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PAUL M. PAKAN,
Complainant,

v.

DENNIS JAVIER PATINO, and
DAVID JUDE JAVOR,
Respondents.

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* CFTC Docket 06-R034
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INITIAL DECISION

Appearances

Paul M. Pakan, Schenectedy, New York, *pro se*, complainant

Dennis Javier Patino, Tamarac, Florida, *pro se*, respondent

David Jude Javor, Del Ray Beach, Florida, *pro se*, respondent

Introduction

Paul Pakan's complaint arises from the solicitation and handling of his non-discretionary options account with KJW, LLC, a now defunct introducing broker. Pakan named as respondents: KJW, LLC; Ken Wolf, KJW owner and chief trader; Andrew Cole and Michael Alexson, KJW sales managers; and Dennis Patino and David Javor, Pakan's account executives.

Pakan's principal allegations are: that Patino fraudulently induced him to make three deposits totaling \$35,468; that Patino and Javor churned his account for \$22,204 in commissions

and fees; that Patino disregarded an instruction to liquidate two spreads; that Wolf, Cole and Alexson violated their supervisory duty by failing to assign a broker for Pakan when Patino abruptly left the country to attend his grandfather's funeral in Argentina; and that Javor fraudulently lulled Pakan into more trades when he succeeded Patino as Pakan's broker. During Patino's tenure as Pakan's account executive -- January 25 to April 25, 2005 -- Pakan paid a total of \$14,459 in commissions and fees, and the account liquidation value declined about \$14,264. During the time that KJW had assigned no broker to handle the account in Patino's absence -- April 26 to May 13, 2005 -- the account liquidation value declined an additional \$14,120. During Javor's tenure as account executive -- May 16, to November 16, 2005 -- Pakan paid an additional \$7,745 in commissions, and the account liquidation value declined an additional \$7,084.

In response to Pakan's allegations, respondents filed answers denying any violations or liability.¹ After the hearing, Pakan settled with KJW, Wolf, Alexson, and Cole. Under two separate settlement agreements, Pakan received a total of \$9,000: \$3,000 from Cole, and \$6,000 from KJW, Wolf, and Alexson.² Under a simplified apportionment: the commissions and losses during Patino's tenure as account executive were reduced by \$3,600; the losses during Patino's absence were reduced by \$3,600; and the losses and commissions during Javor's tenure were reduced by \$1,800.³

¹ Cole, Javor and Patino filed individual answers; and KJW, Wolf and Alexson filed a joint answer.

² This case was stayed for an extended period, while the settling respondents made a series of installment payments.

³ This apportionment reflects the fact that the settling respondents were potentially directly or derivatively liable for all of the damages, and that approximately 40% of the damages had been incurred during Patino's tenure, approximately 40% during Patino's absence, and approximately 20% during Javor's tenure.

After reviewing the documentary record and the parties' oral testimony,⁴ I have concluded that Pakan has established that Patino and Javor churned his account, and that Pakan is entitled to separate awards: \$10,859 from Patino, and \$5,945 from Javor.

This conclusion reflects my assessment of the testimony of the principal witnesses: Pakan, Patino and Javor. On one hand, each of these witnesses appeared to sincerely believe that they were offering truthful testimony. On the other hand, their recollection of significant conversations appeared self-serving and selective. Patino and Javor only took terse notes of their conversations with Pakan, who, in turn, took no notes.⁵ As a result, each of the witnesses could recall the gist, but not the detailed substance, of particular conversations, and Pakan was noticeably confused about the dates and sequences of certain conversations. Pakan's recollection was further hampered by the fact that he had not mastered options terminology, the fact that he had not adequately understood respondents' explanations about their trading strategies, and the fact that he had not made a serious effort to understand the written account statements. However, Patino corroborated, and the other respondents did not dispute, Pakan's believable testimony that Patino and Javor merely disclosed that KJW charged a \$100 commission per option, but did not clearly disclose the total commission cost for the trades that they recommended, which ranged from \$1,500 to \$7,500 per transaction.⁶ Similarly, Patino

⁴ The documentary record includes: (1) Pakan's complaint, addendum to the complaint, motion to amend the complaint, and affidavit; (2) Patino's answer and affidavit; (3) Javor's answer, statement (attached to his discovery requests), and affidavit; (3) Cole's answer; (4) the joint answer of KJW, Wolf and Alexson; (5) Mark Adrian's affidavit (produced by KJW); (6) Stephen Montgomery's affidavit, and equity runs and account-opening documents for the Pakan account (produced by the clearing broker, Rosenthal-Collins); (7) account statements for the Pakan account (produced by various parties); (8) the broker's log maintained by Patino and Javor (produced by Javor); (9) order tickets, "customer profile," "broker attestation," and "account transfer sheet" (produced by KJW); (10) Patino's employment claim (produced by KJW); (11) NYMEX price data provided by CFTC Office of the Chief Economist; and (11) NFA records.

