

UNITED STATES OF AMERICA  
BEFORE THE  
COMMODITY FUTURES TRADING COMMISSION

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Nellie H. Melton and Danny Melton, )  
Complainants )

v. )

CFTC Docket No. 99-R061

Keith Pasqua, Carl Robert Saathoff and )  
Universal Commodity Corporation, )  
Respondents. )

Danny Melton, )  
Complainant )

v. )

CFTC Docket No. 99-R062

Keith Pasqua, Carl Robert Saathoff and )  
Universal Commodity Corporation, )  
Respondents. )

INITIAL DECISION

Appearances at Trial:

Danny Melton, *pro se*.

Before:

Painter, ALJ

OPINION

On January 14, 1999 Danny Melton ("Melton") filed these two reparations claims, pursuant to 7 U.S.C. § 18, to recover losses from his individual account and losses from the joint account he held with Nellie H. Melton (together "Complainants"). Complainants allege that Keith Pasqua, Carl Robert Saathoff and Universal Commodity Corporation ("Respondents") violated the Commodity Exchange Act ("CEA") by engaging in fraud, misrepresentation, non-disclosure, and churning. Complainants assert that Respondents' alleged violations of the CEA

resulted in \$23,332.56 in damages in the individual account and \$17,382.76 in the joint account. In their answer dated June 25, 1999, Respondents deny any wrongdoing.

At the request of Respondents, a telephone conference was conducted in hopes of settling these claims. At one point it appeared Respondents had offered \$12,000 to settle the claims. Subsequently, Melton advised the Court that he had rejected an offer of \$9,000. Later still, Respondents and Complainants agreed to settle all issues with a payment of \$10,000. On the basis of the oral representations of the parties, the hearing was cancelled, and an order of dismissal on settlement was issued. Prior to the receipt of written confirmation that a *bona fide* settlement had been reached, Melton left a voice mail message with the Court indicating that Respondents had breached the agreement. The agreement ultimately received by Melton provided that he was to receive \$5,000 in cash, with the balance of \$5,000 to be invested in a commodity account to be managed by an independent commodity trading advisor selected by Respondents and approved by Melton. The Court vacated the order of dismissal on grounds that the parties had failed to enter into a valid settlement and the matter was scheduled for hearing.<sup>1</sup>

The hearing was conducted on November 3, 1999 in Winston-Salem, North Carolina. All parties have filed post-hearing briefs and this matter is ready for decision. It is noteworthy that although notified by mail and by telephone, none of the Respondents appeared at the hearing of this matter. Not one of the Respondents provided a reason for failing to appear, either before the hearing or afterwards.<sup>2</sup> Respondents' failure to appear made it impossible for the Complainant

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<sup>1</sup> See Hearing Tr., Nov. 3, 1999, 27-33. Hereinafter, all references to "Hearing Tr." Refer to the November 3, 1999 hearing in Winston-Salem, North Carolina.

<sup>2</sup> See Hearing Tr., 2:1-6. Though respondents did not appear at the hearing, their counsel did suggest that federal marshals attend the hearing. This demonstrated at the very least that respondents were well aware of the time, date and location of the hearing. Federal marshals appeared at the hearing and advised the court in chambers that attorney Patrick King had

or the Court to make inquiry into the answers and assertions in their pleadings. The only witness at trial was Complainant Danny Melton. Although his testimony was at times rambling, this Court finds that he testified in good faith. The following findings of fact and conclusions of law are based on the record adduced at trial, including Complainant's un rebutted testimony.

