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UNITED STATES OF AMERICA
before the
COMMODITY FUTURES TRADING COMMISSION

OFFICE OF PROCEEDINGS
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Linda Talbot-Keith,	*	
Complainant,	*	
	*	
v.	*	CFTC Docket No. 05-R061
	*	
Stephen Mark Smith,	*	
Universal Financial Holding Corp.,	*	
Worldwide Commodity Corp., and	*	
South Coast Commodities, Inc.,	*	
Respondents	*	
	*	

INITIAL DECISION

Appearances:

On behalf of Complainant Linda Talbot-Keith
Linda Talbot-Keith, *pro se*
2300 Copper Ridge Road
Arlington, Texas 76006

On behalf of Respondents Stephen Mark Smith, Universal Financial Holding Corp., Worldwide
Commodity, Corporation, and South Coast Commodities, Inc.
Vivian Drohan, Esq.
Drohan & Drohan LLP
150 East 58th Street
New York, New York 10155-0002

Opinion of Painter, Administrative Law Judge

PROCEDURAL HISTORY

On June 24, 2005, Complainant Linda Talbot-Keith filed a Complaint against Respondents Universal Financial Holding Corp., a Futures Commission Merchant, Worldwide Commodity Corp., an Introducing Broker, and its brokers, Stephen Mark Smith and Alice Welton. On March 6, 2006, the Court allowed Complainant to amend her Complaint to include South Coast Commodities, Inc., as a Respondent, based upon South Coast's status as a successor entity to Worldwide Commodity Corp. Complainant alleges that Respondents fraudulently solicited and traded her account, and churned the account, violating 4b(a) of the Commodity Exchange Act, 7 U.S.C. § 6b(a), Section 4c(b) of the CEA, 7 U.S.C. § 6c(b), and Section 33.10(a) and (c) of the Commission's regulations, 17 C.F.R. § 33.10 (a) and (c), resulting in damages in the amount of \$ 57,643.11 and costs. (September 13, 2005 correspondence from Linda Talbot-Keith to Deedra Jones, Director, Office of Proceedings).

Respondent Alice Welton settled with Complainant Talbot-Keith on January 5, 2006, for the sum of \$3000.00. The remaining Respondents filed Answers denying all allegations of wrongdoing.

Complainant paid a \$50 fee to the Commission and requested a "voluntary decisional procedure," which would not have required a hearing. Respondents demanded a formal hearing and paid an additional \$200 fee to ensure that there was a hearing in this matter. (Transcript ("Tr.") at page 6, Tr. 6). Nevertheless, Respondents Stephen Smith, Worldwide, South Coast, and Universal Financial Holding Corp. failed to appear at trial despite the Court's July 6, 2006 Notice of the August 28, 2006 hearing, and several subsequent telephone discussions with

Respondents' counsel Vivian Drohan.¹ In addition, at the last minute, late on Friday, August 25, 2006, Drohan informed the court that Complainant and Smith had settled for the sum of \$7,000.00.² In contradiction, Complainant indicated that discussions had taken place but no settlement had been finalized. Finally, Drohan specifically informed the Court by telephone on the eve of the hearing that Respondents Worldwide, South Coast, and Universal had elected not to attend.

The trial took place in Dallas, Texas on August 28, 2006. Complainant presented her testimony. Since there was not a finalized settlement with Respondent Smith, the Court granted Smith an additional ten days to finalize a settlement before being declared in default. (Tr. 7). As the remaining Respondents elected not to be available for cross examination by Complainant, the Court held them in default and struck their Answers from the record. (Tr. 7).

There is nothing on the record to indicate that Smith has finalized a settlement within the required time period. Evidently, despite her best efforts, and numerous messages and unanswered calls to counsel Drohan's office, Linda Talbot-Keith has not been able to complete an agreement. Keith informed the Court that she notified Smith's counsel Drohan of the Court's grant of ten day period for settlement. Consequently, like Respondents Worldwide, South Coast, and Universal, the Court finds that Smith has defaulted and his Answer is struck from the record.

As a result of Respondents' default, the findings and conclusions below are based solely on the Complainant's reliable documentary submissions and testimony.³ In light of Complainant's credibility concerning her lack of sophistication, and the high-pressure, fraudulent solicitation, control and churning of her account, the Court finds that Respondents fraudulently

¹ See August 2, 2006 letter of Respondents' counsel Vivian Drohan.

