶26,942 at 44,554; Knight I, ¶26,515 at 43,318.

355 Knight II, ¶26,942 at 44,554; Knight I, ¶26,515 at 43,318.

356 Knight II, ¶26,942 at 44,554; Knight I, ¶26,515 at 43,318-19.

357 Knight II, ¶26,942 at 44,554; see Knight I, ¶26,515 at 43,318-19.

358 Ho, ¶23,221 at 32,604.

359 Id. at 32,605.

360 Id.

with the CTA.[361] The FCM's agent also attended the meeting and the CTA referred to the FCM's agent as a partner.[362] Ho later met with the FCM's agent for the purpose of opening an account.[363] At that meeting, the FCM's agent provided and supervised the execution of the FCM's account-opening documents.[364] In addition, the FCM's agent had the CTA's forms on hand.[365] The FCM's agent not only provided the forms to Ho, but executed them "for" the CTA "on a line provided for the . . . [CTA] representative's signature" and collected them from the customer.[366] The CTA later wrote to the FCM indicating that the FCM's agent would act as the CTA's "subcontracting advisor" with regard to Ho's account.[367] The CTA and the FCM's agent also shared commissions.[368] On the basis of these facts, known to the CTA, the Commission found that the FCM's agent was also the agent of the CTA.[369]

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361 Id.

362 Id.

363 Id.

364 Id.

365 Id.

366 Id.

367 Id. (internal quotations omitted).

368 Id.

369 Id.

Clearly, when the FCM provides the account-opening documents to a customer and does so in such a manner that they pass through the hands of a third party, there is the potential that the third party is the FCM's agent. However, the Commission has found that fact, alone and in combination with others, insufficient to establish an agency relationship. Simply stated, a "conduit" for a broker's forms is not necessarily the broker's agent.

In Taylor II, the Commission considered whether a commodity pool operator ("CPO") was the agent of the FCM through which the pool traded. At the hearing stage, the administrative law judge found the following: (1) the CPO "gave" its customers the FCM's forms "to sign to open the account," (2) the CPO represented that he "traded directly through" the FCM and (3) the FCM financially benefited through its relationship with the CPO.[370] On that basis, the judge concluded that the CPO was an agent of the FCM.[371] The Commission, upon review, saw it differently. It held that the CPO's use of the FCM's forms, exclusive dealing and the FCM's financial benefit arising from the relationship did not amount to proof of an agency relationship.[372] Basically, the

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[370] Taylor v. Vista Futures, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,373 at 35,607 (ALJ Dec. 21, 1988).

[371] Taylor II, ¶25,165 at 38,429-30.

[372] Id.

Commission found these facts to be consistent with a CPO that was autonomous or acting on behalf of its customers. This finding was not a one-time anomaly.

In Scheufler II, a case decided about nine months after its review in Knight II, the Commission considered whether a non-guaranteed IB was the agent of an FCM. In that case, the customer called a toll-free number in response to an infomercial.[373] An IB subsequently sent the customer documents that included the IB's information packet and the FCM's account-opening documents.[374] Shortly after the customer received the documents, the IB telephoned the customer and subsequently explained how to complete the account-opening documents.[375] The customer filled out the FCM's account-opening documents and wrote a check for $20,000.[376] The IB sent a courier to pick them up (and presumably forwarded them to the FCM) and the FCM eventually set up an account for the customer.[377] Although the FCM did not directly communicate with the customer during the account-opening

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[373] Scheufler II, ¶27,171 at 45,574.

[374] Id.; Scheufler I, ¶26,926 at 44,495; Exhibit G-1, CFTC Docket No. 94-R169 (Gerald, Inc., the FCM in the Scheufler case, Account Forms).

[375] Scheufler II, ¶27,171 at 45,574.

[376] Id.

[377] Id.

process and although the IB was a conduit for both the FCM's account-opening documents and the customer's deposit funds, the Commission found there was "no evidence that Trinity [, the IB,] acted as Gerald's[, the FCM,] agent."[378] Thus, just because an FCM's account-opening forms pass through the hands of a third party, even if that third party helps the customer open an account with the FCM, the third party is not necessarily (or probably) the FCM's agent.

In the present case, the Club did serve as an intermediary between the FCM and a number of its members. However, as discussed above, respondents were generally unaware that the Club was stockpiling forms. With a few exceptions, the Club requested forms ostensibly to meet the current demand of members. Respondents did not rely on anyone at the Club to oversee the execution of respondents' forms and, when there was a problem with the forms, respondents did not direct the customer to the Club. Rather, Refco contacted the customer directly to resolve the problem. In sum, the circumstances under which the Club handled Refco forms lends weak support, at best, to the conclusion that the Club acted in a representative capacity pursuant to an agreement to do so.

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[378] Id. at 45,577.

Having considered each of the factors set out above and the record as a whole, the Court cannot conclude that a preponderance of the evidence establishes that the Club, any Club member or any Club officer was an agent of respondents. Accordingly, any violations that the Club (and its agents) may have committed cannot form the basis of respondents' liability absent sufficient proof of another basis for vicarious liability.

Respondents Did Not Aid And Abet A Violation Of Section 4(d)(1)

Complainant's second theory of vicarious liability, maintained at the post-hearing stage, is that respondents aided and abetted the Club's failure to register as an introducing broker, a violation of Section 4(d)(1).[379] In order to succeed, complainants must prove: (1) that the Club was an introducing broker, (2) it was unregistered, (3) that respondents aided and abetted the failure to register,[380] and (4) the failure to

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[379] 7 U.S.C. §6d(1); Complainants Brief at 16-20.

[380] Section 13(a) of the Act, 7 U.S.C. §13c(a), states that "[a]ny person who . . . willfully aids, abets, counsels, . . . or procures the commission of, a violation of any of the provisions of this Chapter [of the Act] . . . may be held responsible for such violation as a principal." In order to recover under Section 13(a), complainants must not only prove a primary violation of the Act that harmed them, they must also prove that the alleged aider and abettor: "(1) had knowledge of the principal's . . . intent to commit a violation of the Act; (2) had the intent to further the violation; and (3) committed some (continued..)

register (independent of any fraud involving registration status)[381] was the cause in fact and proximate cause of the complainants injury. In support of the claim, complainants argue the Club "performed all of the services normally performed by an" IB and provide a healthy dose of hyperbole.[382] The complainants'

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act in furtherance of the principal's objective." Damato v. Hermanson, 153 F.3d 464, 473 (7th Cir. 1998). Accord In re Buckwalter, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,995 at 37,686 (CFTC Jan. 25, 1991); In re Western Fin. Management, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,814 at 31,401 (CFTC Nov. 14, 1985); In re Lincolnwood Commodities Inc. of California, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 at 28,254-55 (CFTC Jan. 31, 1984); In re Richardson Securities, Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,145 at 24,644-46 (CFTC Jan. 27, 1981). For a more detailed discussion, see In re FSI Futures, Inc., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,150 at 45,501-02 (CFTC Aug. 1, 1997).

381 Complainants initially claimed that the Club defrauded them by failing to disclose that it was unregistered in violation of the Act. However, they did not include this theory in their post hearing brief and, thereby, abandoned the claim.

382 Complainants Brief at 32. With a characteristic flourish, complainants argue,

> "Respondents admit in their answer that they knew that neither the Club nor Gaiber nor Rhea nor Judy Johnson was registered with the CFTC. They didn't care. Commodity regulations to one side, they did not even have sufficient consideration for their customers to call these neophyte commodity traders on the telephone to make sure that they had at least a rudimentary understanding of the huge risks involved in selling strangles on S&P options. These

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arguments encounter two threshold obstacles that they fail to breach. First, proof that the Club performed certain functions that IBs perform does not amount to proof that the Club was an IB that was required to register. In addition, the evidence does not establish that any violation of Section 4d(1) caused the claimed damages. Therefore, the Court has no need to consider whether respondents aided and abetted any failure to register as an IB.

Complainants Failed To Prove That The Club Was An IB That Was Required To Register

The parties agree that the Club was not registered under the Act in any capacity. Thus, complainants need only establish that the Club was an IB that was required to be registered in order to prove a violation. Complainants base their argument, that they made a sufficient showing, on the plain text of the Act. Respondents base their defense on the plain text of Commission regulation. In a sense, both are correct. Thus, in order to

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> unknowledgeable, neophyte investors had no chance of success. Respondents showed no concern about the serious losses they would inevitably sustain. Caveat Emptor! was Respondents' sole standard of conduct."

Id. at 18 (emphasis in original).

resolve the issue of whether Club should have been registered as an IB, the Court must solve a congressionally-created conundrum.

Congress created the category of IB in the Futures Trading Act of 1982.[383] Section 207 of the 1982 Act amended Section 4d(1), adding the requirement that those acting as an IB "in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery" must register under the Act.[384] The Act defines an IB as

> "any person (except an individual who elects to be and is registered as an associated person of a futures commission merchant) <u>engaged in soliciting or in accepting orders</u> for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market who does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom."[385]

Under a rule based on reading the Act in isolation, as the complainants suggest the Court should do, complainants would have only to prove that the Club engaged in "soliciting" or

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[383] Pub. L. No. 97-444, 96 Stat. 2294 (codified in various sections of 7 U.S.C.).

[384] 7 U.S.C. §6(d).

[385] 7 U.S.C. §1a(14) (emphasis added).

"accepting" orders,[386] terms that have been interpreted broadly.[387] Respondents argue that the Court must consider an additional factor on the basis of Commission regulation.