⁵ See Pakan's testimony at pages 64-65 of hearing transcript.

⁶ Pakan's recollection of commission-related discussions was more reliable, because commissions are not an arcane concept unique to options. Moreover, Pakan's testimony on this issue was substantiated by the fact that, throughout this proceeding whenever respondents were asked about disclosures or trading strategies, they consistently shied

corroborated and the other respondents did not dispute, Pakan's credible testimony that when Patino and Javor recommended a trade, they routinely did not provide a detailed explanation of the trade, but rather merely said that they were relaying Ken Wolf's advice to buy or sell a particular energy spread.

Factual Findings

The parties

1. Paul Pakan was 56 years old when he opened his account with respondents. At that time, he had retired from his job as a sheriff's department investigator. Pakan essentially had no investment experience. For better or worse, upon his father's death, he had liquidated the stocks and bonds that he had inherited, and purchased bank certificates of deposit. He had no experience with commodity futures or options. [See Rosenthal-Collins "Account Information Form" and "Customer Profile;" Pakan's letter to Patino, dated February 24, 2005 (exhibit to Patino answer); Pakan affidavit; and Pakan testimony, at pages 6-9, and 65-67 of hearing transcript.]

2. KJW, LLC was based in Boca Raton, Florida, and was a registered introducing broker from November 2003, to January 2006. KJW introduced its customers accounts to Rosenthal Collins Group.

Kenneth Wolf, the owner of KJW, conducted the account-opening "due diligence compliance review" for the Pakan account, and generated all of the trade recommendations that Patino and Javor passed on to Pakan.⁷ As explained below, these trades involved multi-contract, out-of-the-money, option spreads, with commission charges that ranged from \$1,629 to \$7,550,

away from acknowledging the actual size of the commissions, or acknowledging the detrimental effect of the large commissions on profit potential.

⁷ KJW did not produce a copy of the recorded compliance review.

and commensurate commission-to-net-premium-paid ratios that ranged from 36% to 42%.⁸

Michael Alexson was the KJW sales manager, and supervisor of Patino and Javor, from early January 2005, to late April 2005. In that capacity, Alexson obtained Pakan's authorization to place the five trades recommended by Patino.⁹

Andrew Cole was the KJW sales manager, and supervisor of Patino and Javor, from late April 2005, until KJW went out of business in January 2006. In that capacity, Cole obtained Pakan's authorization to place the three trades recommended by Javor. [See 2nd and 3rd paragraphs on page 1, and 2nd and 3rd paragraphs on page 2, KJW, Wolf, Alexson and Cole joint answer; Adrian affidavit and supplement to affidavit; page 3, Javor statement; ¶ 1, Javor affidavit; ¶ 1, Patino affidavit; Montgomery statement; NFA records; and Cole testimony, at pages 112-115 of hearing transcript.]

3. Dennis Patino had limited commodities experience. He first became registered in 2004, and was a registered associated person with KJW from January 10, to May 16, 2005. He is currently not registered. Patino solicited the Pakan account, and was assigned to Pakan's account from January 25, to May 13, 2005. Pakan recommended a total of five spread trades for the Pakan account. Patino's last conversation with Pakan was on April 25, 2005. Soon afterwards, Patino traveled to Argentina, for a family funeral, and then was terminated by KJW upon his return. During Patino's tenure as Pakan's active account executive – from January 25, to April 25, 2005 -- Pakan paid a total of \$14,459 in commissions and fees, and the account liquidation value declined about \$14,264. [See 3rd paragraph, on page 1, and 12th through 14th paragraphs, on page 4, Patino answer; ¶ 1, Patino affidavit; 1st paragraph on page 2, KJW, Wolf, Alexson

⁸ The commission-to-net-premium-paid ratio, in essence, is the break-even rate, *i.e.*, the amount that an option position, or option spread position, must appreciate to overcome the cost of commissions and fees in order to break even. The higher the commission-to-premium-paid ratio, the less likely the option or option spread will break even or realize a net profit.