#### FINDINGS OF FACT AND CONCLUSIONS

1. Danny Melton is on permanent disability from the federal government and resides at 4590 Camp Betty Hastings Road, Walkertown, North Carolina 27051.<sup>3</sup>
2. Nellie H. Melton is the mother of Danny Melton and she resides at 7340 Simmons Road, Rural Hall, North Carolina 27045.<sup>4</sup>
3. Keith Pasqua ("Pasqua") resides at 310 South Broadwalk, #3B, Hollywood, Florida 33019.<sup>5</sup> Pasqua was registered with the National Futures Association ("NFA") as an Associated Person ("AP") of Universal Commodity Corporation ("UCC") from October 18, 1994 until July 28, 1997.<sup>6</sup> Pasqua was registered with NFA as an AP of Barkley's Financial Corporation from August 4, 1997 until June 30, 1999.<sup>7</sup> Pasqua registered with NFA as an

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informed the marshals' office that a federal marshal should be present at the trial. See Hearing Tr., 14:13-23 and 49:11-50:9.

<sup>3</sup> See Complaint, Jan. 14, 1999.

<sup>4</sup> See *id.*

<sup>5</sup> Respondents' Answer to Complainant's Complaint and Affirmative Defenses, June 24, 1999.

<sup>6</sup> See Respondents' Response to Complainants' Request to Produce and Interrogatories, Sept. 13, 1999.

<sup>7</sup> See *id.*

AP of American Heritage Commodity Corporation on July 18, 1999 and this registration is current.<sup>8</sup>

4. Carl Robert Saathoff ("Saathoff") resides at 1900 S.E. 19<sup>th</sup> Street, Pompano Beach, Florida 33162.<sup>9</sup> Saathoff was registered with NFA as an AP of UCC from June 23, 1993 until August 29, 1997 and as a Principal of UCC from September 29, 1993 until June 2, 1999. Saathoff was also registered as an AP of Universal Financial Holding Corporation from December 5, 1995 until July 15, 1999. Saathoff registered as a principal of Universal Financial Holding Corporation on December 5, 1999 and this registration is current.<sup>10</sup>
5. Universal Commodity Corporation ("UCC") has an office at 3467 N.E. 163<sup>rd</sup> Street, North Miami Beach, Florida 33160.<sup>11</sup> At all relevant times UCC was registered with NFA as an Introducing Broker.<sup>12</sup>
6. First American Discount Corporation ("FADC"), a futures commission merchant ("FCM"), served as the carrying broker for both the individual and joint account introduced by UCC.<sup>13</sup> This FCM has been duly registered with the Commission since May 5, 1984.<sup>14</sup>

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<sup>8</sup> *See id.*

<sup>9</sup> Respondents' Answer to Complainant's Complaint and Affirmative Defenses, June 24, 1999.

<sup>10</sup> All registration information contained in the corresponding paragraph was obtained and verified through the National Futures Association.

<sup>11</sup> Respondents' Answer to Complainant's Complaint and Affirmative Defenses, June 24, 1999. However, the CFTC has an additional mailing address for UCC at 3459 N.E. 163<sup>rd</sup> Street, North Miami Beach, Florida 33160.

<sup>12</sup> UCC was registered with NFA as an Introducing Broker from March 25, 1993 until June 2, 1999.

<sup>13</sup> *See* Complainants' Complaint, Jan. 14, 1999 and Accounting Statements.

7. In April or May 1996, Melton responded to a radio advertisement promoting commodity options.<sup>15</sup> Subsequently, he received a telephone call from one Robert Connahan, an employee of a company named Ceres.<sup>16</sup> Connahan assured Melton that he could expect to double his money by investing in options.<sup>17</sup> Melton sent in \$5,000, all of which was lost.<sup>18</sup>
8. Later, Melton received calls from Arnie Zager, Phil Verde and Keith Pasqua, registered employees of Universal Commodity Corporation.<sup>19</sup>
9. Melton did not do business with Arnie Zager and Phil Verde. In late May 1996 Pasqua persuaded Melton to open an account with FADC through UCC.<sup>20</sup> Melton testified that:

I had explained to [Pasqua] . . . that I was [suffering from] PTSD [posttraumatic stress disorder], I was on medication, I did not understand what he was talking about and I could not understand his contracts or anything about the market. That's the reason he kept telling me "Trust me, I'll make you money. I'll double your money. I'll get you out any time you want out. I'll send you your money back anytime you ask for it."<sup>21</sup>

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<sup>14</sup> Hearing Tr., 16:15-16. Registration information was obtained and verified through the National Futures Association.