Rule 3.4(a) requires "each . . . introducing broker . . . [to] register as such under the Act" unless "otherwise provided in the Act or in any rule . . . of the Commission."[388] The Commission excepts certain persons from the registration requirement in its definition of "introducing broker."[389] Rule 1.3(mm) defines an introducing broker as "[a]ny person who, for compensation or profit, whether direct or indirect, is engaged in soliciting or in accepting orders . . . for the purchase or sale of any commodity for future delivery . . . who does not accept any money . . . to margin . . . any trades or contracts that

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[386] Complainants Brief at 16 ("It is not important that they did not earn a commission on each trade. There is nothing in Section[s] 4d(1) or 1a(14) which requires that a person earn commissions in order to qualify as an introducing broker." (emphasis in original)).

[387] See Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements, 48 Fed. Reg. 35,248, 35,250-51 (CFTC 1983) (final rules) ("Registration and Other Regulatory Requirements"); CFTC Interpretive Letter No. 93-40, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,731 at 40,382-83 (DTM May 5, 1993).

[388] 17 C.F.R. §3.4(a).

[389] See 17 C.F.R. §1.3(mm); Registration and Other Regulatory Requirements, 48 Fed. Reg. at 35,250-51.

result or may result therefrom."[390] Thus, as respondents urge, under the plain text of the Commission's definition, complainants not only must prove solicitations occurred, they must also prove that the solicitation occurred "for compensation or profit."[391] The regulatory history of the IB rules also bears this out.[392] Accordingly, the Court must determine whether, the more restrictive definition set out in Rule 1.3(mm) governs or whether the plain terms of Section 1a(14) set out all that must be established to prove that the Club should have been registered.[393] Fortunately, the legislative history of 1982 Futures Trading Act resolves the dilemma, precluding the need for further inquiry.

The Conference Committee briefly set out the general scheme of the Act's definition of IB and registration requirement. The Conference explained that, rather than imposing a blanket requirement that could not be varied by regulation, the Act's registration requirement generally granted the "the Commission .

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390 17 C.F.R. §1.3(mm) (emphasis added).

391 Respondents Reply Brief at 12-13.

392 See supra note 389; see infra note 397.

393 In other words, the inconsistency, if not otherwise explained, raises the issue of whether the rules refine the Act's registration requirement by exercise of the Commission's plenary authority or whether the rules operate as an impermissible amendment by administrative regulation. See Koshland v. Helvering, 298 U.S. 441, 447 (1936); California Cosmetology Coalition v. Riley, 110 F.3d 1454, 1460 (9th Cir. 1997).

. . authority to require registration as introducing brokers of all persons who solicit public funds and who are not otherwise registered."[394] In other words, Congress created a default rule, all who solicit and accept orders must register unless exempted, while leaving it to the Commission to create exemptions.[395] In its exercise of that authority, the Commission exempted from the registration requirement those who could be said to have solicited customers (in the broadest sense of the term by way of referrals), but were not "compensated on a per-trade basis or by a referral fee."[396] Accordingly, if the Club was not compensated for activity that might constitute solicitation, then there would be no need to register even if it met the definition of IB set out in Section 1a(14).[397]

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[394] Senate Comm. on Agriculture, Nutrition, and Forestry, Futures Trading Act of 1982 39 (Comm. Print 1983) (Joint Explanatory Statement of the Committee of the Conference).

[395] Id.; see S. Rep. No. 97-884, at 41, 70 (1982) ("The Commission would be authorized to develop a regulatory structure for introducing brokers modeled after the one presently in effect for futures commission merchants.").

[396] Registration and Other Regulatory Requirements, 48 Fed. Reg. at 35,250-51; see Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements, 48 Fed. Reg. 14,933, 14,933 (CFTC 1983) (proposed rules).

[397] Registration and Other Regulatory Requirements, 48 Fed. Reg. at 35,250-51.

Assuming, but not finding, that the Club performed the necessary solicitations, the Court will consider whether it received the compensation that would make registration necessary. Complainants do not argue that the Club received compensation for referrals nor do they argue that the Club profited directly from them. Instead, they argue that the Club "intended to benefit financially by using futures and options trading to make their prototype club successful in terms of the size of its membership. This would enable them to procure investors to open other clubs throughout the country. . . . The financial rewards which they expected to reap from commodity trading were indirect, but nonetheless real and substantial."[398] There might be some relationship between referrals and benefit to the Club. However, its is too attenuated to bring the Club under Rule 1.3(mm)'s definition of IB.[399] Accordingly, the Club did not qualify as an

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[398] Complainants Brief at 16-17 (emphasis omitted).

[399] Complainants reason that the Club benefited from developing an interest among members and prospective members in trading, and keeping them trading, and that referrals created and sustained that interest. Id. Even assuming that the Commission intended to include, by use of the term "profit," those who were not compensated for referrals by customers or brokers, the complainants' argument is unacceptable. The Court does not question the premise that the Club benefited from developing and nurturing an interest in trading. However, the referrals do not appear to have been how the Club initially interested members in trading. Rather, the Wednesday-night seminars created the interest and the referrals tended to follow the creation of interest. The referrals did have some role in members opening (continued..)

IB under Rule 1.3(mm), and was, therefore, not required to register and did not violate Section 4d(1).

Complainants Failed To Prove That The Club's Failure To Register As An IB Caused Them Injury

Even if the complainants had established a violation of Section 4d(1), recovery would still depend on proof that the failure to register caused them injury. The injury arising from a violation of a registration requirement is distinct from an injury resulting from a fraud involving the misrepresentation of

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trading accounts with particular brokers. However, the referrals were a lesser factor (and most likely a non-factor) in the decision to open the account with some broker. Beyond the point of choosing a broker, a member's trading results would tend to determine whether they remained interested. Accordingly, referrals were not the source of the initial spark of interest or the source of continued interest. In other words, the relationship is not strong with regard to whether members traded and, thereby, benefited the Club. Nothing in the regulatory history of Rule 1.3(mm), the legislative history of the Futures Trading Act of 1982 or case law that indicates that such a weak relationship between referrals and some financial benefit would satisfy the compensation requirement of Rule 1.3(mm). See, e.g., Registration and Other Regulatory Requirements, 48 Fed. Reg. at 35,250, 35,251 ("the Commission believes that persons who are currently compensated on a per-trade basis or by a referral fee . . . would be . . . generally required to register as, an introducing broker") ("Some commentators noted that the definition of introducing broker should also exclude those persons . . . who refer customers on an occasional basis and without compensation. The Commission believes . . . [this] suggestion[] has merit and has modified the definition of introducing broker to exclude those persons . . . who are not compensated, directly or indirectly . . . .").

registration status. In the former case, respondents must prove causation other than the fraud-related claim that had the customer known the respondent was unregistered (in violation of the Act) the customer would have acted differently. In short, the complainants must establish that the failure to register, itself, caused them injury. This they have failed to do.

In establishing the cause in fact of a Section 4d(1) claim, complainants must prove what would not have occurred "but for" the violation. In other words, they must establish the contrapositive that, if there was no violation, there would not have been the injury. At the risk of oversimplifying the matter, there are two possible alternatives of what would have occurred had the unregistered party complied with Section 4d(1). The first possibility is that the violator would have abstained from engaging in the activity requiring registration. If this were established, then the failure to register might be deemed a cause of the injury. The second possibility is that the violator would have registered and acted identically, with regard to the complainants, as it did in the events underlying this proceeding. Under this scenario, the failure to register would not be deemed a cause of the injury. It is the complainants' burden to prove that, but for the failure to register, the Club would not have interacted with them as they claim it did. The record in this case does not establish that, given the stark possibility of registration or forbearance, the Club, Gaiber and Rhea would have chosen the latter or have had no choice but to abstain. Therefore, even if complainants had established that the Club violated Section 4d(1), this violation cannot support liability because they failed to prove it was the cause of their injuries. Accordingly, the Court has no reason to determine whether respondents aided and abetted the alleged violations of Section 4d(1).

Respondents Violated Rules 1.55 And 33.7, But Are Not Liable In Reparations For Those Violations

Complainants, other than Krubinski,[400] continue to allege that respondents failed to make risk disclosures in accordance with Rules 1.55 and 33.7.[401] Although respondents received and maintained signed risk disclosure statements for each complainant, undisputed facts support the conclusion that respondents violated Rules 1.55 and 33.7 with regard to the Schneiders and Sommerfeld. This is so because respondents did

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[400] Although he alleged a violation of Rules 1.55 and 33.7 in his complaint, Krubinski Complaint at 5, and could have made arguments similar to those of his co-complainants, Krubinski did not include the charge in his post-hearing brief with regard to his account. See Complainants Brief at 40-41. Accordingly, the Court deems him to have waived the claim.

[401] Complainants Brief at 15, 34-35; 17 C.F.R. §§1.55, 33.7.

not directly "furnish" risk disclosure documents to these complainants. However, there is no liability for these violations because respondents did, albeit imperfectly, provide risk disclosure and complainants failed to rebut the presumption that their execution of the risk disclosure acknowledgement created.

