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U.S. COMMODITY FUTURES TRADING COMMISSION

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JO-ANNE MUSKUS, Complainant,

V.

CFTC Docket No. 98-R80

COMMODITY RESOURCE CORPORATION, CHARLES ELIOT STEINHACKER, and GEORGE KLEINMAN, Respondents.

INITIAL DECISION

Jo-Anne Muskus alleges that Charles Steinhacker used a commodity trading seminar, which was attended by her fiancé Frank Udesky, as a vehicle to mislead her into opening a discretionary account with Commodity Resource Corporation ("CRC"). According to Muskus, she was misled by various material misrepresentations and omissions by Steinhacker in his written course materials which Udesky showed to Muskus, in his statements in the seminar which Udesky repeated to Muskus, and in a single brief conversation between Steinhacker and Muskus. Steinhacker's alleged misrepresentations and omissions included: falsely stating that his "Blue Chip" trading system was conservative and low risk, and virtually guaranteed to realize tremendous profits; deceptively downplaying the written risk warnings; failing to disclose that he was principally compensated by CRC to solicit students as new customers; falsely representing

that he had selected CRC to use the Blue Chip trading system after a rigorous search, when in truth CRC was the only firm willing to subsidize his seminar and client-referral activities; and, most significantly, failing to disclose that CRC would not actually be using his Blue Chip trading program. Muskus further alleges that George Kleinman, who traded her account and who owns CRC, failed to deliver a commodity trading advisor disclosure document, and facilitated Steinhacker's violations by failing to ascertain what Steinhacker had said to her during the solicitation, by failing to disclose that he would not use Steinhacker's BCT system, and by failing to supervise adequately Steinhacker's seminar and client-referral activities. Muskus seeks to recover her \$14,393 in out-of-pocket losses.¹

In response, Steinhacker asserts that he disclosed his affiliation with CRC, that he gave a balanced presentation of risk and reward, that he never downplayed the significance of the written risk disclosures, and that he never explicitly represented that CRC would actually use the Blue Chip trading system or philosophy. Kleinman asserts that he fairly and accurately explained his trading philosophy that he would follow in trading Muskus' account, that Muskus knew that he would not be following the Blue Chip trading system, and that Muskus was sufficiently sophisticated to evaluate the relative risks and rewards of trading futures and options.

The findings below are based on the parties' documentary submissions and oral testimony, and reflect my assessment of the relative credibility of the witnesses. None of the key witnesses gave testimony that was particularly compelling: the testimony of Muskus and Udesky was strikingly similar and obviously well coordinated, as was the

¹ Udesky also opened a separate discretionary account with CRC and also filed a substantially similar reparations complaint, which has been tried before another judge.

testimony of Steinhacker and Kleinman; the testimony of Udesky and the testimony of Steinhacker suffered from a self-serving and selective recollection of the seminar; and Kleinman forthrightly admitted that he could not specifically recall his conversation with Muskus during the account opening. However, since the testimony of Muskus and Udesky was more internally consistent, and more consistent with crucial documentary evidence, than the testimony of Steinhacker, the testimony of Muskus and Udesky was generally more plausible and convincing. For the reasons set out below, it has been concluded that Muskus is entitled to a reparations award.

Factual Findings

The Parties and the Witnesses:

- 1. Commodity Resource Corporation ("CRC") is a registered introducing broker located in Incline Village, Nevada. CRC cleared Muskus' trades through Refco.
- 2. George Kleinman, the president and sole owner of CRC, acted as Muskus' account executive, with discretionary trading authority. Kleinman approved the hiring and the employment terms for Steinhacker and admitted that he had direct supervisory authority over Steinhacker. [Page 216 of hearing transcript.]
- 3. Charles Steinhacker, a 61 year old Connecticut resident, has principally been employed as an art teacher and a magazine photographer. [¶ 5 of Steinhacker's answer.] He also was the publisher of the *Blue Chip Trade* newsletter, which ceased publication in 1993.