<sup>15</sup> See Hearing Tr., 5:19-21.

<sup>16</sup> *Id.* at 6:4-7:8.

<sup>17</sup> *Id.* at 6:17-19.

<sup>18</sup> *Id.* at 6:12-8:12.

<sup>19</sup> See Hearing Tr. 7:8-11:6. Commission records show that Universal Commodity Corporation was at all relevant times registered as an introducing broker. See *supra* note 12 and accompanying text.

<sup>20</sup> See Complaint, January 19, 1999 and Amended Complaint, April 5, 1999 (detailing that Keith repeatedly told Complainant that he would "double" Complainant's money); see also Hearing Tr., 11:14-12:23. Complainant testified that Pasqua repeatedly assured him that in a short time Pasqua would "Double my money if I done and said everything he wanted me to." Hearing Tr., 11:19-12:9, November 3, 1999.

<sup>21</sup> See Hearing Tr., 21:22-23:6.

10. Pasqua induced Melton to open the account by assuring him that he could expect to double his investment by trading options, with losses limited to 30%-40% of his investment.<sup>22</sup> This Court finds that Pasqua misinformed Melton as to reasonable expectations of profits and losses.
11. Pasqua managed Complainant's account and did most of the communicating with Melton regarding this account. The Court further finds that "Respondent Pasqua conferred with Respondent Saathoff concerning the best trading strategy for both the individual and joint accounts."<sup>23</sup>
12. Melton began his individual account with an initial deposit of \$10,000 on November 27, 1996, which he transmitted through UCC to FADC.<sup>24</sup>
13. Shortly thereafter Melton requested that Pasqua take him out of the market. Pasqua did not do so. Instead, Pasqua convinced Melton to "trust" him, claiming that by doing so, Melton would make a large return on his investment.<sup>25</sup> On December 4, 1996, Pasqua had FADC send Melton a check for \$3,835.80.<sup>26</sup>
14. After some coaxing by Pasqua, Melton agreed to continue trading through UCC. Subsequently, he sent in \$5,670 on December 18, 1996;

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<sup>22</sup> See Hearing Tr., 11:20-12:23.

<sup>23</sup> See Respondents' Response to Complainants' Request to Admit.

<sup>24</sup> See Account Statement, November 27, 1997 for Individual Account.

<sup>25</sup> "And I called [Pasqua] I think on December 7th, asked him to get me out. And he told me to, that I had to trust him." Hearing Tr., 13:5-7.

<sup>26</sup> See Account Statement, December 4, 1996 for Individual Account.

\$11,500 on January 9, 1997; and \$10,000 on January 21, 1997.<sup>27</sup>

15. Melton testified that near the end of January 1997, Pasqua told him that his account had made approximately \$35,000 in profits. Melton asked Pasqua to remit these funds to him. On or about January 29, 1997, Pasqua had FADC remit only \$10,001.64.<sup>28</sup>
16. In early February 1997, Melton told Pasqua that he was concerned about his mother's financial security. Pasqua persuaded Melton to open a joint account with his mother.<sup>29</sup> Pasqua led Complainant to believe that he would receive back some \$35,000 in the individual account, to be deposited in the newly opened joint account. However, complainant received back from FADC a check for only \$10,001.64. Pasqua had Complainant send in \$30,000 to open the joint account.
17. On February 5, 1997 Respondent Pasqua directed FADC to transfer \$27,280.77 from the single to the joint account. On February 25, 1997, FADC transferred an additional \$19,544.91 to the joint account. The account statements suggest that Complainant made a profit of \$23,463.12 in the single account, and that the joint account suffered a loss of \$64,208.44. The account statements are laced with numerous "cancelled" trades, many of which were reinstated at a later time, making it extremely difficult to determine what did in fact happen in the accounts. It is clear, however, that the two accounts lost a total of \$40,715.32. Respondents confirm this in a court ordered summary filed August 31, 1999.<sup>30</sup>

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<sup>27</sup> See Account Statement, on corresponding dates in Individual and Joint Accounts.