Rule 1.55 provides that,

> "(a)(1) . . . no futures commission merchant, or in the case of an introduced account no introducing broker, may open a commodity futures account for a customer unless the futures commission merchant or introducing broker first:
>
> (i) Furnishes the customer with a separate written disclosure statement containing only the language set forth in paragraph (b) of this section . . . ; and
>
> (ii) Receives from the customer an acknowledgement signed and dated by the customer that he received and understood the disclosure statement."
>
> . . . .
>
> (e) The acknowledgement required by paragraph (a) of this section must be retained by the futures commission merchant or introducing broker in accordance with §1.31."[402]

Rule 33.7 prescribes essentially the same requirements for

[402] 17 C.F.R. §1.55 (emphasis added).

opening an options account.[403] Thus, each rule required Refco and Dearborn to do the following prior to opening the complainants' customers accounts: (1) "furnish" its futures and option customers with proper risk disclosure statements, (2) receive a signed and dated acknowledgement that the customer read and understood the disclosure statement, and (3) properly retain the risk disclosure statement and acknowledgement. There is no dispute that respondents satisfied each of these requirements with regard to Webster.[404] As to Sommerfeld and the Schneiders,

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[403] 17 C.F.R. §33.7.

[404] Complainants maintain that strict, "technical compliance" with the enumerated requirements of Rules 1.55 and 33.7 is insufficient to satisfy fully comply with those regulations. Complainants Brief at 34-35. They do so on grounds of the "fundamental law that one cannot do something and not do it at the same time" and, therefore, "[r]espondents did not comply with the letter or spirit of the Rule." Id. at 35. Regardless of whether this statement of "fundamental law" is tautologically correct, the underlying factual basis does not exist with regard to Webster's account and Rules 1.55 and 33.7. Rules 1.55 and 33.7 are technical in the sense that substantial, but imperfect, compliance with the three enumerated requirements has been found to constitute a violation. See infra text accompanying notes 407-10; see infra note 412. Accordingly, just as the Court must apply those rules strictly, it has good reason to construe them strictly. McCarthy v. Northwest Airlines, Inc., 56 F.3d 313, 316 (1st Cir. 1995). Employing the long-held rule of statutory construction expressed in the maxim expressio unius est exclusio alterius, the Court will presume that the requirements listed in the rules are the only requirements of compliance. Tennessee Valley Auth. v. Hill, 437 U.S. 153, 188 (1978). The undisputed facts demonstrate that respondents directly furnished the risk disclosure statement to Webster, Webster received it, signed it, returned it to respondents, and respondents retained it. Thus, despite complainants' protestations, respondents complied with (continued..)

the parties agree that: (1) complainants received copies of the risk disclosure statements, (2) the risk disclosure statements originated with Refco, (3) complainants executed the risk disclosure acknowledgements, and (4) Refco received the signed risk disclosure acknowledgements and retained them. The parties' dispute boils down to the question of whether Refco "furnished" the forms in compliance with Rules 1.55 and 33.7.

The parties offer differing interpretations of the rules' furnishing requirement. Complainants argue that furnishing requires a direct transmission from the broker to the customer.[405]

(..continued)

the "letter" of the risk disclosure regulations in opening Webster's account and such strict, technical compliance is sufficient. However, that does not preclude the possibility that respondents violated Section 4b or 4c(b) by affirmatively vitiating the risk disclosure statement. It simply means that proof of such affirmative vitiation does not shift the burden of proving reliance from complainants to respondents nor does it eliminate the complainants' need to prove scienter.

[405] Complainants' argument is legally coherent but, factually and as a whole, nonsense. They argue that the Club, its officers and functionaries were agents of Refco. Complainants Brief at 2-5, 7-10, 40-41. It is undisputed that these claimed agents directly provided the risk disclosure forms to the Schneiders, Krubinski and Sommerfeld. However, in the same breath but not in the alternative, they claim that Refco had no direct contact with these complainants. See, e.g., id. at 12 ("The record in this case makes it clear that absolutely no one on Refco's behalf communicated in any way with Sommerfeld or Schneider about risk of loss prior to the opening of their accounts." (emphasis in original)). The Court, having found that neither the Club, Gaiber, Rhea nor Johnson were agents of Refco, does not need to sort this out. However, it bears noting that if the Club was an

(continued..)

Respondents take the position that as long as the forms originated with the broker and found their way to the customer, the furnishing element is met.[406] While this argument is not without merit, recent Commission case law is to the contrary.

In Knight, an FCM supplied an unregistered person with its account-opening documents, including the risk disclosure statements mandated by Rule 1.55.[407] When the complainant opened an account with the FCM, it was the unregistered person who directly provided him the risk disclosure statement.[408] Given these facts, the Commission found that the FCM either expected the unregistered person to fulfill its Rule 1.55 obligation of furnishing the risk disclosure statement to the customer in a representative capacity (and that it occurred) or the FCM "directly failed to fulfill its obligation under Rule 1.55."[409] This statement seems to reject the respondents' argument that

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agent and furnishing the risk disclosure rested within the scope of that agency, then the Club's provision of the risk disclosure statements would be both a direct furnishing and, more generally, direct communication.

406 Respondents Reply Brief at 9-11.

407 Knight II, ¶26,942 at 44,551-52.

408 Id.

409 Id. at 44,554.

origination, receipt and maintenance are enough to satisfy the rule.[410]

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[410] The Court realizes that this statement is mere dicta. However, the Court is bound by such dicta unless it has been clearly contradicted or refined. In re Trillion Japan Co., Ltd., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,082 at 41,589 (CFTC May 23, 1994). It bears noting that the Knight II dicta appears to create a potentially severe result, but not one that is beyond the realm of reason.

Knight II seems to indicate that in the event of a "found" customer, an FCM cannot rely on a customer's signed acknowledgement that it read and understood the risk disclosure statement. For example, assume that prospective customer A contacts an FCM, requests an account-opening kit, and, after that contact, the FCM mails the account-opening documents to prospective customer A's home. Assume further that the account-opening packet contained a separate risk disclosure statement that complied with Rules 1.55 and 33.7. If the prospective customer has no further contact with the FCM, but signs and dates and acknowledgement and then mails it to the FCM, the FCM has fulfilled its obligations under Rules 1.55 and 33.7 provided it properly retains the document.

Assume, in the alternative, that prospective customer A does not fill out the forms, having read the disclosure form and decided not to trades futures and options, and leaves the form on his kitchen table. If neighbor B visits prospective customer A, asks to take the forms, does so, reads the forms, fills them out properly and returns them to the FCM, under Knight II's dicta, the FCM cannot yet open the account. This is so because the FCM did not directly "furnish" the risk disclosure statement to neighbor B. Under this rule, the FCM must directly furnish a second risk disclosure statement to neighbor B to be in technical compliance with Rules 1.55 and 33.7.

The above example illustrates the difficulty the Knight II dicta raises. IBs and FCMs would have to track individual account-opening documents to ensure that they directly furnished them to the customer who returned them, wait until a customer applies to open an account before sending the customer a risk disclosure statement or send customers multiple risk disclosure statements. A subsequent, oral risk disclosure would prevent

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Under Knight II, a broker can furnish a risk disclosure statement, in at least two ways. It can directly provide the customer with the statement or it can authorize someone to provide the statement on the FCM's behalf. The Court will venture so far as to propose a third way this obligation can be fulfilled. The FCM can satisfy the furnishing requirement by directly providing a copy of the risk disclosure statement to a customer's agent. However, if the FCM (or its agent) does not directly provide the statement to the customer (or its agent), then the furnishing requirement of Rule 1.55 or 33.7 is not satisfied.

In this case, the record indicates that the Club received the risk disclosure statements that the Schneiders and Sommerfeld completed, prior to the time they joined the Club. Thus, while the Court has found that the Club was not acting as respondents' agent when it requested and received the forms, it was also not

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liability, due to a failure to technically comply with the direct furnishing requirement, in a reparations case for reasons discussed below. However, oral disclosure would not cure the violation in a technical sense. Accordingly, those IBs and FCMs that sought to cure the technical violation by oral disclosure would face potential liability in enforcement proceedings. While harsh, such a rule does not defy reason *per se*. It could reflect a policy of holding brokers responsible for the conditions under which risk disclosure statements, the acknowledgements of which they seek to rely upon, are presented.

acting as the complainants' agent when the forms were requested. Therefore, when respondents provided the forms that the Schneiders and Sommerfeld used to open their accounts, they did not directly furnish them to the complainants. This amounts to a technical violation of Rules 1.55 and 33.7. However, proof of this violation does not make liability certain.

The complainants still have to prove that the failure to technically comply with Rules 1.55 and 33.7 caused the injuries of which they complain. Reliance sits at the center of the causation inquiry in disclosure matters.[411] Complainants have a presumption of reliance in their favor. However, under the facts of this case, the respondents also have a presumption that works in their favor, one that serves to rebut the presumption of reliance.

Once a complainant has established even a technical violation of Rule 1.55 or 33.7, the Court presumes that the complainant relied on this nondisclosure.[412] While this

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[411] Wenzel v. Patrick Petroleum Co., 745 F. Supp. 211, 214 (D. Del. 1990).

[412] In Batra v. E.F. Hutton & Co., Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,937 at 34,286 (CFTC Sept. 30, 1987), the customer was directly furnished a risk disclosure statement. However, the risk disclosure statement was not physically separate from the other account-opening documents because the person presenting the form forgot to detach it from another document on the same, perforated sheet of paper. Id. On that basis, the Commission held that Hutton had violated Rule (continued..)

presumption is mandatory,[413] it is rebuttable.[414] When a failure to comply with Rules 1.55 and 33.7 is merely technical, respondents have little difficulty overcoming it.