In April 1993, Steinhacker became a registered associated person with Eiger International, and began a modest seminar and customer-referral business. Steinhacker conducted an adult continuing education course, titled "Understanding the Commodity Futures Markets," in Fairfield County, Connecticut, and Westchester County, New York. According to Steinhacker, he principally taught the course because he found futures trading to be "fascinating." However, the record establishes that his motivation was not entirely aesthetic, because Steinhacker referred students who wished to open accounts to Eiger, and later to CRC, for a forty-percent share of the commissions. This commission-derived income, in fact, dwarfed the nominal fees that Steinhacker received for teaching the course. Also, Steinhacker had planned to expand his business to larger seminars in larger metropolitan areas, which was to be subsidized by CRC if he generated sufficient business.

At the conclusion of a seminar attended by Udesky, Steinhacker would convince first Udesky, and then Muskus, to open a CRC account. Although Steinhacker would not act as Muskus' account executive, he did send her the CRC account-opening package, did receive copies of her account statements directly from CRC, did discuss her account with Kleinman, and did receive a forty percent share (about \$5,000) of the commissions generated by the trades in Muskus' account. [¶¶5 and 14 of Steinhacker's Answer; ¶¶1 through 4, and 9 of Steinhacker's affidavit (filed September 22, 1998); and pages 145, 257 and 261-262 of hearing transcript.]

4. Kent Knock, a witness for respondents, attended Steinhacker's class with Muskus. Knock's testimony indicates that he entered Steinhacker's seminar very skeptically. In this connection, he had initially believed that Muskus was a "set-up" acting for Steinhacker when she gushed on about the steady profits that she was then making in her CRC account.

5. Frank Udesky, Muskus' fiancé, is in his forties, is employed as an Internal Revenue Service auditor, and has a Bachelor of Science degree in accounting. Before opening the account with respondents, Udesky had no previous experience with commodity futures or options. Udesky had maintained mutual fund and managed stock accounts.

After Udesky had attended the first session of Steinhacker's class, he informed Muskus that Steinhacker had developed a trading system that Udesky understood to be consistently successful, conservative and low-risk, and showed her the course flyer and the class handout. After the last session, Udesky was encouraged by Steinhacker to urge Muskus to open a CRC account, which Udesky told Muskus would be traded pursuant to Steinhacker's Blue Chip trading system. [See pages 114-127 of hearing transcript.]

Neither side produced corroborative witnesses who attended the class with Udesky.

6. Jo-Anne Muskus, a resident of Westport, Connecticut, is a certified public accountant. Muskus has a bachelors degree in accounting and a masters degree in business administration. Muskus stated on the account application that her annual income was between \$50,000 and \$75,000, and that her net worth was between \$250,000 and \$500,000.

Muskus, whose investment experience was limited to mutual funds, described herself as a "conservative" and risk-averse investor. The plausibility of this characterization was underscored by the fact that she promptly asked Kleinman to trade less aggressively when she experienced the first significant loss, and then quickly closed her account the next time she experienced a large loss. [See Muskus' replies to Kleinman/CRC interrogatories 1-5; account application (produced by CRC on August 10, 1998, in

response to Muskus' document request number 2); ¶ 5 of Steinhacker's affidavit; and pages 5-7 of hearing transcript.]

The Relationship Between Steinhacker and CRC:

7. In late 1995, Steinhacker began looking for a new firm to fund his seminars. Steinhacker contacted CRC's owner, Kleinman, and proposed an arrangement where in exchange for referring students to open accounts with CRC, he would receive a significant percentage of commissions from the accounts of those former students. CRC was the only firm that was interested in funding Steinhacker's seminars. [See ¶ 25 of Steinhacker answer.]

Steinhacker sent Kleinman a three-page "outline" of the course, which stated that the main course objectives were:

How to open and trade your own commodity futures account.

How to utilize the futures markets to reduce the risk of your stock and bond portfolios.