⁹ KJW did not produce a copy of the recorded trade authorizations by Alexson and Cole.

and Cole joint answer; Adrian affidavit and supplement to affidavit; ¶ 1, Javor affidavit; page 1, KJW, Wolf, Alexson and Cole joint answer; KJW “Account Transfer” form, dated Friday, May 13, 2005; and NFA records.]

4. David Javor was first registered as an associated person in 1995. Javor was a registered associated person with KJW from January 2004, to January 2006. He is currently not registered. Javor’s first day as Pakan’s account executive was Monday, May 16, 2005. Javor recommended a total of three spread trades for the Pakan account. During Javor’s tenure as account executive, Pakan paid an additional \$7,745 in commissions, and the account liquidation value declined an additional \$7,084. [See page 2, Javor answer; page 3, Javor statement; ¶ 1, Javor affidavit; 1st paragraph on page 2, KJW, Wolf, Alexson and Cole joint answer; “Account Transfer” document dated May 13, 2005; NFA records; and Javor testimony, at page 141 of hearing transcript.]

The solicitation and account opening

5. In mid-January 2005, Patino cold-called Pakan, and they spoke for about an hour. Pakan was initially reluctant to speak to Patino, because he had placed himself on the do-not-call list. Nonetheless, since Pakan found Patino low-key and likable, he gave him an opportunity to make a presentation. Pakan told Patino that he had no investment experience, that he had his savings in bank CD’s, that he knew very little about the petroleum markets, and that he knew nothing about exchange-traded options. Patino told Pakan that Ken Wolf, the owner of KJW, specialized in trading energy options, and strongly inferred that Wolf had been successfully trading energy contracts, and making money for his firm’s clients for many years.

Patino discussed the mechanics of options trading, discussed the energy markets, and discussed the risk of loss generally associated with options trading. Pakan explained that Wolf

would be providing the trade recommendations, which Patino in turn would pass on to Pakan. According to Pakan, Patino told him that Wolf was routinely making 40% profits for his customers. In contrast, Patino asserted that he merely told Pakan that Wolf's target was to make a 40% profit. Patino also asserted that he told Pakan that options on futures could potentially achieve a higher rate of return than bank CD's, but with a correspondingly higher risk of loss. Pakan and Patino agree that Patino emphasized that with options any losses could not exceed the purchase cost of options, or the purchase cost of option spreads.

Patino also stated that Wolf would control risk by using option spreads. Like many novice traders, Pakan had a difficult time mastering, and recalling, the new terminology used by Pakan, and as a result, he concluded from Patino's explanation of spreads that somehow spreads involved a reduced, "hedged," level of risk, and that the worst case scenario would be that he could break even. Patino told Pakan that KJW charged a \$100 dollar commission. When Pakan stated that \$100 sounded like a large amount, Patino replied that some firms charge \$200. Unfortunately, Patino did not use this obvious opportunity to explain to Pakan that he should expect to pay thousands of dollars in commissions for multi-contract spread trades. At the conclusion of the conversation -- through a combination of confusion by Pakan, and incomplete disclosure about the size of commissions by Patino -- Pakan believed that Wolf was a successful trader who had reliably made money for his firm's customers; that the strategies recommended by Wolf had a reasonable likelihood of achieving a 40% return; that Wolf could limit the risk of loss, and the size of loss, by using spread trades; and that KJW's commissions would run in the hundreds, not the thousands, of dollars, per transaction. [See Pakan testimony, at pages 8-17, and Patino testimony, at pages 126-132, of hearing transcript; pages 1 and 2 of Pakan complaint;

¶¶ 2 and 3.d, Pakan affidavit; ¶¶ 1 through 4, Patino answer; ¶ 2 of Patino affidavit; and ¶¶ 11 and 12, KJW, Wolf, Alexson and Cole joint answer.]

6. The Rosenthal Collins Group account-opening package included: the account owner information form, the customer agreement, a standard CFTC rule 155 futures and options risk disclosure statement, and an additional risk disclosure statement for first-time traders. A few days after Patino sent the account-opening documents, he called Pakan, who informed him that he was ready to sign the documents. Patino then walked Pakan through the documents, telling him where to sign. [See Pakan testimony, at pages 17-20, and 85-97, and Patino testimony, at pages 85-97, of hearing transcript; and ¶ 2 of Patino answer.]

