UNITED STATES OF AMERICA

Before the

COMMODITY FUTURES TRADING COMMISSION

In the matter of:	)	**CFTC Docket No. 01-09**
MADISON FINANCIAL GROUP LLC; **RICHARD A. COHEN; and RONALD G. SCOTT** **1964 Westwood Boulevard, Suite 150** **Los Angeles, California 90025**	)	**COMPLAINT AND NOTICE OF HEARING PURSUANT TO SECTIONS 6(c), 6(d), 8a(3) and 8a(4) OF THE COMMODITY EXCHANGE ACT, AS AMENDED**
Respondents.	)	

The Commodity Futures Trading Commission ("Commission") has received information from its staff which tends to show, and the Commission's Division of Enforcement ("Division") alleges, that:

I.

SUMMARY

1. From May 1998 to the end of March 2001, respondent Madison Financial Group LLC ("Madison"), a registered introducing broker (“IB”), fraudulently solicited customers to open accounts with Madison and to trade options on commodity futures contracts (“commodity options”) at the direction of Madison’s principals, respondents Richard A. Cohen (“Cohen”) and Ronald G. Scott (“Scott”). Madison used aggressive telemarketing

by unregistered telemarketing assistants and registered associated persons ("APs") to solicit customers by knowingly misrepresenting, and failing to disclose, material facts concerning, among other things: (i) the likelihood that a customer would realize large profits from commodity options trading; (ii) the risks involved in trading commodity options; (iii) the performance record of those following Madison's advice; and (iv) numerous other specific facts calculated to cause customers to effect specific trades. Cohen and Scott instructed Madison's sales force to "make up a story" to get trades. Overwhelming evidence establishes that the sales force did so. In contrast to the respondents' representations to customers, over 97% of the more than 2,800 accounts opened with Madison from May 14, 1998 through February 28, 2001, lost money. Customer losses totaled in excess of $17 million. The lack of any supervisory structure at Madison also allowed Madison's APs to commit fraud on customers. Madison, Cohen, and Scott have accordingly failed to exercise diligently their supervisory duties.

II.

RESPONDENTS

2. **Madison Financial Group LLC** is a California limited liability company with its former principal place of business at 1964 Westwood Boulevard, Los Angeles, California 90025. Madison has been registered as an Introducing Broker ("IB") since May 1998. Madison was a guaranteed IB of E.D. & F. Man International, Inc. from August 31, 1998 to November 12, 1999. Since November 1999, Madison has been a non-guaranteed IB of E.D. & F. Man.

3. **Richard A. Cohen,** who resides in Los Angeles, California, has been the President, a principal, and a registered Associated Person ("AP") of Madison since May 1998.

4. **Ronald G. Scott**, who resides in Beverly Hills, California, has been a principal, and a registered AP of Madison since May 1998.

III.

FACTS

5. From May 1998 to March 2001, Madison, at the direction of Cohen and Scott, solicited members of the general public to open commodity option accounts. Cohen and Scott have operated Madison continuously since its inception in May 1998. Through the end of March 2001, Madison employed a total of approximately fifty APs. Cohen made all hiring and firing decisions at Madison. Many, if not most, of the APs learned their trade on the job at Madison, and all have received training directly from either Cohen or Scott upon being hired.

6. Scott and Cohen trained the APs to use a general trading strategy of purchasing inexpensive "deep out-of-the-money" commodity options. Madison's trading strategy was a means for brokers to generate large commissions. Under the strategy, customers could purchase more options when they bought inexpensive out-of-the-money options and Madison could collect increased commissions which were assessed on a per option basis. The Commission is informed and believes that the majority of Madison's customers were solicited to trade deep out-of-the-money options pursuant to Madison's

trading strategy. Madison charged commissions as high as $100 for the purchase and sale of each option.

7. Madison APs generally provided their own trading advice to their customers, but oftentimes made recommendations based on the specific direction of Scott. Inexperienced APs were required to trade based on the specific direction of Scott.

8. From May 1998 to at least February 2001, Cohen and Scott were aware of the commodity options purchased and sold by Madison customers, as well as Madison's trading results, because among other things:

(a) Cohen and Scott personally conducted Madison's trade confirmation procedure whereby Madison tape recorded a conversation with each customer documenting the specific details of each customer order and/or they listened to trade confirmations conducted by other Madison employees; and

(b) Cohen and Scott reviewed daily reports that disclosed the option trades in Madison's customer accounts.