Respondents may rebut the presumption of reliance in one of three ways. First, they may prove an actual disclosure of the risks.[415] In addition, they may present evidence that complainants were made aware of the information contained in the risk disclosure statement.[416] Finally, respondents may otherwise prove that disclosure of the withheld (or imperfectly disclosed) information would have had no ultimate impact on the complainants' trading decisions.[417] The Court will concern itself

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1.55. Id. In addition, it held that this fairly technical violation "raised a rebuttable presumption that 'the customer relied upon the FCM's failure to disclose the facts contained in the risk disclosure statement.'" Id. at 34,286-87 (citation omitted).

[413] See County Court of Ulster County v. Allen, 442 U.S. 140, 158-59 (1979) (describing the characteristics of a mandatory presumption).

[414] Batra, ¶23,937 at 34,287; Domenico v. Rufenacht, Bromagen & Hertz, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,642 at 30,726 (CFTC June 27, 1985).

[415] J.E. Hoetger & Co. v. Ascenio, 572 F. Supp. 814, 20 (E.D. Mich. 1983); Batra, ¶23,937 at 34,287.

[416] Id.

[417] Id.; Domenico, ¶22,642 at 30,726.

with the first two methods of rebuttal only, since they sufficiently dispose of the issue.

The question of whether actual disclosure of the risks occurred is "essentially objective," involving proof of the disclosure itself and its content.[418] On the other hand, proof of a complainant's awareness of the undisclosed information is "more subjective" in nature, focusing on the complainant's understanding.[419] Respondents succeed in rebutting the presumption of reliance by both methods. The parties agree that the risk disclosure forms originated with Refco and found their way into the complainants hands (albeit by an imperfect method). Thus, actual disclosure took place. As for the second method of rebuttal, respondents have a presumption upon which to rely.

Each of the complainants received a risk disclosure statement, the contents of which are not alleged to have failed to comply with Rules 1.55 and 33.7. They also signed and returned acknowledgements that they read and understood the risk disclosure statement. "[S]igning and returning the acknowledgement [of having read and understood the contents of a risk disclosure statement] creates a presumption that the

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[418] Batra, ¶23,937 at 34,287.

[419] Id.

customer understands the risks involved . . . ."[420] Thus, unless complainants can rebut this presumption, respondents have made a showing that is sufficient to rebut the presumption of reliance.

The only evidence that might rebut the presumption of having read and understood the risk disclosure statement is complainants' self-serving testimony. As discussed above, the Court has found their testimony unreliable and, in this case, finds it insufficient to rebut the presumption that they read and understood the risk disclosure statement. Complainants have produced no other evidence that respondents' technical failure to comply with Rules 1.55 and 33.7 induced reliance. Accordingly,

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[420] McNally v. Gildersleeve, 16 F.3d 1493, 1500 n.14 (8th Cir. 1994); accord Waters v. International Metals Corp., 172 F.R.D. 479, 486 n.3 (S.D. Fla. 1996). In a Rule 10b-5 case, Myers v. Finkle, 950 F.2d 165, 167 (4th Cir. 1991), the Fourth Circuit considered the effect of a plaintiffs' failure to read the warnings contained in a private placement memoranda and set out a more sweeping rule.

> "In our view, knowledge of information should be imputed to investors who fail to exercise common caution when they have in their possession documents apprising them of risks attendant to the investments. Investors are charged with constructive knowledge of the risks and warnings contained in the private placement memoranda. Consequently, in evaluating the factors relevant to justifiable reliance, the conduct of the Myers must be examined as if they were aware of the warnings."

Myers, 950 F.2d at 167 (citations omitted).

they have failed to establish that the violations of Rules 1.55 and 33.7 caused them harm. Therefore, the respondents' failure to directly "furnish" the risk disclosure statement does not support a finding of liability on the part of respondents.

Complainants Did Not Establish Fraud Based On The Nondisclosure Of Material Facts

Complainants advance a second theory for respondents' direct liability, fraud based on a failure to disclose material facts. They argue that Refco had an affirmative duty to disclose the risks inherent in trading to complainants, under Sections 4b and 4c of the Act, and that the mere provision of the risk disclosure statement did not satisfy that obligation.[421] Respondents take

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[421] Complainants Brief at 14. They do not specify further which provision of 4c they rely upon. The Court will presume that complainants allege a violation of Section 4c(b), 7 U.S.C. §6c(b). Section 4c(b) provides that "[n]o person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity . . . which is of the character of . . . an 'option' . . . contrary to any rule, regulation, or order of the Commission." Rule 33.10 is the Commission's anti-fraud provision with respect to exchange-traded commodity option transactions. <u>See</u> 17 C.F.R. §33.2 (excluding Section 4b, 7 U.S.C. §6b, from the provisions of the Act that apply to Part 33 transactions). Rule 33.10 prohibits "any person," either "directly or indirectly," from cheating, defrauding or attempting to cheat or defraud "any other person . . . in or in connection with an offer to enter into, the entry into, the confirmation of the execution of . . . any commodity option transaction." 17 C.F.R. §33.10.

(continued..)

the position that, when the FCM merely executes the customer's orders and provides no trading advice and does not exercise discretion, provision of the risk disclosure statement is all the disclosure that is required.[422] Under the facts of this case, the Court finds that respondents have the better argument on this point.

In order to recover under Section 4c(b) (by virtue of Rule 33.10) or Section 4b based on nondisclosure, complainants must prove the following: (1) respondents had an obligation to disclose a particular fact, (2) the fact was material, (3) the fact was not disclosed, (4) the nondisclosure occurred with scienter, (3) the failure to disclose the fact occurred in connection with an order to purchase or sell (or the purchase or

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Complainants similarly do not specify the provision of Section 4b upon which they base their claims. The Court will presume that their fraud claims, with regard to futures contracts, rest on Section 4b(a)(1) or Section 4b(a)(2). Since the alleged fraud involved Refco, a member of a contract market, and its agents (disputed and undisputed) and futures contracts traded on or subject to the rules of a contract market, the Court need not decide which subsection the Complainants relied upon since (with the exception of the contracts covered and the status of the person involved) the elements of a cause of action are identical under each provision. Section 4b(a) makes it unlawful to "cheat or defraud or attempt to cheat or defraud" another person "in connection with" commodity futures transactions and orders to engage in such transactions. 7 U.S.C. §6b(a)

[422] Respondents Reply Brief at 5-9.

sale of) a contract for futures delivery or an option on commodity futures contract, (4) that the nondisclosure was the cause in fact of complainants' injuries, and (5) that the nondisclosure was the proximate cause of their injuries.[423]

The parties do not dispute that respondents had an obligation to disclose the risks of trading commodity futures and options to complainants. Likewise, there is no disagreement that each complainant received a written risk disclosure statement that originated with respondents. The parties disagree as to the effect of that statement. Complainants argue that the provision of a written risk disclosure statement, unaccompanied by

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[423] Steen v. Monex Int'l, Ltd., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,245 at 38,726 (CFTC Mar. 3, 1992) (Gramm, Chairman, concurring) ("However, in order to prevail in a case involving deception or misrepresentation, the customer must . . . prove that he relied on any misrepresentation to his detriment, *and* that such reliance was justified." (italics in original)) (citing Haralson v. E.F. Hutton Group, Inc., 919 F.2d 1014, 1025 (5th Cir. 1990) and Royal American Managers, Inc. v. IRC Holding Corp., 885 F.2d 1011, 1016 (2d Cir. 1989)); Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,225 at 38,650 (CFTC Jan. 17, 1992) ("It is self-evident that every customer loss does not result from injurious conduct . . . . It is also evident . . . that not all violations of the Act cause harm to customers. Even when a statutory violation and customer losses are present in the same set of circumstances, a cause-and-effect relationship is not automatically assumed."); In re Thomas, CFTC Docket No. 98-13, 1998 WL 846647, at *11 (CFTC Dec. 7, 1998); In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,923-28 (ALJ June 5, 1996), aff'd in part rev'd in part, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 (CFTC Dec. 18, 1997).

additional, oral disclosure, cannot satisfy this obligation.[424] Respondents, not surprisingly, disagree. They argue that, under the circumstances of this case, the written risk disclosure statements satisfied their burden.[425]

Complainants do not explain how the written risk disclosure statement falls short of what Sections 4b and 4c(b) require under the circumstances this case.[426] Rather, their argument presumes that disclosure of the information mandated by Rules 1.55 and 33.7 can never be satisfactory. In support of this position,

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[424] Complainants Brief at 13-14 ("This affirmative duty could not possibly be satisfied by Respondents' passive receipt, from some third person, of printed risk disclosure statements signed by Complainants." (emphasis in original)).

The above parenthetical quote and other similar passages illustrate one of the unfortunate aspects of the computer age. Complainants' counsel tended to use the font formats that his word processing software provided in order to emphasize certain words he found to be important or, presumably, persuasive. See, e.g., id. at 11, 12, 13, 14, 16, 17, 18, 19, 20, 21, 22, 23, 24, 27, 28, 32, 33, 34, 35, 36, 37, 38, 40. While the Court is not preternatural in its ability to comprehend the pleadings submitted for its consideration, parties may rest assured that the Court can discern their arguments (written in modern English) even if buzzwords and important passages are not underlined, **printed in bold script**, *italicized,* CAPITALIZED or ***SUBJECTED TO SOME COMBINATION*** of the ***four***, provided their prose is **REASONABLY *clear***.

[425] Respondents Reply Brief 5-9.