² See August 25, 2006 letter of Smith's counsel Vivian Drohan.

³ The principal documents and items in the evidentiary record include, but are not limited to Linda Talbot-Keith's Amended Complaint and exhibits, her Pre-Hearing Submissions, the Transcript of the August 28, 2006 Hearing before this Court, the NFA BASIC details for the Respondents, and the available account statements.

solicited her account, and churned it with trading conducted between late May and August 2004 for the sole purpose of generating commissions.

Factual Findings

The parties

1. Linda Talbot-Keith (“Keith”) resides at 2300 Copper Ridge Road, Arlington, Texas 76006. While Keith had previously invested in the stock market, she had never previously traded futures or options. (Tr. 6).

2. Worldwide Commodity Corporation (“Worldwide”) was registered with the National Futures Association (“NFA”) as an Introducing Broker (“IB”) from November 20, 1998 until it withdrew on March 13, 2005, with NFA ID 0291471. Its business address was 700 N. Hiatus Road #203, Pembroke Pines, Florida 33026. Worldwide introduced its business through Universal Financial Holding Corporation until January 31, 2005. On January 31, 2005, Worldwide’s assets were transferred to South Coast Commodities, Inc., which had the same ownership and utilized the same brokers.

Worldwide has been the subject of nine reparations actions, and along with South Coast Commodities, Inc., is defendant in a Commission injunctive action. In its Complaint for Injunctive Relief, filed on October 26, 2005,⁴ the Commission alleges that Worldwide, South Coast Commodities, and Universal, among others, violated Commodity Exchange Act (“CEA”) Sections 4c(b), 7 U.S.C. § 6c(b), and Commission regulation 33.10(a) and (c), 17 C.F.R. § 33.10(a) and (c), by misrepresenting and failing to disclose material facts concerning the likelihood of realizing large profits from trading commodity options, the related risk of loss, and the poor performance record of Respondents’ customers.

⁴ See October 26, 2005 Amended Complaint for Injunctive and Other Equitable Relief and Civil Monetary Penalties pursuant to the Commodity Exchange Act, No. 2:04-CV-3641, United States District Court for the Eastern District of Pennsylvania.

3. South Coast Commodities, Inc. (“South Coast”) was registered with the NFA as an IB on January 1, 2005, with NFA ID 0346902, and a business address of 700 N. Hiatus Road #203, Pembroke Pines, Florida 33026. South Coast introduced its business through futures commission merchant Comtrust, Inc., and was a successor corporation to Worldwide, sharing the same owners and APs. Since its inception, South Coast has been the subject of five reparations actions, as well as a named defendant in the Commission’s enforcement action against Worldwide, described above. (NFA BASIC records; October 26, 2005 Amended Complaint, *supra*).

4. Universal Financial Holding Corp. (“Universal”) is a Florida corporation whose principal place of business was in Aventura, Florida 33180. Universal was an FCM and guarantor for Worldwide. Universal has been the subject of two regulatory actions by the NFA (resulting in findings of FCM responsibility for its guaranteed IBs, joint and several liability for \$275,000 and \$50,000 in fines, and ultimately, in November 2004, a permanent bar from NFA membership) and 54 Commission reparations cases. In addition, Universal has been the subject of two Commission injunctive actions.(NFA BASIC Records).

In August 2004, the Commission filed an injunctive action against Universal as a result of its guarantee of Worldwide’s fraudulent performance. *See n. 4, supra*. In January 2006, Universal entered into a consent order relating to its guarantee of Chase Commodities Corp., agreeing to assume joint and several liability for \$4.2 million in restitution to defrauded customers.⁵ In both instances, Universal sponsored IBs, including Worldwide, the IB in this matter, which failed to supervise their employees despite ongoing demonstrations of fraudulent solicitation and management of customer accounts.

⁵ *See, Commodity Futures Trading Commission v. Chase Commodities, Lee La Gorio, Excel Obando and Universal Financial Holding Corporation*, United States District Court for the Central District of California, Case No. CV 04-6463, *Consent Order of Permanent Injunction and Equitable Relief against Defendants*, January 25, 2006.