<sup>28</sup> Transcript at 15:8-18 and Account Statement, January 29, 1997 for Individual Account.

<sup>29</sup> See Complaint, Jan. 14, 1999 and Hearing Tr., 17:21-18:7.

<sup>30</sup> See Account Activity Statement, August 31, 1999.

18. The joint account was closed out June 3, 1997.<sup>31</sup>

19. Commissions on the two accounts totaled \$32,600.<sup>32</sup>

### DISCUSSION

Complainants contend that Respondents, through a combination of misrepresentation and nondisclosure, fraudulently solicited and induced Melton to open the individual account, to continue to send in money for use in the individual account, and then open the joint account. Complainants further assert that Respondents churned their accounts for the purpose of generating commissions and not in the interests of Complainants.<sup>33</sup> The Court agrees on both counts. Respondents defend against all claims by asserting that the action is time-barred. The Court finds, however, that it is not precluded from hearing these claims because, at the time that Melton filed his complaint, the statute of limitations had not run out.

#### *I. Statute of Limitations*

Section 14(a)(1) of the Commodity Exchange Act states that a cause of action may be brought within two years of its accrual. In the instant case, the individual account was opened on November 27, 1996 and closed on February 25, 1997. The joint account was opened January 31, 1997 and closed on June 3, 1997. The complaints were filed on January 14, 1999 and served on Respondents on or about May 14, 1999.<sup>34</sup> Respondents argue that the complaint was not filed

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<sup>31</sup> See Account Statements.

<sup>32</sup> *Id.*

<sup>33</sup> Complaint alleges that the trading was "not to make more profit for me but to make more profit for [Pasqua]." Amended Complaint, Dec. 17, 1998.

<sup>34</sup> In the Post-Hearing Brief of the Respondents dated December 20, 1999, Respondents represent that the complaints were not filed until *June* 19, 1999. However, the complaints were filed on *January* 14, 1999. In fact, Respondents' Motion for an Extension of Time was sign and

within two years of the closing of the account, and is therefore time barred. However, a cause of action does not accrue until “the complainant discovers or in the exercise of reasonable diligence should have discovered the wrongful activity underlying the claim.”<sup>35</sup> There are three essential facts that affect the timing of when discovery could have reasonably been made in this case: (1) Melton’s severe disabilities; (2) the less than straightforward accounting statements; and (3) the causes of action themselves.<sup>36</sup>

First, Danny Melton suffers from numerous physical and mental disabilities that are well documented in the record. It is clear from speaking to Melton, in person or via telephone, that he has severe disabilities that affect his reasoning and decision-making capacity. Melton’s mental condition clearly contributed to his inability to promptly detect the wrongdoing in this case. Furthermore, the Court finds that Respondents knew of Melton’s disabilities and used that knowledge to manipulate and exploit him.<sup>37</sup>

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dated June 11, 1999, three days earlier than Respondents are representing that the complaints were filed.

<sup>35</sup> FDIC v. Shearson Lehman Hutton Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,044 at 37,901 (CFTC April 26, 1991) (citing Graves v. Futures Investment Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,457 at 26,165 (CFTC 1982); Sommers v. Conti Commodity Services, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,244 at 35,105 (CFTC 1988); Reinhard v. Ace American, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,375 at 35,617 (CFTC 1988)).