[426] See Complainants Brief at 13-14.

complaints rely on Adler v. First Commodity Corporation of Boston.[427] This reliance is misplaced.

In Adler, the customer "received, read and executed" the risk disclosure statement.[428] However, an AP of the respondent FCM also represented that the there was no reason to be concerned with risk since it "never came into play" and that the investment was "not risky."[429] The judge found that the AP had "negated the legal effect of the executed risk disclosure statement" by failing to otherwise "inform the Complainant of the great risk involved."[430] Thus, Adler held that provision of a written risk disclosure statement, unaccompanied by supplemental disclosure is not only incomplete, it is a legal nullity. If Adler were binding Commission precedent, respondents in this proceeding would no doubt be found to have failed to make an effective disclosure. However, Adler is not Commission precedent. Upon review, the Commission summarily affirmed the initial decision, apparently on the basis of the affirmative misrepresentations,[431]

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427 [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,050 (ALJ Dec. 10, 1987); Complainants Brief at 13.

428 Id. at 34,615.

429 Id. (internal quotations omitted).

430 Id.

431 Adler v. First Commodity Corp. of Boston, CFTC Docket No. 87-R12, 1988 WL 228986, at *1 n.2 (CFTC Aug. 22, 1988).

but declined to adopt the rationale of the administrative law judge and stated that neither the initial decision nor summary affirmance should serve as Commission precedent.[432] Not only does the Adler initial decision lack precedential authority, it lacks persuasiveness and the Court does not adopt it.[433]

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[432] Id. at *1.

[433] Complainants also cite to Johnson & Hagen for the proposition that written risk disclosure statements required by Commission regulations are generally insufficient risk disclosure. Complainants Brief at 13 (citing Philip McBride Johnson & Thomas Lee Hagen, Commodities Regulation, §5.08(12)(D) (3rd ed. 1998) ("Johnson & Hagen"). The treatise does not state that written risk disclosure statements are ineffective per se. Rather it indicates that, under certain circumstances, they may be incomplete or vitiated. This point is underscored by the fact that, with the exception of Adler and O'Hey v. Drexel Burnham Lambert, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,390 (ALJ Oct. 17, 1984), each of the Commission cases that Johnson & Hagen cites relied on affirmative misrepresentations, rather than a lack of oral, supplementary disclosure, as the basis for holding that the written risk disclosure was ineffective. Johnson & Hagen, §5.08(12)(D) n.745; Smith v. First Commodity Corp. of Boston, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,163 at 34,882 (CFTC Feb. 17, 1988); Wagner v. First Commodity Corp. of Boston, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,109 at 34,780 (CFTC Jan. 15, 1988); Acalin v. First Commodity Corp. of Boston, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,107 at 34,776-77 (CFTC Jan. 14, 1988); Kuykendall v. International Trading Group, Ltd., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,728 at 33,874 (CFTC July 10, 1987); Kahn v. First Commodity Corp. of Boston, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,668 at 30,843 (CFTC July 31, 1984).

O'Hey illustrates the legal effect of unaugmented written disclosure. In that case, respondents were found to have made representations that understated the inherent risk of loss in trading. O'Hey, ¶22,390 at 29,799. However, the initial decision did not base its conclusion, that the written risk

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Whether a written risk disclosure statement discloses all necessary, relevant information about the risk of trading is a circumstantial inquiry. There are, no doubt, some circumstances under which such a statement would be incomplete. However, the risk disclosure statement is not insufficient as a matter of law. "Normally, the fact that the [complainants] signed and returned the risk disclosure statement satisfies the broker's duty to inform his clients of the risks involved."[434] As the Commission put it, "if the broker is acting as a mere agent for execution of customer's orders, compliance with Rule 1.55 will normally

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disclosure was ineffective, on the affirmative misrepresentation. The court had also found that respondent's AP engaged the complainants in conversation while complainants completed the account-opening documents. Id. Based on that finding, the initial decision reasoned that the conversation distracted the complainants, "rendered communication [by the written risk disclosure statement] virtually impossible," and, therefore, negated the effect of the written risk disclosure statement. Id. Upon review, the Commission disagreed as to the effect of the distracting conversation. O'Hey, ¶22,754 at 31,141 ("Nor do we believe that the mere fact that Pratt was engaged in conversation with complainants, absent any indication that he was intentionally seeking to distract them, excuses their failure to read the risk disclosures prior to reading them."). The Commission did affirm the initial decision's finding of vitiation based on affirmative misrepresentations. Id. at 31,141-42. Thus, provision of the written risk disclosure statement, even under less than ideal circumstances, does not amount to fraudulent nondisclosure.

[434] McNally, 16 F.3d at 1499; accord Purdy, 968 F.2d at 521 ("Disclosure literature accompanying the initiation of an account satisfies a firm's disclosure obligations . . . .").

fulfill the broker's duty to provide adequate risk disclosure."[435] The complainants offer no proof of extraordinary circumstances regarding their relationship with respondents. Accordingly, complainants' pure omission theory, based on the lack of supplementary, oral disclosure, fails.

There Was No Unauthorized Trading In Webster's Account And, Even If There Was, It Did Not Injure Him

Webster claims all of the trading that occurred in his account, prior to April 17, 1997, was unauthorized and, therefore, performed in violation of Rule 166.2.[436] On that basis, he claims that respondents are directly liable for the losses that occurred during that period.[437] In support of his

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[435] Holmes v. Wheat First Securities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,823 at 36,875 (CFTC Apr. 3, 1990); accord Lehoczky v. Gerald, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,441 at 42,923-24 & n.24 (CFTC June 12, 1994) (holding that a failure to disclose a broker's track record did not violate Section 4b while noting that Rule 1.55 did not mandate its disclosure).

As this Court stated in Staryk, ¶26,701 at 43,926 n.72 (citations omitted), "Similarly, 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. An omission may also violate the Commission's disclosure rules. If neither of these two conditions are met, a 'pure omission' is not unlawful."

[436] Complainants Brief at 32-34.

[437] Id.

claim, he testified and argues that he did not directly place the orders that led to these trades with respondents.[438] As noted above, the Court found Webster's testimony on the issue to be insufficiently credible to prove that he did not provide authorization directly to respondents. Even if Webster had established violations of Rule 166.2, his evidence failed to prove that the violations, in fact, caused him injury.

Rule 166.2 provides,

> "No futures commission merchant, introducing broker or any of their associated persons may . . . effect a transaction in a commodity interest for the account of any customer unless before the transaction the customer, or person designated by the customer to control the account—
>
> (a) Specifically authorized the futures commission merchant, introducing broker or any of their associated persons to effect the transaction . . . or
>
> (b) Authorized in writing the futures commission merchant, introducing broker or any of their associated persons to effect transactions in commodity for the account without the customer's specific authorization . . . ."[439]

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[438] Tr. at 314.

[439] 17 C.F.R. §166.2.

Although "[an] oral grant of general discretion" may be "irrelevant" with respect to an FCM, IB or their AP,[440] it is not clear that such authority is irrelevant if the recipient of

[440] Kacem v. Castle Commodities Corp., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,058 at 45,031 (CFTC May 20, 1997) (quoting In re Heitschmidt, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,263 at 42,204 (CFTC Nov. 9, 1994)). Kacem stated that such oral authorization "is . . . irrelevant" with respect to brokers. Kacem, ¶27,058 at 45,031. The Court uses the term "may," because Kacem may not express the most current reading of Rule 166.2.

Implicit in the Commission's reading of Rule 166.2 is that a neither a broker nor a broker's AP can qualify as a "person [orally] designated by the customer" to exercise general authority or limited, but not specific, authority. The Second Circuit seems to disagree. In Peltz v. SHB Commodities, Inc., 115 F.3d 1082, 1084-86 (2d Cir. 1997), the customer granted oral authority to an FCM who exercised that authority and, the customer claimed, exceeded it. The customer then sued his brokerage firm, claiming a violation of Rule 166.2. Peltz, 115 F.3d at 1086. Peltz held that a broker could be the designee of a customer, authorized to exercise general discretion over an account and provide specific authorization to a second broker, who holds the customer's account, and that such authorization could be oral. Id. at 1087. The case did not address the specific question of whether its holding applied in cases when the designee was not only a broker but the AP of the broker who held the customer's account. However, it did nothing to suggest that the rule would be different in that situation. See id. Indeed, Peltz read subsection (a) of 166.2 as distinct from and unmodified by subsection (b). Id. If that is the case, then it would permit a customer to make the broker holding its account the "person designated" to grant specific authorization. Of course, at that point, the process of specific authorization would become entirely internal. In Webster's case, however, the Court need not address the question of what range of oral, non-specific authority a broker may lawfully exercise.

general authority is not associated with an IB or FCM.[441] Regardless of whether someone not associated with a broker may exercise general, oral authority, an IB's or FCM's execution of a customer order certainly complies with Rule 166.2 when (1) there is a written power of attorney in effect, at the time of the transaction, authorizing the broker to effect the transaction, (2) the order was placed by a third party with written authorization to do so, or (3) the customer or his designee

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[441] In Wolken v. Refco, Incorporated, the Commission held that, "[a]s a practical matter, Rule 166.2 requires that a principal's intent to grant general trading authority to certain agents be reflected in a written instrument." [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,509 at 36,188 (CFTC July 18, 1989) (emphasis added). Perhaps recognizing that brokers, given their control over accounts and per-trade compensation scheme, face a greater moral hazard, the Commission defined those "certain agents" by stating "Rule 166.2 applies to futures commission merchants, introducing brokers, and their associated persons." Id. at 36,188 n.1. As discussed above, this may reflect an out-dated reading of the regulation. However, even if it is current law, Wolken did not foreclose the possibility that a customer may grant general, oral authority to a person who is not a futures commission merchant, introducing broker, or one of their associated persons. Likewise, Rule 166.2's plain language does not require that such oral authority be memorialized in writing. Regardless, in this case, there is no need to address the question of general authority given the proof of specific authority.

specifically authorized the transaction.[442] There was no written power of attorney over the Websters' account in effect before April 17, 1998. Accordingly, the Court must determine whether the trades that occurred during that period were specifically authorized or, more precisely, whether Webster proved that they were not.