5. Stephen Mark Smith (“Smith”), NFA ID 02392, resides at 113 N. 48th Terrace, Hollywood, Florida 33021. Smith was an Associated Person (“AP”) with Worldwide from January 2004 until July 2004. He previously was associated with a multitude of firms, including but not limited to Commonwealth Financial Group, Inc., Concorde Trading Group, Inc., Carrington Financial Corp., Cromwell Financial Services, Inc., and FSG International, Inc. Since his departure from Worldwide, Smith has been associated with Universal Commodity Corporation. He has been the subject of two reparations actions.

Solicitation, Account Opening and Management, and Churning

6. Complainant Keith’s credible testimony and documentary evidence establish that Respondents fraudulently solicited and managed her account, and churned the account:

A. Towards the end of May 2004, after responding to a CNBC advertisement, Keith was contacted by Welton. Welton assured Keith she could double her investment of funds. Upon Keith’s loss of approximately \$500 in two weeks, Welton transferred Keith to Smith, claiming he was a specialist in bond market options. (Amended Complaint; Tr. 5).

B. Smith pressured Keith to expend in excess of her available funds of \$10,000 on the promise of a trade with a “big pay back.” He assured Keith the trade would bring in \$50,000.00 every quarter, and that there was huge potential for Keith to make \$300,000.00 before the options expired. He told Keith she needed to invest \$35,000 in order to purchase fifty options positions for minimally effective trading. (Keith’s Affidavit, appended to March 22, 2006 Pre-Trial submission; Tr. 5). To ensure Keith made the trade Smith promised that, after the trade, they would “head for the five million mark” that he “achieves for all his clients.” (*Ibid.*)

C. Approximately two weeks later, Smith again contacted Keith to do a trade that “guaranteed to double her money in less than a week,” Smith called less than ten minutes before the market closed and said that he required an immediate answer. Keith resisted Smith’s efforts, but ultimately complied with his request that she enter into an \$11,332.00 trade in T-bond options. (*Ibid.*)

D. Smith called the next day and encouraged Keith to get out of the previous evening’s trade for \$1,700.00. Keith stated “Twelve hours ago I was going to double my money and now I am being offered a chance to get out with an 80% loss.” (*Ibid.*) When questioned, Smith advised Keith to stay in the trade. In two days the trade was worth \$781.50. (*Id.*)

E. Subsequently, Keith was contacted by Worldwide supervisor Bruce Crown and entered into additional arrangements. These arrangements have been the subject of separate prosecutions and Keith’s subsequent losses resulting from her trading through Crown are not the subject of her present Complaint.⁶

F. Complainant indicates that subsequent to her settlement with Welton, she had an out-of-pocket loss of \$54,643.11 resulting from Respondents’ solicitation and trading of her account. (*Ibid.*; Keith’s September 13, 2005 letter to Deedra Jones, Director, Office of Proceedings).

DISCUSSION

Keith’s credible testimony and documentation establish that

- (I) Keith was not a sophisticated options trader;
- (II) Respondents controlled the trading of Keith’s account;

⁶ See September 26, 2005 correspondence from Deedra K. Jones, Director, Office of Proceedings to Linda Talbot Keith.

- (III) Respondents fraudulently solicited and managed Keith's trading account using high pressure and misleading sales tactics, while omitting material information, in violation of CEA Section 4c(b) and Commission Regulation 33.10;
- (IV) Respondents churned Keith's account in violation of CEA Section 4c(b) and Regulation 33.10;
- (V) Worldwide, South Coast and Universal are liable for the conduct of the relevant brokers pursuant to Section 2(a)(1)(B) of the CEA, 7 U.S.C. § 2(a)(1)(B) and Universal's guarantee.

I. Keith was not a Sophisticated Options Trader

Although Keith previously invested in stocks, she had no commodity trading experience. (Tr. 6-7). Her inexperience with the options market is demonstrated by her assumptions about the use of "stop orders,"⁷ as well as by her complete reliance on Respondents. *See generally Skinner v. Gombos International*, 2000 W.L. 15593.

II. Respondents Fraudulently Solicited and Managed the Dukes Account

Section 4c(b) provides "No person shall....enter into or confirm the execution of any transaction involving any.....option....contrary to any....regulation of the Commission."