<sup>36</sup> See Kuzma v. Best Commodities Services, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,744 at 33,955 (Initial Decision July 8, 1987), *aff’d in part*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,110 (CFTC Jan. 19, 1988) (“The difficult question is deciding at what point in time this discovery should have been made. Three factors must be considered in determining this factual question: the sophistication of the investor; the information provided [or concealed from] the investor; and the cause of action itself.”).

<sup>37</sup> The Court bases its finding here on Melton’s pleadings; Melton’s testimony about his disability; the numerous medical records that he submitted to the Court; and importantly the Respondents’ Post-Hearing Brief dated Dec. 20, 1999, at 15-16 (“Mr. Melton’s account application states that he was disabled . . . in the space in which he was to list his employer.”).

Second, regardless of Melton's impairment, the causes of action alleged here are not readily discoverable because the account statements are so laced with cancelled entries that even the Court finds them misleading. There are at least 20 entries of transactions that were made and subsequently cancelled, including commissions that were charged and subsequently credited back to the accounts. These apparently meaningless entries only serve to obfuscate the accounting statements. In addition, the ambiguities and inconsistencies in the statements made it even more difficult for Melton, a most unsophisticated investor, to discover the wrongdoing of Respondents.

Third, the causes of action in this case encompass general fraudulent schemes that are not easily detectable from daily and monthly account statements.<sup>38</sup> The Commission has recognized that general fraudulent schemes are not readily detectable and that complainants often need time to examine the full records of the entire account.<sup>39</sup> This is especially true in this case. As discussed below, Melton was continuously assured that his individual account was highly profitable. Based on these representations he continued to send in money and he opened the joint account. All the while, Respondents churned Complainants' accounts and induced Melton to send in more money. Here the Court views the misrepresentations and churning to be general and continuous fraudulent schemes that could not have been detected by Melton without a full examination of the entire record of the account. Moreover, the Commission recognizes that "the

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<sup>38</sup> See *Fox v. First National Monetary Corp.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,094 at 32,244 (Initial Decision June 12, 1986), *finalized* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,690 at 33,779 (CFTC June 23, 1987) ("[W]here a specific trade was at issue, the limitation period would run from the date that the complainant was informed of the trade whereas a general scheme might have to wait for such developments that would provide the party with the necessary facts.").

<sup>39</sup> *Fox v. First National Monetary Corp.*, [1986-1988 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,094 at 32,244.

nature of churning . . . rarely lends itself to early detection.”<sup>40</sup> For the reasons stated above, the Court finds that the cause of action accrued after the joint account was closed and Complainants had time to examine the statements and reflect on their entire trading relationship with Respondents.

## *II. Fraud, Misrepresentation and Nondisclosure*

Section 4b, the Commodity Exchange Act’s prohibition on fraudulent transactions, codified at 7 U.S.C. § 6b, states in pertinent part:

It shall be unlawful (1) for any member of a contract market, or for any correspondent, agent, or employee of any member, in or in connection with any order . . . (i) to cheat or defraud or attempt to defraud such other persons; . . . [or] (iii) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract . . . .

Complainants allege that Melton was fraudulently induced to open the individual account and that Respondents further used fraudulent practices to keep him in the market. To establish the charge of fraudulent inducement, it must be established by a “preponderance of the evidence . . . that respondents’ solicitation misrepresented either the likelihood that [the customer] would earn a profit or the likelihood that [the customer] would suffer a loss if she agreed to trade options . . . .”<sup>41</sup>

Melton testified that Pasqua told him that he would “[d]ouble my money if I done and said everything he wanted me to . . . that he would send me my initial investment back within

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<sup>40</sup> Kuzma v. Best Commodities Services, Inc. [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,744 at 32,955 (citation omitted).