Under subsection (a), "a transaction is specifically authorized if the customer or the person designated by the customer to control the account specifies (1) the precise commodity interest to be purchased or sold and (2) the exact amount of the commodity interest to be purchased or sold."[443] Webster claims that he "never called in any trades to Refco."[444] However, proof of this fact would not preclude a finding of compliance. Rule 166.2 does not expressly require direct communication between the customer and broker nor does it define specific authorization in a manner that would necessitate direct communication. There is no reason to conclude that specific authority does not exist when the following conditions exist: (1) a customer authorizes someone else to place an order on his or

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[442] Peltz, 115 F.3d at 1087; Kacem ¶27,058 at 45,031; In re Heitschmidt, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,263 at 42,204 (CFTC Nov. 9, 1994).

[443] 17 C.F.R. §166.2(a).

[444] Complainants Brief at 33.

her behalf, (2) the customer specifies the commodity interest, whether it is to be bought or sold, and the exact amount to be transacted, and (3) the person authorized to communicate with the broker places the order in accordance with the customer's instructions. Under general principles of agency, the person charged to place the order would have authority to do so and that authority would be specific, not general.[445]

Accordingly, even if Webster had managed to prove that he never directly spoke to respondents, but that Rhea called in his orders, Webster would still have to address the question of whether he authorized Rhea to place specific orders on his behalf. Webster testified that he did not authorize Rhea to place some number of orders on his behalf.[446] However, the Court

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[445] Of course, if an IB or FCM accepts an order for a customer from someone who is not authorized in writing to exercise discretion over the account, the FCM or IB assumes the risk that the customer did not authorize the person placing the order to do so. If that risk were realized, the FCM or IB would be liable if it was negligent in accepting the order. Peltz, 115 F.3d at 1088 ("Generally, before accepting trades from a third party, the FCM must make a reasonable inquiry into the nature and extent of the individual's authority").

[446] Webster testified that prior to April 17, 1997, Rhea did not seek Webster's specific authorization before calling certain orders into Refco. Tr. at 323-24. This included a two-week period (the date of which was not testified to) when Webster was out of town. Id. at 324. Webster did not testify that Rhea never sought his approval before calling in a trade. Accordingly, even if the Court found Webster credible on this point, culling the unauthorized trades from the authorized trades would have

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found Webster's testimony incredible and there is more reliable evidence that Rhea relayed orders with Webster's specific authorization.[447] Having failed to prove that he did not

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been an impossible task based on Webster's testimony and any causal determination would have been speculative in the extreme.

[447] In his post-hearing brief, complainants' counsel argues "[t]here is no evidence in this record, however, that Webster orally authorized anyone to place orders for execution in his account." Complainants Brief at 33. In this unqualified statement, Mr. Pfingst mischaracterizes the record. Aiello testified that he personally accepted orders from Webster. Tr. at 752. In addition, he testified to the following.

> "Well, Stan [Rhea] would call up and quote the market. I would give him that quote, and he would say, you know, sell ten. And then I would say, 'Okay, Stan.' And all of a sudden he would be interrupted and you'd hear, 'Well, Neal [Webster] wants you to do two also.' And I -
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> I would ask Stan to put Neal on the phone.
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> And Neal would get on the phone and say, 'Yeah. John go ahead.' . . . I can't even count how many times Mr. Webster did this."

Id. Johnson and Rhea corroborated this testimony. Id. at 604, 871. Questions of reliability aside, there is plainly some evidence that Webster "orally authorized" someone "to place orders" for his account.

specifically authorize Rhea to call in the orders on his behalf, Webster has failed to prove a violation of Rule 166.2.[448]

Even if the respondents had violated Rule 166.2, recovery depends upon proof that such a violation caused Webster's loss.[449] More precisely, Webster must prove that the violation was the cause-in-fact of his losses and that the cause was sufficiently proximate, in the chain of events leading to the injury, that overarching policy considerations do not preclude imposing liability.[450] In this case, Webster failed to prove that the alleged lack of specific authority was, in fact, the cause of his losses. Indeed, his testimony precludes such a conclusion.

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[448] For this reason, the Court has no cause to decide whether or not Webster might have granted general authority to Rhea. However, there is evidence that would support such a grant.

[449] Muniz, ¶25,225 at 38,650 ("It is self-evident that every customer loss does not result from injurious conduct . . . . It is also evident . . . that not all violations of the Act cause harm to customers. Even when a statutory violation and customer losses are present in the same set of circumstances, a cause-and-effect relationship is not automatically assumed.").

[450] Rodriguez-Cirilo v. Garcia, 115 F.3d 50, 52 (1st Cir. 1997) ("The concept of proximate causation restricts tort liability to those whose conduct, beyond falling within the infinite causal web leading to an injury, was a legally significant cause."); Id. at 54 (Campbell, J., concurring) ("Causation in tort law is generally divided into two concepts: causation in fact . . . and proximate causation."); Fedorczyk v. Caribbean Cruise Lines, Ltd., 82 F.3d 69, 73 (3rd Cir. 1996) ("Causation includes cause in fact and legal causation, which is often referred to as proximate cause. Courts have often conflated cause in fact and legal causation into 'proximate cause,' but the two are conceptually distinct.").

In order to establish that unauthorized trading was the cause-in-fact of their injuries, complainants must first satisfy a "but-for" test.[451] This test requires to Court to consider the factual validity of the contrapositive.[452] Reparations cases rest on the proposition that, because there was a violation, there was an injury. Accordingly, the Court must determine whether Webster has established that, in the absence of the alleged Rule 166.2 violation, the injury would not have occurred.

Establishing the factual validity of the necessary contrapositive requires proof of how Webster would have acted had Refco refused to accept orders from Rhea for Webster's account. To be more precise, Webster must prove that, if respondents had not accepted orders from Rhea for Webster's account, Webster would not have placed the orders himself.[453] Not only has Webster

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[451] Causation in fact, in cases that involve customer trading, can be divided into two stages. First, there is the question of transaction causation, whether the violation caused the trade. Transaction causation, the threshold question, involves a "but for" inquiry. Purdy, 968 F.2d at 519; Waters, 172 F.R.D. at 490. The next stage, loss causation, involves the more diluted, substantial factor test. This is so because, once the trade occurs, factors other than the trade itself (e.g. market movements having no connection with the violation) must generally come to bear before an injury (other than the transaction costs) can occur.

[452] Fedorczyk, 82 F.3d at 73.

[453] This requirement rests on the simple proposition that, "[a]n act or an omission is not regarded as a cause of an event if the (continued..)

failed to prove that this would not occur, his testimony clearly supports the opposite conclusion. When questioned as to whether he would have abstained from trading, rather than call in his own trades, if Rhea had been unwilling to call them in for him, Webster replied "No. I wouldn't have had any problem, no."[454] On the basis of that answer (and assuming that the trades lacked authorization) the Court concludes that, if Refco had refused to accept orders from someone other than Webster (or his wife), Webster would have placed them himself. Therefore, even in the absence of the alleged violations of Rule 166.2, it appears his account would have experienced substantially the same losses. In other words, there is an insufficient causal link between the alleged violations of Rule 166.2 and Webster's losses. For this reason, sufficient proof that unauthorized trading occurred would not have supported a finding of liability on the part of respondents.[455]

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particular event would have occurred without it." Prosser and Keeton §41, at 265.

[454] Tr. at 326-27.

[455] Surprisingly, respondents did not raise ratification as an affirmative defense in this case. See Answer to Webster. Thus, they are deemed to have waived it despite the fact that they now raise the defense in their post-hearing briefs. Lord v. W.D. Gann Trading Co., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,257 at 38,813 (CFTC Mar. 17, 1992); In re Murphy,
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[1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,798 at 31,341 (CFTC Sept. 25, 1985); Respondents Reply Brief at 16-17. However, given the unique evidentiary record, some discussion of the defense is merited. Ratification is "the affirmance of an act done originally without authority." Mills v. Smith Barney, Harris, Upham & Co., Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,762 at 31,184 (CFTC Oct. 1, 1985) (citing Restatement (Second) of Agency §82). Success of the defense requires establishing a complainant's knowing adoption of wrongful conduct and the respondents bear the burden of proof. Embree v. Macro Int'l Group, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,932 at 43,271-72 (CFTC Sept. 29, 1987). Accordingly, the Court's inquiry would focus on the customer's intent and seeks to determine whether the customer intentionally adopted the unauthorized actions of the FCM. Gilbert v. Refco, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,081 at 38,058 (CFTC June 27, 1991). Mills, ¶22,762 at 31,185. A finding of such intent may be proved in one of two ways.