How to utilize a <u>prudent</u>, business-like approach to trading the markets.

How to convert this <u>conservative</u>, <u>low-risk methodology</u> into the ideal business.

[Emphasis added, exhibit 9 to Klein and CRC answer.] This list of course objectives was virtually identical to the course flyer distributed by Steinhacker. Significantly, Kleinman testified that had he reviewed the course flyer before distribution he would not have approved it on a "stand-alone basis," because it did not mention risk. [Pages 181-182 and 215-217 of hearing transcript.] The outline concluded with a list of 35 topics, set out in the order that they would be discussed by Steinhacker. The fundamental nature of the vast

majority of these topics – such as "what is a futures contract" and "understanding and managing the risks of futures trading" – clearly showed that Steinhacker's course was designed for novices. The list culminated with a handful of topics such as "conservative low-risk strategies," "specific systems for a trading edge" and "futures trading as a conservative business," which would be the subject of the last session. [Emphasis added.] Thus, Steinhacker obviously intended to conclude the course with a discussion of specific, conservative, low-risk trading systems.

According to Kleinman, he approved the hiring of Steinhacker after concluding that Steinhacker's presentation of relative risks and rewards would be "balanced," mostly because Steinhacker would be incorporating an NFA booklet into the course. Kleinman approved the employment terms where, in exchange for referring students to CRC as prospective customers, Steinhacker would receive a forty-percent share of the commissions generated in the CRC accounts opened by his student-customers. Steinhacker also would be paid a nominal fee of about \$15 per hour from the communities that sponsored the evening course. [See Steinhacker's replies to interrogatories 9 and 10; and pages 147, 170, 182-183, 251-253 of hearing transcript.]

A fax from Kleinman to Steinhacker, dated October 13, 1995, confirmed the terms of their arrangement:

This fax will briefly outline our understanding:

- 1) You will become an AP [i.e., associated person] of CRC. Next week I will have my operations manager put together the necessary NFA form and forward to you.
- 2) . . . If you have [any compliance problems or customer complaints] in the future you will promptly notify me of such complaint.

- 3) You will refer to us future accounts from your efforts, including the current classes you're involved in, in return for <u>a 40% share of gross</u> commissions.
- 4) When the first three accounts are 'on our books' and trading, I agree to fund a seminar in a mutually agreed city for the purpose of generating new business. You will be entitled to the 40% share of gross from all accounts opened for this seminar.

6) If this first seminar generates enough business to make it worthwhile for us both, we will continue with this arrangement in additional locations indefinitely. . . .

[Produced by respondents in response to Muskus' document request; emphasis added.]

According to Kleinman, the arrangement eventually "died of its own accord," because "it was not lucrative enough." [See pages 147, 209 and 251-254 of hearing transcript.]

8. Although Kleinman acknowledged that he had supervisory authority over Steinhacker, he would never review the course descriptions or the written class materials prepared and distributed by Steinhacker; and would never attend Steinhacker's class or ask for a tape-recording of the class. The extent to which Kleinman would keep himself in the dark about Steinhacker's conduct is underscored by the fact that he would not become aware of Steinhacker's "Blue Chip" trading system until Muskus filed her complaint. [See Kleinman's and CRC's answer, and pages 185-190, 209, 210, 215-217, 236-245, and 249 of hearing transcript.]

Steinhacker's Seminar:

9. In the early autumn 1995, Udesky read an evening course flier, that had been sent to residents of Fairfield, Connecticut.² The course flier included a synopsis of Steinhacker's "Understanding the Commodity Futures Markets." The synopsis – prepared by Steinhacker – was outdated in that it described Steinhacker as the current editor of an ongoing publication which actually had not been published for two years and stated that he was associated with Eiger. More importantly, the synopsis described Steinhacker as an experienced trader, but did <u>not</u> refer to Steinhacker as an associated person, employee or agent with CRC; and otherwise did <u>not</u> mention CRC:

A two-session course for anyone desiring an overview of how the futures markets work, including:

- 1. How to open and trade your own commodity futures account,
- 2. How to utilize a prudent, business-like approach to trading the markets,
- 3. How to convert this <u>conservative</u>, <u>low-risk</u> methodology into the ideal business,
- 4. How to utilize the futures markets to reduce the risk of your stock and bond portfolios.