<sup>41</sup> Bishop v. First Investors Group of the Palm Beaches, Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,004 at 44,840 (CFTC March 26, 1997).

very short weeks,” and that losses were limited to 30-40%.<sup>42</sup> Melton further testified that based upon Pasqua’s assurances about minimal risks, he agreed to trade options with Respondents. In reality, trading commodity options is a risky endeavor. Not only is it impossible to predict that one will make a profit, it is not possible to predict how much profit will be made or that one can double someone else’s money. In addition, risk of loss is not limited in trading commodity futures or options, especially not to 30-40%. Therefore, the Court finds that Pasqua misrepresented and failed to disclose the real risks involved with trading commodities. The Court further finds that this misrepresentation and non-disclosure was for the purpose of fraudulently inducing Melton to open an account.

Once Melton was induced to open the account, Respondents engaged in fraudulent lulling, which occurs “in furtherance of a preexisting fraud.”<sup>43</sup> “[O]nce the customer is hooked by solicitation fraud they then are vulnerable to a host of other fraudulent activities . . . .”<sup>44</sup> In this case, to further the preexisting fraud, fraudulent inducement, Pasqua made numerous misrepresentations and failed to accurately disclose the true status of the account.

Melton’s unrebutted testimony catalogs the numerous times that he requested to get out of the market and have the full amount of his account remitted back to him. “Every time I would ask him to send my money back he would tell me he made me money.”<sup>45</sup> After being induced to

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<sup>42</sup> Hearing Tr. 11:20-21; and 12:8-20.

<sup>43</sup> *Buckler v. ING (U.S.) Securities, Futures & Options, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,379 at 46,727 (Initial Decision Aug. 4, 1998), *finalized*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,663 at 48,143 (CFTC June 1, 1999)

<sup>44</sup> *Muniz v. Lassilla*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,225 at 38,653 (CFTC Jan. 17, 1992) (Commissioner West, concurring).

<sup>45</sup> Hearing Tr. 17:22-23.

open the account on November 26, 1996, Melton had uncertainties about trading: "I still felt I did not need to be in the market."<sup>46</sup> He requested that Pasqua take him out of the market in early December 1996. Instead of doing so, Pasqua had FADC remit \$3,835.80 to Melton. Then Pasqua convinced Melton to continue trading.<sup>47</sup> Melton testified that by January of 1997:

I started making a profit. But I was still scared of losing it all . . . I tried to close the first [account] out and get my money back but Mr. Pasqua would not send the money back . . . He was telling me that -- he sent me a check -- we was talking about \$35,000 . . . but he sent me back \$10,000.<sup>48</sup>

Having never received the full \$35,000, Melton persisted in trying to get his money back. "I had been asking, begging, Keith Pasqua to send my money back to me, that I wasn't doing nothing but losing. And all he was talking me into was sending him more."<sup>49</sup>

The charge of lulling is further established by an examination of the following transaction. The account statements indicate that on January 28, 1997, nineteen March 1997 IMM J-Yen puts were bought for \$17,812.50 ("yen transaction") in Melton's individual account. The very next day, January 29, 1997, the yen transaction was cancelled. Sometime after the cancellation, Melton agreed to open the joint account with his mother and sent Respondents a check for \$30,000. The joint account was opened on January 31, 1997. Pasqua then convinced

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<sup>46</sup> Hearing Tr. 13:1-5.

<sup>47</sup> Hearing Tr. 13. Melton testified that Pasqua told him that "I had to trust him. If I done and said anything -- everything he wanted me to say, that he would take care of me." *Id.* at 13:12-13. See also Accounting Statement for Individual Account, Dec. 4, 1996.

<sup>48</sup> Hearing Tr. 15:8-12; 15:21-22.

<sup>49</sup> Hearing Tr. 23:22-24:1. Melton testified that Pasqua told him that if he sent in an additional \$30,000 to open a joint account with his mother, that he would receive \$30,000 from the individual account. Melton sent in an additional \$30,000 on January 31, 1997 but was never sent \$30,000 from the individual account. See *id.*; and corresponding Account Statements.