Commission Regulation 33.10 provides:

It shall be unlawful for any person directly or indirectly – (a) to cheat or defraud or attempt to cheat or defraud any other person; (b) to make or cause to be made to any other person any false report or statement thereof or cause to be entered for any person any false record thereof; (c) to deceive or attempt to deceive any other person by any means, whatsoever – in connection with an offer to enter into, the entry into, the confirmation of, or the maintenance of any commodity option transaction.

⁷ See Complainant's Pre-Hearing Submission. *See also* Tr. 5.

As a result of Respondents' default, there are no statements on the record to contradict Complainant's credible and substantial testimony and records sustaining the Court's finding that Respondents fraudulently solicited and handled Keith's account. The evidence demonstrates that Respondents used high-pressure tactics, including material false promises of doubling or obtaining high profits on Keith's funds and material misrepresentations of past trading success, while failing to mention Respondents' actual customer histories and the demonstrably high risk of loss.

Keith has met the burden of demonstrating that Respondents (1) made misrepresentations or misleading statements; (2) acted with scienter; and (3) that the misrepresentations were material. *See Commodity Futures Trading Commission v. R.J. Fitzgerald & Co., Inc.*, 310 F. 3d 1321 (11th Cir. 2002). Misrepresentations and omissions are material when a reasonable investor would consider them important in deciding whether to make an investment or not. *R.J. Fitzgerald, supra*, 310 F. 3d 1321, 1333. As an unsophisticated investor, Keith understandably relied on Respondents' promises of high profits supported by Respondents' claims of past trading success.

Scienter may be established indirectly, and may be satisfied by indirect evidence of recklessness. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). Smith's insistence that Keith exceed a proposed trade of \$10,000.00 with a trade of \$35,000.00 in response to his high pressure promise of profits provides one example of such recklessness.

Even in the presence of standardized warnings, Respondents' material false promises of trading success and false customer histories provide substantial basis for the Court's determination that Respondents fraudulently solicited Keith's funds. *See Commodity Futures Trading Commission v. R.J. Fitzgerald & Co., Inc.*, 310 F. 3d 1321 (11th Cir. 2002); *Ferriola v.*

Kearse-McNeill, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,172 at 50,153 (CFTC 2000); *Bishop v. First Investors Group of the Palm Beaches*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,004 at 44,841-44,842 (CFTC 1997).

III. Respondents Churned Keith's Account for the Purpose of Generating Commissions

Keith testified and provided account statements to establish her charge that Respondents churned her account. Complainant met the requirements of law by her demonstration that Respondents controlled her account, traded her account excessively and without legitimate purpose, diverging from any meaningful trading strategy other than that of generating commissions. *See Fields v. Cayman Associates, Ltd.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,688 at 30,928 (CFTC 1985); *Smith v. Siegel Trading Co.* [1980-1982 Transfer Binder] Comm. Fut. L. Rep. ¶ 21,105 at 24,452-53 (CFTC 1980).

When an associated person acts in an advisory capacity, his duties to that customer broaden substantially. *Siegel Trading Co., supra*. As a result, "a finding of control is not dependent on the account being formally labeled discretionary but is based rather on who in fact was making the decisions." *Siegel Trading Co., supra, citing Newberger, Loeb & Co., Inc. v. Gross*, 365 F. Supp. 1364, 1371 (S.D.N.Y. 1973), citing *Hecht v. Harris, Upham & Co.*, 283 F. Supp. 417, 432-33 (N.D. Cal. 1968), *mod. as to damages*, 430 F. 2d 1202 (9th Cir. 1970). It is entirely clear from Keith's testimony and the records in this matter that Smith and the other brokers recommended trades and, with full disclosure of her absence of any relevant knowledge, Keith deferred to Respondents' misrepresentations of their expertise and past success.

In making an assessment of where actual control lies, the factors include (1) a lack of customer sophistication; (2) a lack of commodity trading experience on the part of the customer and a minimum of time devoted by him to his account; (3) a high degree of trust and confidence

reposed in the associated person by the customer; (4) a large percentage of transactions entered into by the customer upon the AP's recommendation; (5) the absence of prior customer approval for transactions; and (6) customer approval for transactions where it is based upon inaccurate or misleading information supplied by the AP. *Siegel Trading Co., supra, citing Carras v. Burns*, 526 F. 2d 251 (4th Cir. 1975). Nor does the absence of a written control agreement foreclose a claim such as Keith's. *Siegel Trading Co., supra*.