Charles Steinhacker <u>is</u> the editor of the Blue Chip Trades Newsletter and has been a commodity futures trader for the past twenty years.

[Emphasis added; exhibit A to complaint.] Muskus and Udesky both credibly testified that the synopsis, along with Steinhacker's 61-page class handout, was a significant factor in their decisions to open discretionary accounts with CRC. Udesky credibly testified that he

² Other courses offered included "Successful Money Management," "Watercolor Painting," and "The Wide World of Beer."

was especially drawn by the description of "conservative, low-risk" trading methodology, which Steinhacker admitted was designed to attract students.

- 10. In October of 1995, Udesky enrolled in Steinhacker's course, which was to be taught in three 90-minute sessions over three weeks. At the first session, Steinhacker introduced himself as someone who had traded commodities for twenty years in order to supplement his photography career, and who had made a "killing" in the silver market in the 70's. Steinhacker mentioned that he was "affiliated" with CRC, but never indicated during the entire seminar or during the opening of the account that CRC principally compensated him to refer new accounts. Udesky credibly testified that Steinhacker presented himself as an educator rather than a salesman for CRC, and as a result Udesky was less critical when evaluating Steinhacker's written and oral representations about the Blue Chip trading system. Udesky also credibly testified that Steinhacker's story about his successful silver trades made the most vivid impression, despite the fact that Steinhacker spent only a few minutes on it.
- 11. Steinhacker then spent the bulk of the first session conducting a virtually verbatim review of the first part of the class handout, which was a copy of an NFA brochure titled *Understanding Opportunities and Risks in Futures Trading*. [This part of the handout was produced as an exhibit to Steinhacker's answer.] The preamble of the NFA booklet stated that it was designed to provide the basic "information you need to be an informed investor." The subject matter of this brochure corresponded to the first 25 topics listed in the outline that Steinhacker had given to Kleinman. The brochure contained several unambiguous discussions about the general risks associated with trading commodity futures and options and about the use of stop orders. However, since these

were the only meaningful risk warnings in the class handout and since Steinhacker's oral presentation closely tracked the handout, he would make far fewer references to risk during the sessions in the second and third weeks. [See pages 2, 7, 19, 20, 21 and 23 of booklet, exhibit to Steinhacker answer; and page 131 of hearing transcript..]

- 12. After the first session, Udesky showed the class handout to Muskus. Although Muskus read the NFA brochure, she and Udesky focused on the second and third parts of the handout, which featured actual trading strategies and which would be the subject of the second and third sessions. The second part of the handout written by Steinhacker consisted of a four-page article titled "How Historic Opportunities Lead to Huge Profits," and the third part consisted of several price charts documenting what appeared to be successful Blue Chip trades, plus copies of two issues of Steinhacker's *Blue Chip Trades* newsletter (dated November 1992, and February 1993). [The second and third parts of the handout were produced as exhibit B to the complaint, and as an exhibit to Steinhacker's answer.] Kleinman testified that had he reviewed these parts of the course handout he would not have approved them on a "stand-alone basis" because they contained no meaningful references to the possibility or risk of loss. [See pages 181-182, and 215-217 of hearing transcript.]
- 13. The second section "How Historic Opportunities Lead to Huge Profits" described Blue Chip trading as a "strategy" or "system" that had been developed and perfected presumably with actual trades over three years, and that had generated significant profits, with the least amount of risk compared to "all of the trading methods out there." This section stated that the Blue Chip trading system could be implemented in a managed account at a firm recommended by Steinhacker:

[A Blue Chip Trade is an] opportunity that presents itself only when a specific market is making an historic high or low. This very special situation allows the investor to enter the market when the <u>risk/reward is completely out of whack and very much in his/her favor.</u>

.