Melton to transfer the remainder of the individual account into the joint account.<sup>50</sup> Despite the fact that it had been cancelled out of Melton's account, Respondents then liquidated the yen transaction on February 4, 1997. The liquidation resulted in an apparent net gain of \$9,500.<sup>51</sup> The next day, February 5, 1997, a transfer was made from the individual account into the joint account in the amount of \$27,280.77.

In other words, the accounting statements show that Respondents had liquidated a position that they had cancelled one week prior. It is not possible, however, to liquidate a trade that has been cancelled or removed from an account. Thus, the Court finds that the liquidation was made in order to give the appearance that the individual account was more profitable than it was. This deception was used to induce Melton to transfer the remainder of the individual account into the joint account.

Finally, Respondents have not established that the Complainants' accounts were not themselves a fraudulent scheme. Respondents offer no office order tickets, trade tickets, or other evidence to verify that the trades indicated in the accounting statements were ever executed. Without such information, the Court has strong doubt as to whether any of the trades represented in the account statements were ever made. This doubt is furthered by the mysterious yen transaction.

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<sup>50</sup> Melton testified that instead of sending him the remainder of the individual, "[Pasqua] had talked me into transferring seemed like \$47,000 to the joint account, that he would send it all back at one time." Hearing Tr. 21:11-14.

<sup>51</sup> For reasons that are unclear to the Court, the account statement calls this net gain a "Net Memo Option Premium." See Accounting Statement for the Individual Account, Feb. 4, 1997.

### III. Churning

The CFTC Glossary defines churning as “[e]xcessive trading of an account by a broker with control of the account for the purposes of generating commissions while disregarding the interests of the customer.” Such trading is a violation of Section 4b(a) of the Commodity Exchange Act, 7 U.S.C. § 6b(a), which prohibits fraudulent transactions. To prove a claim of churning a complainant must establish that (1) the broker had control over the account and (2) that the broker traded excessively for the purpose of generating commission.<sup>52</sup>

As mentioned above, the claimant here is severely disabled. In addition, the transcripts indicate that there were numerous times in which Melton requested that his account be closed. However, Respondents disregarded that request and did not liquidate Complainant’s account until it had been almost completely drained. In light of these facts, there is no question that Respondents had full control over the accounts. In order to establish the second requirement of churning, excessive trading, there are five recognized indicia: (1) high commission-to-equity ratio; (2) high percentage of day trades; (3) a departure from previously agreed upon trading strategy; (4) trading in an under-margined account; and (5) in-and-out trading.<sup>53</sup> However, these indicia are not an exhaustive list and not all of the indicia must be present to establish churning.<sup>54</sup>

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<sup>52</sup> See *Fields v. Cayman Associates Ltd.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,688 at 30,928 (CFTC Jan. 2, 1985).

<sup>53</sup> *Id.*

<sup>54</sup> *Fields v. Cayman Associates Ltd.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,688 at 30,928 (quoting *In re Lincolnwood Commodities Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 at 28,251 (CFTC Jan. 31, 1984)) (“A finding of excessiveness does not require the presence of all of the above indicators.”).

There is in the instant case a high commission-to-equity ratio. In addition, the obfuscated accounting statements indicate that Complainants' accounts were churned. This is particularly true in regards to the January 28, 1997 yen transaction.

First, the Court finds that the commission-to-equity ratio<sup>55</sup> was excessive for the months of January 1997, February 1997 and April 1997. In the first two months of the individual account, November and December of 1996, the commissions charged complied with reasonable standards.<sup>56</sup> However, in January, the last month the individual account was open, Respondents charged to the individual account commissions amounting to 53% of the account's value.<sup>57</sup> In February, Respondents charged Complainants' commissions of 27% of the value of their joint account.<sup>58</sup> In April, the percentage of commissions charged from the joint account equals 20%.