7. Respondents assert that KJW routinely conducted a recorded, account-opening “due-diligence” compliance review. However, respondents did not produce a recording of the review, and respondents did not produce any reliable testimony by anyone with first-hand knowledge of the compliance review conducted for the Pakan account. [See Patino testimony, at pages 129-130 of hearing transcript; and ¶¶ 3 and 4 of Patino answer.]

Trading activity

8. Pakan deposited a total of \$35,622.50: \$5,300 on January 25, 2005; \$5,322.50 on February 22; and \$25,000 on March 8. On December 22, RCG returned the \$154.50 account balance. Thus, Pakan’s out-of-pocket losses totaled \$35,468.

9. Pakan’s KJW account was charged a total of \$22,204 in commissions and fees: \$14,459 was charged during Patino’s tenure as account executive (January 25 to April 25); and \$7,745 was charged during Javor’s tenure as account executive (May 16 to December 22).

10. The history of Pakan’s KJW account can be divided into three distinct periods. During the first period, from January 25, to April 25, Patino acted as the account executive for

the Pakan account. Patino recommended a total of five light crude and unleaded gasoline spread trades, two of which were closed out for a modest profit before April 25, and three of which were open on Patino's last day as Pakan's account executive, April 25. During this first period, the Pakan account was charged \$14,459 in commissions, and the account lost \$14,263.50: *i.e.*, the liquidation value declined from \$35,622.50 to \$21,359. Thus, during this period, the amount of the commissions and the net amount of the trading losses were essentially coextensive.

During the second period, from April 25, to May 15, KJW did not assign an account executive to cover Pakan's account in Patino's absence, and the account lost \$14,120: *i.e.*, the liquidation value declined from \$21,359, to \$7,239.

During the third period, from May 16 to December 22, KJW assigned Javor to be the account executive. Javor recommended an additional three light crude oil spread trades. The account was charged an additional \$7,745 in commissions and fees, and the account lost an additional \$7,084. Thus, during this period, the amount of the commissions and the net amount of the trading losses also were essentially coextensive. [See phone log, account statements, and equity runs.]

11. All of the trades in the Pakan account were initially selected by Ken Wolf, and then relayed to Pakan by Patino or Javor. For each of the trades, Patino and Javor would typically inform Pakan that Mr. Wolf was recommending a trade, and then would briefly describe the trade. Pakan convincingly testified that, for each of the trades, Patino and Javor during the initial recommendation, and Alexson and Cole during the trade authorization, did not tell him the total amount of the commissions.

All of the trades were spreads involving out-of-the-money light crude oil or unleaded gasoline options. With the exception of the unleaded gasoline spread, the premium on each of

the out-of-the-money options was at most half of the premium for the at-the-money option.

According to Wolf:

The strategy was to purchase a close-to-the-money option spread that would produce results positive results with a relatively small, and highly likely, underlying market movements. We state vigorously that there would be no expert witness that would describe the trades as high risk outside the inherent risk of trading in these markets by their nature.

[6th paragraph of KJW, Wolf and Alexson joint answer.] However, Wolf did not factor into his leverage or price-sensitivity rationale the fact that KJW charged commissions on a per-contract basis, with the result that the out-of-the-money spread trades recommended by Wolf consistently generated substantial commission charges which significantly hindered profitability and thus made the trades significantly more risky.

Set out below is a summary of the trading in the Pakan account. As previously noted, Patino initiated the first five trades, and Javor initiated the other three trades:

<i>In</i>	<i>Out</i>	<i>Trade</i>	<i>Net result</i>	<i>Commission</i>	<i>Commission-to-Premium Ratio</i>
1-26	3-3	7 May Light Crude calls	\$2,310	\$1,620	39%
2-18	3-9	7 June Unleaded calls	\$2,136	\$1,620	39%
3-8	6-16	35 July Light Crude calls	(\$26,700)	\$7,550	39%
3-8	6-16	8 July Light Crude puts	(\$3,912)	\$2,392	38%
3-10	6-16	9 July Light Crude calls	(\$6,882)	\$1,842	36%
5-19	6-2	7 Sep. Light Crude calls	\$2,270	\$1,510	37%
6-6	8-8	11 Oct. Light Crude calls	\$4,006	\$2,374	43%
8-8	11-16	16 Dec. Light Crude calls	(\$11,612)	\$3,452	42%

As can be seen, the trades involved multi-contract, out-of-the-money, option spreads, with commission charges that ranged from \$1,629 to \$7,550, and commensurate commission-to-net-