How does the individual investor take advantage of this <u>powerful money-making principal</u>? How does he or she <u>transfer theory into practice</u> so that these <u>huge profits become reality</u> and not just an unattainable ideal? That's where Blue Chip Trades comes into the picture.

... While I initially targeted the "historical trade" back in 1984, <u>it has</u> only been in the last 3 years that I've been able to develop the optimum <u>strategy or "system"</u> for taking full advantage of it.

The system is the basis for the Blue Chip Trades Newsletter. The recommendations which appear in the Newsletter each month are used by subscribers to trade their own accounts. . . . And some of them, because they do not have the time and/or experience to call in their own orders, open managed accounts at Eiger [International]. Either way, these subscribers/clients are exploiting the tremendous profit potential that is inherent in an historic price.

. . . Of all the <u>trading methods</u> out their, it is my opinion that the <u>long</u> term Blue Chip Historic Trading Strategy combines the <u>greatest profit with</u> the least amount of risk.

[Emphasis added, exhibit to complaint.] As can be seen, this article contained no reference to the risk, or the possibility, of loss.³

14. The third section featured several commercially printed price charts which Steinhacker used to portray actual trades that had been recommended in the Blue Chip newsletter.

Steinhacker added to each chart a summary of a purported Blue Chip trade. Each summary included the profit on the trade, and the rate of return (stated as a percentage of

³ According to Steinhacker, he just "forgot" to revise the outdated references to Eiger in the report. [Page 181 of hearing transcript; and ¶ 4 of Steinhacker's answer.]

the amount invested and as a percentage on an annualized basis). The rates of return ranged from 673% to 2,823%, and the annualized rates of return ranged from 2,658% to 15,810%. None of the charts showed a losing trade, and none of the charts otherwise referred to the risk of loss. [Exhibit D to complaint, and pages 38-48 of attachments to Steinhacker's answer; see page 163 of hearing transcript, and ¶ 17 of Steinhacker answer.]⁴ Despite the fact that Steinhacker spent relatively little time discussing these charts, Udesky credibly testified that he more readily grasped these charts than the other narrative parts of the handout, and that he found the portrayal of consistent and huge profits quite convincing.⁵ As a result, Udesky relied to a large extent on these charts in concluding that Steinhacker's Blue Chip trading system had consistently realized significant profits without any losses; a conclusion that he relayed to Muskus.

15. At the last two sessions, Steinhacker closely tracked the second and third parts of his handout, discussing in more detail how to trade futures and options, and explaining his Blue Chip trading system or philosophy. Udesky credibly testified that Steinhacker described the basic Blue Chip strategy as using five-percent stop-loss orders and "letting the profits run," which, if successful, would result in a few trades with large profits that would exceed the small losses in the losing trades.

At the end of the last session, in response to a question about potential profits,

Steinhacker replied, "Zero to three-hundred percent." Udesky interpreted this to mean
that, over time, the risk of loss was negligible or nonexistent. In light of the huge 673% to

⁴ The copies of these charts produced by Steinhacker appeared to be the "teacher's edition," and the copies produced by Muskus appeared to be the charts with Udesky's class notes.

⁵ This is not surprising, in light of the fact that Udesky's job as an auditor shows that he has a facility for numbers.

2,823% profits portrayed in the class handout and discussed by Steinhacker, this projected 300% profit actually appears comparatively conservative.

Udesky also credibly testified that Steinhacker concluded the course by stating that although he no longer managed commodity accounts, he had interviewed "one hundred and fifty brokers" in search of a broker who would "embrace" his trading strategy, and had selected George Kleinman of CRC. Actually, as noted above, CRC was the only firm that had even considered hiring Steinhacker and funding his seminars. Steinhacker encouraged any student interested in trading the Blue Chip trading system to contact him about opening an account with CRC, suggested that his students also refer any interested friend to Steinhacker, and offered to provide CRC account-opening packages. Steinhacker told the class that the written risk warnings in the account-opening documents would "scare the hell out of you." Based on Steinhacker's inflection and previous assurances that the Blue Chip system could manage risk, Udesky assumed that Steinhacker was sardonically disparaging the formal written risk warnings. In contrast, Steinhacker asserted that he meant literally what he said in order to emphasize the importance of the risk disclosure statements.