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<sup>55</sup> The Court focuses on the monthly commission-to-equity ratio, which was calculated by dividing the total amount of commissions charged in that month by the "value" of the account. The "value" of the account is calculated by averaging the "account value at market" (from the monthly account statements) and total amount complainants sent in that month. Thus the formula reads:

$$\frac{\text{Total amount of Commissions charged}}{([\text{Account Value at Market} + \text{Amount Received from Complainants}] / 2)} = \text{Percentage of Commissions Charged}$$

All figures in the churning section of this decision are taken from the accounting statements for the individual and joint accounts.

<sup>56</sup> The individual account was opened on November 27, 1996 and for that month, the commissions charged were 16.7% of the value of the account. For the month of December, the individual account was charged commissions that were 12% the value of the account.

<sup>57</sup> This figure includes the commissions charged for the January 28, 1997 yen transaction. These commissions are included because although the Court finds that the yen transaction was not executed, it still appears on the individual accounting statement and Respondents include it in their calculations. The specifics of this are discussed below. If the Court had not included the commissions from the January 28, 1997 yen transaction, then the total commission charged to this account for January would have been 41%.

Since the Commission has held that commission-to-equity ratios of 18.8% are sufficient to substantiate a charge of churning, all of the percentages of commissions charged above substantiate the Complainants' allegations that Respondents churned their account.<sup>59</sup>

Second, the account statements were so muddled with cancelled trades and other meaningless entries that the Court finds these entries served the purpose of hiding the high percentage of commissions from the Complainants. Moreover, the yen transaction further establishes that Respondents' churned Complainants' accounts. Respondents liquidated a cancelled trade in order to make the individual account seem more profitable and induce Melton to transfer money into the joint account. From that joint account, Respondents were able to garner an additional \$14,200 in commissions, 44% of the total commissions charged by Respondents.

Finally, in view of the many violations of the CEA's anti-fraud provisions and the "cancellation" tactics that Respondents used in the account statements, the Court believes that it may be appropriate for the CFTC Division of Enforcement to review this matter.

## VIOLATIONS

Liability on these claims is joint and several. By misrepresenting and failing to disclose the reality of the risks associated with options trading and continuing to misrepresent the status of the accounts and by churning Complainants' accounts, Pasqua violated CFTC Regulation 33.10 and Section 4(b) of the CEA. By failing to adequately supervise Pasqua, Saathoff violated

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<sup>58</sup> If however, the cancelled yen trade was not charged to Melton's account, the commissions from the joint account would be 27% for the month of February.

<sup>59</sup> In re Lincolnwood Commodities Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 at 28,249 (CFTC Jan. 31, 1984).

CFTC Regulation 166.3. Under Section 2(a)(1)(A) of the CEA, UCC is liable for its employees' wrongdoings.

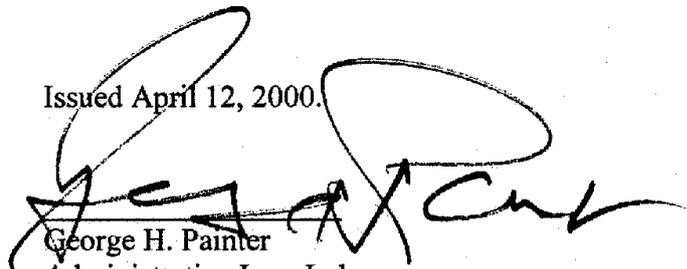
**DAMAGES**

Since fraud has been established in this case, the measure of damages is equivalent to Complainants' out-of-pocket expense, \$40,715.32.

**ORDER**

Complainants have established by the weight of the evidence that Respondents violated the CEA causing damages of \$40,715.32 to Complainants. Accordingly, Respondents are ordered to pay reparations to the Complainants in the amount of \$40,715.32, plus interest compounded annually at the rate of 6.197% from June 3, 1997 until the date of payment to Complainants.

Issued April 12, 2000.

  
George H. Painter  
Administrative Law Judge

Legal Intern: Christina A. Barone