In most cases of claimed ratification, there is no direct evidence that a customer intended to adopt unauthorized trades at the time they were made. Indeed, the only direct evidence on the question of intent is usually a complainant's self-serving testimony that he lacked such an intent. In the absence of direct evidence to test the credibility of such testimony, the Court must draw inferences from proof of whether the customer disputed those unauthorized trades that were known to him. See Gilbert, ¶25,081 at 38,058; Mills, ¶22,762 at 31,185. However, the Court need not always rely on qualified inaction in concluding that unauthorized trades were ratified.

On rare occasions, the Court may have a record that includes affirmative statements indicating the customer's intent to adopt the unauthorized trades when they occurred. If there is sufficient, affirmative evidence that a customer had a contemporaneous intent to adopt unauthorized trades, then the respondents need not prove those facts necessary to infer ratification from circumstantial evidence. To be more precise, if a customer testifies that he intended to adopt unauthorized trades when they occurred, there is no need to prove that customer knew he could object to unauthorized trades. That is so because that knowledge is only necessary to infer a fact that the

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Reliance On Claimed, Affirmative Misrepresentations

As discussed above, complainants seek compensation based on the alleged misrepresentations of Gaiber, Rhea and Johnson. They claim these Club members fraudulently induced them to trade futures and options, in violation of Sections 4b and 4c(b) of the Act, by misrepresenting the risk of loss inherent in trading, or in the case of Johnson, minimizing the importance of the risk disclosure statement. In addition to establishing grounds for vicarious liability, their recovery depends on proof that: (1) Gaiber and the others misrepresented a fact to complainants, (2) that the misrepresentation involved a material fact, (3) that

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customer has already evidenced more directly. This is a case were an intent to adopt unauthorized trades was established by affirmative proof of intent.

Webster testified that he was aware that Rhea was placing trades on his behalf. Tr. at 318, 324-25, 370-74, 376. When asked if he objected to the trading he claims to have been unauthorized, Webster replied in the negative, stating "I had no reason to because I had made a lot of money." Id. at 325. While the failure to object, without proof of more, would not support a finding of ratification, Webster's testimony indicated an affirmative intent to adopt the trades and a motive to do so. The mere fact that they turned out worse than expected does not negate Webster's state of mind at the time they were made. Therefore, had respondents raised ratification in a timely manner, Webster's testimony would have precluded recovery even if complainants had established a violation of Rule 166.2 and causation.

misrepresentation occurred with scienter,[456] (4) that the misrepresentation was the cause in fact of complainants' injuries and (5) that the misrepresentation was the proximate cause of the injuries of which the complainants complain. As discussed above, complainants failed to establish the existence of an agency relationship. Accordingly, there is no need to address the questions of causation, whether misrepresentations occurred, materiality, scienter and the amount of damages and the Court will not further address the last four. However, the question of causation merits some discussion based on the facts of this case.

As noted above, causation in fraud cases involves both cause in fact and proximate causation inquiries and turns largely on the question of reliance. In order to succeed, complainants must prove that they actually relied on the alleged misrepresentations and that the reliance was justified.[457] The Court does not assume

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[456] Staryk, 1998 WL 834656, at 18 n.36.

[457] Minasian v. Standard Chartered Bank, PLC, 109 F.3d 1212, 1215 (7th Cir. 1997) ("In New Jersey, as in most other states, a person claiming to be the victim of commercial fraud must show that he justifiably relied on the other party's false statement."); Indosuez Carr Futures Inc. v. CFTC, 27 F.3d 1260, 1264-65 (7th Cir. 1994); Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020, 1032 (2d Cir. 1993); Atari Corp. v. Ernst & Whinney, 970 F.2d 641, 645-46 (9th Cir. 1992). "Justifiable reliance is not a theory of contributory negligence; rather it is a limitation on a[n] . . . action which insures there is a causal connection between the misrepresentation and the plaintiff's harm. Only when the plaintiff's conduct rises to . . . [reckless] conduct . . . will reliance be unjustifiable." Zobrist v. Coal-
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that, because misrepresentations preceded a transaction, the misrepresentation induced the transaction.[458] Rather, the Court considers the following factors in resolving the reliance issue: (1) the sophistication and expertise of the complainants in financial and commodities matters,[459] (2) the existence of long-standing business or personal relationships, (3) access to relevant information, (4) the existence of a fiduciary relationship,[460] (5) concealment of the fraud, (6) opportunity to detect the fraud, (7) whether the complainant initiated the transaction in question or sought to expedite it, and (8) the generality or specificity of the misrepresentations.[461] None of

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X, Inc., 708 F.2d 1511, 1516 (10th Cir. 1983) (citations omitted), quoted in, Atari, 970 F.2d at 645-46.

[458] In re Staryk, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 at 45,812 (CFTC Dec. 18, 1997); Muniz, ¶25,225 at 38,650.

[459] Relevant factors in this inquiry include: wealth, age, education, professional status, investment experience, and business background. Myers, 950 F.2d at 168.

[460] When there is a fiduciary relationship, once a complainant has "relevant information" that is "completely at odds" with the representations of an ostensible fiduciary, "[a]ny fiduciary relationship . . . must . . . be considered suspect at this point." Kennedy v. Josephthal & Co., Inc., 814 F.2d 798, 805 (1st Cir. 1987).

[461] Myers, 950 F.2d at 167; Jackvony v. RIHT Fin. Corp., 873 F.2d 411, 416 (1st Cir. 1989); Zobrist, 708 F.2d at 1516.

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these factors are dispositive.[462] However, one factor carries considerable weight.

In determining whether a customer justifiably relied on a misrepresentation, the Court must consider the information to which the customer had access. More to the point, "a plaintiff may not reasonably or justifiably rely on a misrepresentation where its falsity is palpable."[463] A misrepresentation may be

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The more specific a misrepresentation and, therefore, the more likely it is "subject easily to verification or refutation," the more likely other information known (or imputed) to a complainant will render reliance upon the misrepresentation unjustifiable. Kennedy v. Josephthal & Co., Inc., 635 F. Supp. 399, 401 (D. Mass. 1985).

[462] Zobrist, 708 F.2d at 1516-17.

[463] Holdsworth v. Strong, 545 F.2d 687, 693 (10th Cir. 1976), cert. denied, 430 U.S. 955 (1977); accord Indosuez Carr Futures, 27 F.3d at 1265-66 ("Generally, 'an investor cannot close his eyes to a known risk'"); Brown, 991 F.2d at 1032; Kennedy, 814 F.2d at 805 ("When they closed their eyes and passively accepted the contradictions between Sinclair's statements and the offering memorandum, appellants could not be said to have justifiably relied on the misrepresentations."). The "palpably" false requirement ensures that complainants are not subjected to a contributory negligence rule. See Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522, 527- 29 (7th Cir. 1985); Zobrist, 708 F.2d at 1517.

Under certain circumstances, the palpable falsity of a misrepresentation may stem from a disclosure document that a trader has in its possession, but did not actually read. Cf. Brown, 991 F.2d at 1032. See Kessenich v. Rosenthal & Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,181 at 24,862 n.4 (CFTC Mar. 24, 1981). In general, a trader is charged with constructive knowledge of disclosure documents that a broker

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palpably false when it is made or become palpably false as a result of experience.

The Commission has held that, when a customer is fraudulently induced to act, continued reliance depends upon whether the false nature of the statement (or omission) becomes known to the customer.[464] More specifically, if a customer is induced to trade, but the outcome of trading or some other event produces or conveys information that contradicts the fraudulent misrepresentations, then the customer's knowledge of the trading outcome would break the causal chain.[465] This is so because even

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provided, even if the trader proved that she did not actually read the disclosure. Myers, 950 F.2d at 167; Edington v. R.G. Dixon and Co., No. 90-1274-C, 1992 WL 223822 at *5 (D. Kan. Aug. 7, 1992) ("What is imputed is only the knowledge of that information 'actually . . . disclosed' and not the inferences which a knowledgeable investor would draw from the information."). When knowledge of the disclosure is imputed, "the only consequence" is that the Court, in "determining justifiable reliance," "must evaluate the relevant factors as if the plaintiff were aware of the warnings found in the official statement." Id.

[464] Muniz, ¶25,225 at 38,651.

[465] Puckett v. Rufenacht, Bromagen & Hertz, Inc., 903 F.2d 1014, 1020 (5th Cir. 1990) (quoting Clayton Brokerage Co. of St. Louis, Inc. v. CFTC, 794 F.2d 573, 578-79 (11th Cir. 1986)); Muniz, ¶25,225 at 38,651. Simply stated, a customer who (1) is mislead to believe there is no risk of substantial loss in trading, (2) traded, (3) suffered a substantial loss (even a paper loss), (3) learned of the loss and (4) subsequently traded, cannot recover for the subsequent trading losses. J.E. Hoetger & Co., 572 F. Supp. at 819-20; O'Hey, ¶22,754 at 31,142-43.

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if there was subsequent, actual reliance, such reliance would no longer be justifiable.