9. Madison APs generally did not use a consistent sales pitch when soliciting the majority of customers. Instead, APs were encouraged by Cohen and Scott to "make up a story" when soliciting customers. The Commission is informed and believes that Madison APs solicited the vast majority of customers in that fashion.

Misrepresentations Overstating Madison's Performance Record

10. During the course of high-pressure telephone solicitations, Madison, through its APs, at the direction of Cohen and Scott, misrepresented and overstated Madison's historical performance record to customers through misrepresentations made between May 1998 and February 2001 including:

(a) that Madison's APs achieved highly profitable results for their customers based on their trading strategy of analyzing fundamental market data;

(b) that Madison's customers had various high success rates; and

(c) that Madison's customers "are all making money here," or words to that effect.

11. Customers of Madison did not make the profits that Madison promised. From May 1998 through February 2001, Madison opened over 2,800 accounts with about $20 million in customer funds. Approximately ninety-seven percent (97%) of these accounts suffered net losses. Total net losses in Madison's accounts were in excess of $17 million. The average net loss for each customer was $6,042. The fraud committed by Madison on customers was the cause of the net losses suffered by the majority of Madison's customers. The total net losses of Madison customers exceeded their total gains by an overwhelming ratio of thirty losing customers to every profitable customer. During the same period, Madison made over $9 million in commissions and fees.

Misrepresentations Exaggerating the Likelihood of Profit

12. During the course of high-pressure telephone sales solicitations, Madison, through APs acting at the direction of Cohen and Scott, misrepresented the likelihood of profits from the purchase of commodity options including, but not limited to, the following misrepresentations made between May 1998 and February 2001:

(a) that an easily predictable price move will translate into large profits to the customer;

(b) that the customer could, through specific trades, at least double the customer's money in a matter of months or a comparable time frame;

(c) that Madison brokers have a high success rate on behalf of customers;

(d) that Madison APs have information not known to the general public which has led to a high success rate; and

(e) that specific trading recommendations are "winners" or words to that effect.

Misrepresentations and Omissions Minimizing Risk of Loss

13. During the course of high-pressure telephone sales solicitations, Madison, through its APs, acting at the direction of Cohen and Scott, routinely failed to disclose adequately the risk of loss inherent in trading commodity options. Minimal references to risk were nullified by Madison's high-pressure sales tactics and by its misrepresentations and omissions which falsely conveyed that while losses on commodity options are

theoretically possible, purchasing commodity options with Madison was virtually risk free. Such misrepresentations and omissions include, but were not limited to, the following misrepresentations made between May 1998 and February 2001:

(a) that the customer "couldn't lose," or words to that effect;

(b) that the customer's risk in buying options was lower than other forms of investment, or words to that effect; and

(c) that Madison's strategy had a high success rate, thereby eliminating the risk in trading.

Other Types of Fraudulent Conduct

14. During the course of high-pressure telephone solicitations, Madison, through its APs, acting at the direction of Cohen and Scott, made other statements to customers that were fraudulent in order to deceive customers into opening accounts and trading as soon as possible. Examples of other types of fraud by Madison include the following misrepresentations made between May 1998 and February 2001:

(a) that APs had more experience as a commodities broker than they actually had;

(b) that APs had connections or contacts within the commodities industry which make them a better broker;

(c) that APs traded for their own account and had been making money in the same markets that the AP was soliciting customers to trade;

(d) that APs were aware of significant moves in the markets by "big traders"; and

(e) that certain APs were “analysts” or “experts” in specific commodity markets, inferring a greater level of experience or competence as an AP.

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15. Each of the misrepresentations made by APs to customers alleged in paragraphs 9 through 14 were materially false, deceptive and misleading or they omitted material facts that would make the statements not false, deceptive, or misleading. Such misrepresentations were made without a reasonable basis to believe the truth of what they were saying. Cohen and Scott knew or recklessly disregarded the fact that those statements were materially false, deceptive and misleading, or omitted material facts that would make the statements not false, deceptive, or misleading.

Supervision Failures

16. Cohen and Scott had supervisory duties and obligations at Madison, and were obligated to implement, carry out, monitor or enforce policies and procedures of a supervisory system to deter and detect violations of the Act or the Commission's Regulations. However, from Madison’s inception through March 2001, Madison operated without regard for ensuring that the necessary personnel and systems were in place to adequately protect customers.