The Court has determined that Keith was not sophisticated, and had no relevant trading experience. She placed her trust in Respondents, who initiated all the trading in her account on the basis of fabricated and misleading information. Respondents fully exercised control over Keith's account in satisfaction of the first element of the churning determination.

Respondents generated at least Thirty Two Thousand Eight Hundred Dollars of commissions⁸ on Complainant's investment of approximately Fifty Four Thousand Dollars in the time period described, generating commissions of approximately sixty one percent of the account value. See account statements and account summary. The Commission has characterized commissions on options transactions as "high" when in excess of forty percent. See *Hinch v. Commonwealth Financial Group, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,056 (CFTC 1997).

In the context of futures trading, the indicia of churning include high commission to equity ratios; high percentages of day trades; a broker's departure from a previously agreed upon trading strategy; trading in an under-margined account and reestablishment of a previously liquidated position in the same or a related future contract without any apparent trading strategy. *Murlas, supra, citing In re Lincolnwood Commodities, Inc.*, [1982-1984 Transfer Binder] Comm.

⁸ An additional \$8000 in commissions was charged and may have been returned for a trade "made in error" on July 26, 2004. The record is not entirely clear on this point.

Fut. L. Rep. (CCH) ¶ 21,986 (January 31, 1984). While these criteria cannot be precisely applied in the options context,⁹ those factors that are applicable are prevalent in this case: there is a high commission to equity ratio and Respondents implemented in and out trading for misrepresented purposes, even going so far as to pressure Keith to enter a trade that Respondents bargained to remove from her account within twenty four hours.

Keith's allegations are deemed credible and are not rebutted. Keith has substantiated her claim that Respondents churned her account.

IV. Worldwide and South Coast (and Universal, as guarantor) are Responsible for the Acts of their APs

Smith and Welton were brokers acting within the scope of their employment when they fraudulently solicited Keith's account and churned it. Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2(a)(1)(B), provides that the "act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment shall be deemed the act, omission or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent, or other person." Consequently, pursuant to their defaults, Worldwide and South Coast, and Universal, as their guarantor, are liable for the full scope of the brokers' conduct.

CONCLUSIONS OF LAW

Complainant has established by the weight of the evidence that:

- (1) Respondents fraudulently solicited and managed her account in violation of

⁹ See *Hinch, supra*.

CEA Sections 4b(a) and 4c(b), 7 U.S.C. §§ 6b(a) and 6c(b), and Commission Regulation 33.10 (a) and (c), 17 C.F.R. § 33.10(a) and (c).

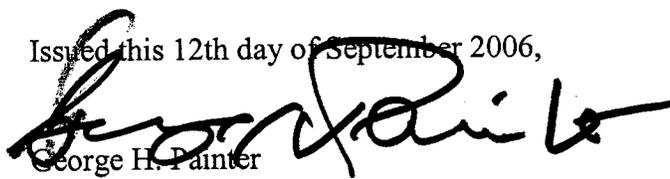
- (2) Respondents churned Keith's account in violation of Section 4c(b) of the CEA, and Commission Regulation 33.10.
- (3) Respondents Worldwide, South Coast and Universal (as their guarantor) are liable pursuant to Section 2(a)(1)(B) of the Act for the acts of their agents acting within the scope of their employment.

Respondents' violations of the Commodity Exchange Act and the implementing regulations resulted in direct monetary damages to Complainant Keith in the amount of \$54,643.11. Keith opened her account and entered into trading directed by Respondents based upon their misrepresentations concerning profits and their historical success, as well as their omissions of their accurate customer trading histories. Complainant was misinformed about the bases for the ongoing trading of her account, involving a trading strategy that related only to the generation of commissions for Respondents. Since her account was fraudulently solicited and traded, Keith is entitled to judgment for the full extent of her losses. *Pacific Trading Group v. Global Futures & Forex, Ltd.*, 2004 WL 2591468.

ORDER

Respondents Smith, Universal, Worldwide and South Coast are ordered to pay to Complainant Keith \$ 54,643.11, the out-of-pocket losses sustained on her account, plus interest at the rate of 1.30% per annum from October 18, 2004 until this award is paid in full, and the \$50.00 filing fee. Respondents are jointly and severally liable for the payment of this judgment.

Issued this 12th day of September 2006,



George H. Painter
Administrative Law Judge

Judith Hutchison
Attorney-Advisor