The post-inducement knowledge that an earlier statement was false does more than break the chain of continued reliance. Evidence of such knowledge tests the claim of initial reliance.[466] It is perilously easy for a complainant to make a prima facie showing of subjective reliance. Since the issue of reliance centers on a complainant's own, prior state of mind, self-serving testimony generally does the trick. Because no one can go back in time, testing the reliability of such testimony generally involves nothing more than determining the witness's overall

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Complainants are not of one mind as to this theory. The Schneiders concede that, once they experienced their catastrophic losses, they could no longer rely on any failure to disclose the risk of trading or any affirmative misrepresentations with regard to that risk. Complainants Brief at 27. Webster, on the other hand, claims that he continued to rely on the alleged failure to disclose risk and alleged misrepresentations after his account lost over 90 percent of its value in a short period of time. Id. at 34-35. This is so even though Webster was fully aware of the losses at the time they occurred. Tr. at 314-17. At that point Webster either knew or must have known that trading strangles presented a substantial degree of risk. Accordingly, the Court is puzzled why, unlike other complainants represented by the same counsel, he would seek to extend the causal chain beyond this point. The Court's puzzlement only increases when it considers that, by his own admission, Webster actually discussed the risk of loss with Aiello shortly after the losses occurred and, before the losses occurred, attended the breakfast meeting at which risk was discussed. Id. at 333.

[466] See, e.g., McNally, 16 F.3d at 1501-02.

credibility. When a customer claims inducing fraud, learns of the misrepresentation's falsity and continues to trade, the Court has more to work with.

If, in time period A, a person is misled with regard to a material fact and traded and, in time period B, the same individual learns of the true fact and subsequently continues to trade, then, barring a credible, alternative explanation,[467] the Court may safely infer that if, in time period A, the person was not misled, they still would have traded.[468] In other words, the person's later action, when she knew the misrepresentation to be false, provides a basis upon the which the Court can draw an inference as to whether belief in the misrepresentation caused the actions that resulted in injury. In short, seemingly credible testimony of initial reliance may become incredible if the customer learned of losses yet continued to trade.

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[467] Usually, complainants will attribute continued trading to a "desperate" attempt to recoup the earlier losses. Under these circumstances, continued reliance rests largely on a credibility determination.

[468] Domenico v. CFTC, No. 87-7469, 1989 WL 18805, at *5 (9th Cir. Dec. 13, 1989) (unpublished disposition). Indeed, the Eighth Circuit made this finding as a matter of law. McNally, 16 F.3d at 1501. While this Court will not go so far as to say that post-loss trading, if not otherwise explained in a credible manner, establishes non-reliance as a matter of law, it does adopt the inferential basis underlying the rule.

Assuming, but not finding, that each complainant relied on misrepresentations that they claimed to have been subjected to,[469] events occurred that might have broken the causal chain. These include the complainant's trading losses, information they learned from others and knowledge of the trading losses experienced by others.

When Van Essen and Aiello visited the Club, there is no dispute that they discussed the risks inherent in selling options in general and selling strangles in particular. There is no dispute that they characterized the strategy as relatively risky and there is no dispute that they illustrated the point with a concrete, fairly recent, historical example. Accordingly, the Court would be inclined to find that Sommerfeld and Webster, if

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[469] In certain respects, this assumption would be particularly strong. Complainants are uniform in their assertions that Gaiber misled them with respect to selling options only and, painted buying options as a losing proposition. Accordingly, the Court would have a difficult time finding that Gaiber's misrepresentation proximately caused losses that resulted from purchasing options or trading futures contracts. In Sommerfeld's case, $1,250 of his trading losses resulted from buying options and $3,750 of his losses resulted from futures transactions. LS000054; LS000070; LS000079; LS000080. In Webster's case, over $70,000 of trading losses, up through April 16, 1997 (nearly one-half of his claimed losses), resulted from futures trading and not options on futures trading. NW000119; NW000122. Thus, even if there was a basis for vicarious liability, even if the Court had believed their claims of inducing fraud and even if the causal chain was as temporally long as claimed, Sommerfeld's award probably would have been somewhat less than what he sought and Webster's would likely have been much less than he claimed.

they were not aware of it before, became aware that selling strangles was not a low risk strategy and that it involved the risk of possible, catastrophic losses. On that basis, it would have been difficult not to find that, at some reasonable time (in which open positions could be liquidated) after the breakfast meeting, the losses in Webster's and Sommerfeld's account were no longer the result in fact and the proximate result of the alleged misrepresentations.[470]

The same logic applies to losses that post-dated April 16, 1997. No party disputes the fact that Club members shared information and discussed the outcomes of trading, both good and bad. Thus, their personal trading experience was not the only source of experiential learning. In mid-April, a number of Club members suffered substantial trading losses. These losses were discussed among the Club membership. Accordingly, even those Club members who escaped those losses, such as the Hans and Sommerfeld, would have learned that selling options involved substantial risk of loss if they attended the Club at that time.[471] On that basis, it is likely that Hans would have learned

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[470] Likewise, Webster admitted that, just after his April 16, 1997 losses, he discussed the risk of trading strangles with Aiello. Tr. at 333.

[471] Complainants seem to suggest that Hans may have been out of the country during the mid-April period. Complainants Brief at 24. However, the record suggests, through complainants'

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that selling options involved a significant risk of loss and Sommerfeld would have had the lesson of the March breakfast meeting reinforced.

Finally, there is evidence that complainants would have learned about the risks involved in selling strangles from their own trading results at a time prior to when they claimed to have done so. For example, Webster admits to learning that selling options was not risk-free immediately after his April 16, 1997 trading losses. As of March 25, 1997, Webster's account value was $53,428.72 and during that day he wrote 12 S & P strangles.[472] Six days later, Webster offset the strangles at a net loss of over $25,000, not counting commissions and fees, and his account value had fallen to about $12,963.76, a decline of over 75 percent in six days.[473] Accordingly, there is significant reason to believe (although the Court does not consider all the factors necessary to find) that Webster would have been aware that he might lose significantly more than $1,000 per trade, by writing

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counsel's cross-examination of Gaiber, that Hans returned from the trip on April 8, 1997. Tr. at 966-67.

[472] NW000109.

[473] NW000109-10. See supra note 154.

strangles, even if he had been effectively misled up to that point.

Likewise, the Schneiders may have learned a practical lesson (assuming they had not already come upon this information) just before they experienced their most catastrophic losses. On April 28, 1997, the Schneiders' account had a liquidating value of $491,187.18.[474] On the next day, they sold five calls and, by the end of the day, the account value fell to $424,062.18.[475] One week earlier, they had sold five calls.[476] On April 30, 1997, the Schneiders offset the April 22nd and 29th calls at a total loss of $28,850 and the account value was down to $419,502.88.[477] As soon as the Schneiders learned the result of this activity, there is every reason to believe that they no longer thought that selling options was a virtually riskless endeavor.

Sommerfeld was a member of the Club during the mid-April turmoil and attended the Dearborn breakfast meeting. Therefore, even if Gaiber had misled him with respect to options trading, there is a significant reason to believe that he knew that selling options was not risk-free before his account experienced

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[474] HS000125.

[475] HS000126.

[476] HS000123.

[477] HS000127.

substantial losses. Assuming, arguendo, that this is not the case, his trading would have taught that lesson at the end of April 1997. On April 22, 1997, Sommerfeld sold 10 S & P calls and, at the close of the trading day, his account's net liquidating value of $149,974.78.[478] On April 29th, the account's value fell to $110,837.28 and, the next day, Sommerfeld offset the April 22 calls at a loss of $47,000.[479] At about this time, there is substantial evidence that Sommerfeld must have been, and actually was, aware that selling options entailed significant risks of loss even if he had not learned this already.[480]

Even if the Court assumes that Krubinski relied on the various misrepresentations he attributes to Gaiber and Rhea, he also appears to have learned a practical lesson from trading and one that preceded most complainants' trading losses. On March 25, 1997, the value of the K-R account was $84,396.[481] On that day, the partnership sold 12 S & P strangles.[482] On March 31st, the partnership offset the 12 strangles at a loss of $25,800 and, by the close of the trading day, the account had fallen in value

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[478] LS000063.

[479] LS000064-65.

[480] Tr. at 1112-13.

[481] DK000052.

[482] Id.

to $40,231.76.[483] Accordingly, there is a basis upon which to conclude that Krubinski was aware that selling strangles entailed a substantial risk of trading loss.

For reasons of economy and due to the complainants' failure to prove substantial portions of their cases, the Court declines to place the time at which each complainant could no longer justifiably rely on the claimed misrepresentations, assuming that they occurred and were initially relied upon. However, there is evidence that, even if they were lied to, each respondent would have stumbled upon information revealing the false nature of those misrepresentation from one of a number of sources and at a point before they claimed to have done so. If this was the case, then claims of continued reliance and even initial reliance would have become suspect.

Conclusion

For the reasons set out above, the Court **FINDS** that complainants failed to establish an agency relationship between the Club and respondents, failed to prove that respondents engaged in unauthorized trading and failed to prove that the Club violated the Act's IB registration requirement. Complainants did

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483 DK000054.

prove that respondents violated the risk disclosure requirements. However, they failed to prove that the violations caused injury. Accordingly, the Court **FINDS** that complainants have failed to establish that respondents are liable to them for their claimed damages and their complaints are, therefore, **DISMISSED WITH PREJUDICE**.

IT IS SO ORDERED.[484]

On this 1st day of February, 1999

Bruce C. Levine
Administrative Law Judge

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[484] Under 17 C.F.R. §§12.10, 12.314 and 12.401(a), any party may appeal an Initial Decision to the Commission by serving upon all parties and filing, with the Proceedings Clerk, a notice of appeal within 20 days of the date of the Initial Decision. If no party properly perfects an appeal - and the Commission does not place the case on its docket for review - the Initial Decision shall become the final decision of the Commission, without further order by the Commission, within 30 days after service of the Initial Decision.