In any event, at the conclusion of the seminar, Udesky believed that the Blue Chip trading system was successful, conservative and low-risk in that it could "control and manage" general risks, and that Steinhacker had selected a firm that would trade the Blue Chip trading system. Udesky, in turn, passed these impressions on to Muskus. As discussed below, Steinhacker would make little effort to ascertain what Muskus had gleaned from Udesky, let alone cure her of any misconceptions.

- 16. When Udesky told Steinhacker that he and his fiancée might be interested in opening an account, Steinhacker provided two account-opening packages. On November 19, Udesky and Muskus filled out and signed the account-opening forms, which included a customer information form, a customer contract, and a standard risk disclosure statement. However, they then hesitated, and did not send their account applications to CRC. During a follow-up conversation about a week later, Udesky told Steinhacker said he had "cold feet" because he was concerned about the risk. Steinhacker encouraged Udesky to go he ahead and "try it," which Udesky did.
- 17. At about the same time, Muskus and Steinhacker spoke for about five minutes. Muskus credibly testified that she told Steinhacker that she was interested in opening an account that would be traded in accordance with the trading system discussed in Steinhacker's class, which she understood to be conservative, low risk and successful. Steinhacker reassured her that his trading system successfully limited losses and that he had selected CRC to trade his system. Steinhacker did not mention how he was compensated by CRC. Muskus then decided to send in the account-opening package and her initial deposit. Thus, Muskus' decision to open a CRC account was based on Steinhacker's course materials lent to her by Udesky; on Udesky's somewhat selective impressions of Steinhacker's statements in the class; and on her brief conversation with Steinhacker. [Pages 14-28,151-152, 162-163, 190-193 of hearing transcript.] Muskus would eventually invest a total of \$44,959.

⁶ Muskus would not know about Steinhacker's affiliation with CRC until about two weeks into trading when he told her that CRC was sending him copies of her account statements.

18. On November 29, 1995, CRC sent an introductory letter to Udesky and Muskus. The CRC letter did not mention Steinhacker or the Blue Chip trading system, but did describe a trading philosophy that appeared to Muskus to closely resemble Steinhacker's Blue Chip trading strategy of using tight stop-loss orders and letting profits ride:

We're pleased you've decided to open a managed trading account with us and are looking forward to a long and mutually rewarding relationship.

This letter will serve as an introduction to what you might expect, as well as to answer some common questions.

First of all, as you are aware, trading is different from traditional investing. Our objective is for a <u>higher return than more conservative investments</u>, and due to the leverage inherent in our markets, this is <u>quite achievable</u>. Leverage, however, can be a two-edged sword; and that is why <u>we emphasize risk management</u>.

. . . . Our profit objectives can sometimes be reached in a very short period of time. Additionally, we are quick to cut losers, and we try to never let a reasonable profit, once achieved, turn into a loss.

We use risk points (stops or options) on every trade to limit our loss if the trade is not working. Many of our trades may result in only a modest net profit or loss. Additionally, if there is any 'danger signal', whether the trade is profitable or not, we have found it is better to exit the trade as soon as possible. (Hoping is generally not a recipe for success in our business.)

If our trading methods are working properly, there will be a <u>small number of "significantly" profitable trades</u> each year. These will be the trades which will <u>allow us to achieve our major objectives</u>. We've found through experience we cannot always predetermine which trades these will be, but when they come, <u>these few trades should more than offset numerous small losers</u>. . . .

[Emphasis added; exhibit F to complaint.]