17. Madison, Cohen, and Scott instructed APs to engage in false and misleading sales solicitations. In so doing, Madison, Cohen and Scott failed to adequately implement, carry out, monitor or enforce policies and procedures of a supervisory system which would have deterred and detected violations of the Act or the Commission's Regulations.

18. Cohen and Scott monitored and supervised sales solicitations at Madison by listening to telephone sales presentations made by APs to customers, but failed to stop APs from engaging in false and misleading solicitations as a routine practice. Cohen and Scott also personally handled complaints from employees and customers, but they failed to take meaningful corrective action when those situations came to light. Indeed, no meaningful change in procedures, policies, or training occurred as a result of those complaints. Madison, Cohen, and Scott therefore failed to adequately implement, carry out, monitor or enforce policies and procedures of a supervisory system that should have been designed to deter and detect violations of the Act or the Commission's Regulations.

IV.

VIOLATIONS OF THE ACT AND COMMISSION REGULATIONS

COUNT ONE

VIOLATIONS OF SECTION 4c(b) OF THE COMMODITY EXCHANGE ACT, AS AMENDED, 7 U.S.C. § 6c(b), AND OF SECTION 33.10 OF THE COMMISSION'S REGULATIONS, 17 C.F.R. § 33.10:

FRAUD BY MISREPRESENTATION AND OMISSION OF MATERIAL FACTS IN CONNECTION WITH THE SOLICITATION AND MAINTENANCE OF COMMODITY OPTIONS TRANSACTIONS

19. The allegations contained in paragraphs 1 through 18 above are re-alleged and incorporated herein by reference.

20. In or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of commodity option transactions, Madison, Cohen, and Scott directly or indirectly, cheated, defrauded or deceived, or attempted to cheat, defraud, or deceive, other persons by engaging in various acts including, but not limited to, the practices set forth above, in violation of Section 4c(b) of the Act and Section 33.10 of the Commission's Regulations.

21. The foregoing acts, omissions and failures of Cohen, Scott, and the Madison APs occurred within the scope of each such person's employment with Madison. Madison is therefore liable for these acts pursuant to Section 2(a)(1)(A)(iii) of the Act, 7 U.S.C. § 2(a)(1)(A)(iii).

22. Cohen and Scott have willfully aided, abetted, counseled, commanded, induced, procured, caused, or acted in combination or concert with other persons in the foregoing violations of Section 4c(b) of the Act, 7 U.S.C. § 6c(b), and Regulation 33.10, 17 C.F.R. § 33.10. Cohen and Scott are therefore responsible for these violations by operation of Section 13(a) of the Act, 7 U.S.C. § 13c(a).

23. Cohen and Scott, directly or indirectly, controlled Madison and did not act in good faith, or knowingly induced, directly or indirectly, the acts constituting these violations of Section 4c(b) of the Act, 7 U.S.C. § 6c(b), and Regulation 33.10, 17 C.F.R. § 33.10. Cohen and Scott are therefore liable for these violations by operation of Section 13(b) of the Act, 7 U.S.C. § 13c(b).

24. Each material misrepresentation or omission, and each willful deception made during the relevant time period by, or at the direction of, Madison, Cohen, and Scott including but not limited to those specifically alleged herein, is alleged as a separate and distinct violation of Section 4c(b) of the Act, 7 U.S.C. § 6c(b), and Regulation 33.10, 17 C.F.R. § 33.10.

COUNT TWO

VIOLATIONS OF SECTION 166.3 OF THE COMMISSION'S REGULATIONS, 17 C.F.R. § 166.3:

FAILURE TO SUPERVISE DILIGENTLY

25. The allegations contained in paragraphs 1 through 24 above are re-alleged and incorporated herein by reference.

26. Madison, Cohen, and Scott failed to exercise their supervisory duties by failing to monitor and supervise diligently the sales practices and solicitations of APs at Madison including but not limited to, the acts, practices and conduct set forth in Count One, in violation of Section 166.3 of the Commission's Regulations. Madison, Cohen, and Scott have failed to exercise diligently their supervisory duties, including, but not limited to, the following:

(a) failing to supervise diligently the sales solicitations of Madison APs;

(b) failing to supervise diligently the trading of customer accounts; and

(c) failing to design, implement, monitor and follow a program of supervision and compliance designed to deter and detect violations of the Act or the Regulations including, but not limited to, the foregoing violations of Section 4c(b) of the Act, 7 U.S.C. § 6c(b), and Regulation 33.10, 17 C.F.R. § 33.10.