19. Kleinman then called Muskus. Kleinman did not specifically recall this conversation. Muskus credibly testified that the conversation was brief, that Kleinman

welcomed Muskus, and that he described his trading philosophy in a manner consistent with the CRC introductory letter. [See pages 199-200 of hearing transcript.]

During this conversation, Muskus did not tell Kleinman that she believed that Kleinman would follow Steinhacker's trading system, and Kleinman did not ask Muskus what Steinhacker had told her. As a result Kleinman did not discover Muskus' expectation that he would be following the Blue Chip system, and Muskus did not discover that Kleinman would not be following Blue Chip system. [See pages 27, 198-203, 217-218, 221-222, and 258 of hearing transcript; and pages 5-6, and 8 of Klein/CRC answer.]

Trading the Account:

- 20. Trading from December through March was overall very successful, with a few profitable trades more than offsetting the small losing trades, which appeared to Muskus to be consistent with the Blue Chip system. [See exhibit 8, and pages 7 and 10, of Kleinman/CRC answer; and exhibit H of complaint.]
- 21. In January, Muskus took Steinhacker's course at Fairfield. At the beginning, she was so excited by the profits in her CRC account that one of her classmates, Kent Knock, initially suspected that she was a "set-up." [Page 130 of hearing transcript.]
- 22. On April 10, 1996, the account suffered its first large loss, and Muskus asked Kleinman to limit trades to soybean contracts. Soon after the next large loss, in early June, Muskus closed the account. Muskus' out-of-pocket losses totaled \$14,392. [See ¶¶ 40-42 of complaint.]

Discussion and Conclusions

Muskus has shown by a preponderance of the evidence that Steinhacker misrepresented that Muskus' account would be traded pursuant to the Blue Chip trading system. Steinhacker represented in his handout that a "Blue Chip Trade" is an "opportunity that presents itself only when a specific market is making an historic high or low;" that he has developed and perfected the "optimum strategy or 'system'" for taking full advantage of the highs and lows; that this "system is the basis for the Blue Chip Trades newsletter;" and that students could open managed accounts which would trade according to recommendations based on this system. Steinhacker repeated these assertions in the class and encouraged his students to refer any friends who might be interested in opening managed accounts. Steinhacker reinforced the notion that CRC would exclusively trade the Blue Chip trading system by discussing only past trades that had been made by the Blue Chip trading system, and by claiming that he had selected CRC because it was the only firm to "embrace" his Blue Chip trading system. In these circumstances, when Muskus told Steinhacker that she was interested in opening a managed account that would use the system he discussed in Steinhacker's seminar, she could only have meant the Blue Chip trading system. Here, Steinhacker's failure to inform Muskus "in unequivocal terms" that Kleinman did not intend to follow Steinhacker's system - no matter how good Kleinman's own trading system may have been - was sufficient to establish a claim of fraud. See Holmes v. Wheat First Securities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,823 (CFTC 1990). Although Kleinman did not expressly tell Muskus that he would use the Blue Chip trading system, and although he did fairly describe his trading strategy, he did not ask Muskus what she had learned from Steinhacker - that CRC

would be trading her account pursuant to a specific conservative and extremely successful trading system designed and tested by Steinhacker — and thus failed to supplant the false information provided by Steinhacker. See Levine v. Refco, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,488 (CFTC 1987); and O'Hey v. Drexel Burnham, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,754 (CFTC 1985).

Muskus also has shown by a preponderance of the evidence that Steinhacker misrepresented the likely effect of his Blue Chip trading system on both the opportunity for profit and the risk of loss. Kleinman admitted that the portions of the class handout prepared by Steinhacker, which Steinhacker closely tracked in class, deceptively distorted the relative risks and rewards of the Blue Chip trading system. The most significant distortions included the claims that the Blue Chip trading system "combined the greatest profit with the least amount of risk," consistently made profits ranging from 673% to 2,823%, and successfully controlled the size and overall amount of losses. This overall combination of bold predictions of huge profits with claims that risk could be managed amounted to a deceptive guarantee of profit. See Levine, supra; and Hannay v. FCCB, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,986 at 34,282 (CFTC 1987). Steinhacker reinforced this guarantee when he confidently predicted profits up to 300% at the same time that he had encouraged Udesky to refer Muskus, and when he assured Muskus that losses could be limited and managed.