27. For all the foregoing reasons, Madison, Cohen, and Scott have failed to supervise diligently the handling by their partners, officers, employees and agents (or persons occupying similar status or performing a similar function) of all commodity interest accounts that they carried, operated, advised or introduced and all other activities of their partners, officers, employees, and agents (or persons occupying a similar status or performing a similar function) relating to their business as Commission registrants, in violation of Section 166.3 of the Regulations, 17 C.F.R. § 166.3.

28. Each act by Cohen, Scott, and/or Madison that constitutes a failure to supervise diligently the handling by their partners, officers, employees and agents (or persons occupying similar status or performing a similar function) of all commodity interest accounts that they carried, operated, advised or introduced and all other activities of their partners, officers, employees, and agents (or persons occupying a similar status or performing a similar function) relating to their business as Commission registrants, including but not limited to those specifically alleged herein, is alleged as a separate and distinct violation of Section 166.3 of the Regulations, 17 C.F.R. § 166.3.

V.

By reason of the foregoing allegations, the Commission deems it necessary and appropriate, pursuant to its responsibilities under the Act, to institute public administrative proceedings to determine whether the allegations set forth in Parts I-IV above are true, and, if so, whether an appropriate order should be entered in accordance with Sections 6(c), 6(d), 8a(3) and 8a(4) of the Act, 7 U.S.C. §§9, 15, 13(b), 12a(3) and 12a(4) (1994).

Section 6(c) allows the Commission to enter an order: (1) prohibiting the respondents from trading on or subject to the rules of any registered entity and requiring all registered entities to refuse such person all privileges thereon for such period as may be specified in the Commission's Order; (2) if the respondents are registered with the Commission in any capacity, suspending, for a period not to exceed six months, or revoking the registration of that respondent; (3) assessing against each respondent a civil penalty in the amount of not more than the higher of $110,000 or triple the monetary gain to each respondent for each violation of the Act or Regulations occurring prior to or on October 22, 2000 and a civil penalty in the amount of not more than the higher of $120,000 or triple the monetary gain to each respondent for each violation of the Act or Regulations occurring on or after October 23, 2000; and (4) requiring restitution to customers of damages proximately caused by the violations of the respondents.

Section 6(d) allows the Commission to enter an Order directing that the respondents cease and desist from violating the provisions of the Act and Regulations found to have been violated.

Sections 8a(3) and 8a(4) allow the Commission to refuse to register, to register conditionally, to suspend, to revoke or to place restrictions upon the registration of any respondent who is found to meet any of the criteria for such action by the Commission provided for in Section 8a(3).

VI.

WHEREFORE, IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence and hearing arguments on the allegations set forth in Parts I-IV above be held before an Administrative Law Judge, in accordance with the Rules of Practice under the Act, 17 C.F.R. §10.1 *et. seq.*, at a time and place to be fixed as provided in Section 10.61 of the Rules of Practice, 17 C.F.R. §10.61, and that all post-hearing procedures shall be conducted pursuant to Sections 10.81 through 10.107 of the Rules of Practice, 17 C.F.R. §§10.81 through 10.107.

IT IS FURTHER ORDERED that the Respondents shall file an Answer to the allegations against them in the Complaint within twenty (20) days after service pursuant to Section 10.23 of the Rules of Practice, 17 C.F.R. §10.23, and pursuant to Section 10.12(a) of the Rules of Practice, 17 C.F.R. §10.12(a), shall serve two copies of such Answer and of any document filed in this proceeding upon Bernard J. Barrett, Louis V. Traeger, or David S. Brown, Attorneys, Commodity Futures Trading Commission, Division of Enforcement, 10900 Wilshire Boulevard, Suite 400, Los Angeles, CA 90024, or upon such other counsel as may be designated by the Division. If the Respondents fail to file the required Answer or fail to appear at a hearing after being duly served, they shall be deemed in

default, and the proceeding may be determined against them upon consideration of the Complaint, the allegations of which shall be deemed to be true.

IT IS FURTHER ORDERED that this Complaint and Notice of Hearing shall be served on the Respondents personally or by certified or registered mail forthwith pursuant to Section 10.22 of the Commission's Rules, 17 C.F.R. §10.22.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of the investigative or prosecutorial functions in this or any factually related proceeding will be permitted to participate or advise in the decision upon this matter except as witness or counsel in proceedings held pursuant to notice.

By the Commission

Dated: June 6, 2001

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Jean A. Webb
Secretary to the Commission
Commodity Futures Trading Commission