The fact that respondents provided an NFA brochure and a standard risk disclosure statement, and that Kleinman did not similarly guarantee profits, does not supplant respondents' general duty to disclose material facts and does not shield respondents from liability for affirmative misrepresentations of risk. See Levine, supra; Batra v. E.F. Hutton &

Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,937 at 34,286 (CFTC 1987). Once it has been established that Steinhacker provided Muskus with a mix of material information that was false and misleading, respondents have the burden to show not only that they subsequently made proper disclosure, but that the accurate data they provided actually supplanted the deceptive information provided by Steinhacker. Here, respondents have failed to make such a showing.

Muskus has also established that Kleinman violate CFTC rule 166.3 by failing to supervise diligently the activities and conduct of CRC's agent, Steinhacker. Kleinman hired Steinhacker to "refer accounts" and to "generate business," and admitted that he had supervisory authority over Steinhacker. However, other than directing Steinhacker to inform him of any "compliance problems or customer complaints," Kleinman never reviewed the deceptive course descriptions or the written class materials prepared and distributed by Steinhacker; never attended Steinhacker's class or asked for a tape-recording of the class; and otherwise failed to establish any policies and procedures reasonably designed to detect and deter Steinhacker from making the sort of deceptive written and oral statements that misled Muskus.

Muskus' claim that Kleinman failed to deliver a commodity trading advisor ("CTA") disclosure document in violation of CFTC rule 4.31(a) must fail, however, because she has produced no evidence that contradicted Kleinman's assertions that his advisory activities were limited to a small percentage of his customers and were otherwise undertaken solely in connection with his business as an introducing broker. Thus, on this record, Kleinman qualified for the rule 4.14(a) exemption from CTA registration, and was not required to provide a CTA disclosure document. See CFTC Interpretive Letter 95-85, [1994-1996]

Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,540 (October 12, 1995); and CFTC Interpretive Letter 93-6, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,571 (January 27, 1993).

ORDER

Charles Steinhacker violated Section 4b and 4c(b) of the Commodity Exchange Act, and George Kleinman violated CFTC rule 166.3, which – separately and together – caused damages of \$14,392. Commodity Resource Corporation is liable for Steinhacker's and Kleinman's violations pursuant to Section 2(a)(1)(A) of the Act. Accordingly, Charles Steinhacker, George Kleinman, and Commodity Resource Corporation are ORDERED to pay to Jo-Anne Muskus reparations of \$14,392, plus interest on that amount at 4.918% compounded annually from December 12, 1995 to the date of payment, plus \$125 in costs for the filing fee. Liability is joint and several.

Dated March 5, 1998.

Philip Y. McGuire, Judgment Officer.

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The November 1992 and February 1993 issues of the *Blue Chip Trades* newsletter contained the only references to risk in the second half of the class handout.⁷ The November 1992 issue discussed spread trading and advised subscribers to "call in" for specific trade recommendations. The February 1993 issue discussed the concept of "scaling" into the market, using previous trades as examples, and concluded:

Scale trading requires a serious bank account and a strong stomach. But as the man says, "You can't lose!"

[Exhibit C to complaint, emphasis added; see pages 145, and 261-262, and ¶¶ 2, 3, 4 and 9, Steinhacker's affidavit.]

⁷ The warning, which was printed in capital letters at the end of each issue of the newsletter stated, in pertinent part: "Futures trading is risky and can result in substantial loss. The use of options and options trading involves a high degree of risk. The use of stops may not limit losses to intended amounts. Spread positions may not be less risky than outright futures positions. Past results do not indicate future results."