U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581

FRANK J. UDISKEY,	*	
	*	
Complainant,	*	
	*	
v.	*	CFTC Docket No. 98-R081
	*	
COMMODITY RESOURCE CORPORATION,	*	
GEORGE KLEINMAN, and	*	
CHARLES ELIOT STEINHACKER,	*	
	*	
Respondents.	*	
	*	

INITIAL DECISION

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Before: Bruce C. Levine, Administrative Law Judge

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Overview

This is the case of an intelligent and well-educated man -- a man who developed an interest in commodity trading, marshaled the facts he thought were necessary to make a decision he was comfortable with, mulled the decision over for some time and, after a bout of cold feet, took the plunge. With the benefit of hindsight, it turned out to be a poor decision. Now that man wants his money back from the people who helped him lose it. That man is complainant Frank J. Udiskey ("Udiskey") and he wants respondents Commodity Resource Corporation, George Kleinman and Charles Eliot Steinhacker to restore his trading losses.

In an effort to get his money back in this forum, Udiskey accused respondents of fraud and failing to provide commodity trading advisory disclosures. His drive toward compensation foundered, however, at the oral hearing in this matter. Udiskey simply failed to prove that respondents defrauded him. In addition, he failed to prove entitlement to any disclosures other than those which he received. Accordingly, for reasons set out below, the Court **FINDS** that Udiskey is not entitled to recovery in reparations and **DISMISSES** his complaint.

Procedural History

Complainant Udiskey is a 39-year old Internal Revenue Service agent, who resides at 2150 Sturges Highway, Westport, Connecticut.[1] He has a B.S. in accounting and performs tax audits of individuals and small businesses.[2] His fiancé, 43-year old Joanne Muskus ("Muskus"), resides at 2150 Sturges Highway, Westport, Connecticut, also has a B.S. in accounting and has an M.B.A. in corporate finance as well.[3] She is a certified public accountant who worked at Arthur Andersen and currently presides over of her own accounting firm.[4]

In November 1995, both Udiskey and Muskus opened separate, managed commodity accounts with respondents George Kleinman ("Kleinman") and Commodity Resource Corporation ("CRC") for the

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[1] Transcript of Oral Hearing, United States District Court, New York, New York, July 10, 1998 ("Tr."), at 8. Prior to his employment with the Internal Revenue Service, Udiskey was the controller of a closely held advertising agency. Complainant's Response to Discovery Request, dated May 19, 1998, ¶1.

[2] Tr. at 9, 55 (Udiskey).

[3] Tr. at 124, 131-33 (Muskus).

[4] Tr. at 131, 135-37 (Muskus).

purpose of speculation.[5] Both accounts were traded in the same manner[6] and, over time, both lost money. While Muskus cut her losses and closed her account in early June 1996 after losing $14,393,[7] Udiskey continued to trade until the end of January 1997, losing $35,648.[8] In February 1998, both filed reparations complaints, seeking their money back.[9] Although both complaints name the same respondents and contain nearly identical

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[5] Kleinman is a registered Associated Person ("AP"), president and sole shareholder of CRC. Commodity Futures Trading Commission Reparations Complaint Form, dated January 22, 1998 ("Complaint"), ¶¶1, 6; Answer of Commodity Resource Corporation and George Kleinman, dated March 20, 1998, at p.1. CRC is a registered Introducing Broker ("IB"). Commodity Futures Trading Commission Registration Records.

[6] Tr. at 231, 255 (Kleinman).

[7] Tr. at 153 (Muskus); Complaint, ¶44.

[8] Complaint, ¶48.

[9] See infra note 10.

allegations,[10] this Court considers only Udiskey's complaint.[11]

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[10] Udiskey elected to have his complaint adjudicated as a formal decisional proceeding under Subpart E of the Rules Relating to Reparations ("Reparation Rules"), 17 C.F.R. §§12.300-315. Since Muskus claimed damages of less than $30,000, she could not avail herself of this option. Accordingly, she elected to have her complaint heard under the less formal, summary decisional procedures contained in Subpart D of the Reparation Rules, 17 C.F.R. §§12.200-210. See Muskus v. Commodity Research Corp., CFTC Docket No. 98-R080, 1999 WL 118165 (JO Mar. 5, 1999) (appeal pending). This precluded the complaints from being consolidated for hearing. See Letter from R. Britt Lenz, Director of the Office of Proceedings, to Charles Eliot Steinhacker, dated April 1, 1998; Letter from George Kleinman, President Commodity Resource Corp., to R. Britt Lenz, Director of the Office of Proceedings, filed March 25, 1998; Letter from Charles Steinhacker to Office of Proceedings, filed March 24, 1998.

[11] Complaint, with exhibits: Fairfield, Connecticut Continuing Education Course Catalogue 18 ("Exhibit A"), Part Three of "Understanding the Commodity Futures Markets," ("Exhibit B"), Blue Chip Trades Newsletters, dated February 1993 and November 1992 (collectively, "Exhibit C"), Historic Price Charts of the Dollar Index, "January Effect," Coffee and the British Pound (collectively, "Exhibit D"), a September 1990 article from Corporate Report Minnesota, an article from Fortune's 1990 Investor's Guide and an advertisement describing CRC's past performance in the United States Trading Championship (collectively, "Exhibit E"), Letter from George Kleinman, President of CRC, to Frank Udiskey, dated November 29, 1995 ("Exhibit F"), Explanatory Statement ("Exhibit G"), Udiskey's monthly account statements ("Exhibit H" or "Monthly Account Statements"), Acknowledgement of Conflict of Interest ("Exhibit I").

Udiskey's four-count Complaint alleges that respondents collectively caused his trading losses by (1) failing to provide a risk disclosure document in violation of Commission Regulation, 4.31, 17 C.F.R. §4.31, (2) unauthorized trading, (3) churning his discretionary account and (4) failing to diligently supervise the activities of their agents in violation of 17 C.F.R. §166.3. Complaint, ¶¶49-63.

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On July 10, 1998, the Court conducted a one-day oral hearing in this matter at the United States District Court for the Southern District of New York in New York, New York.[12] At the

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Respondents, initially appearing pro se, filed answers generally denying the allegations in the Complaint. General Response, dated March 20, 1998, with exhibits: Letter from Fred P. McIntyre to Office of Proceedings, dated March 17, 1998, Excepts from course materials "Understanding the Commodity Futures Markets;" Answer of Commodity Resource Corporation and George Kleinman, dated March 20, 1998, with exhibits: Testimony of Glenn Toth ("Exhibit 1"), Customer Agreement ("Exhibit 2" or "Customer Agreement"), Risk Disclosure for Futures and Options ("Exhibit 3"), Discretionary Account Agreement and Acknowledgement of Conflict of Interest (collectively, "Exhibit 4"), Explanatory Statement ("Exhibit 5"), Request for Taxpayer Identification ("Exhibit 6"), Commodity Resource Corporation advertisement ("Exhibit 7"), Spreadsheet of Udiskey's account activity prepared by Kleinman ("Exhibit 8"), Course syllabus for "Understanding the Commodity Futures Markets" ("Exhibit 9"), Monthly account statements for January and February 1997 ("Exhibit 10," included as part of "Monthly Account Statements"). See Notice of Appearance, dated June 10, 1998.

The Court notes that each of the account-opening documents produced by Kleinman contains Udiskey's signature. While Udiskey produced copies of two of the documents, the Acknowledgement of Conflict of Interest and the Explanatory Statement, it appears that his signature on both copies was whited-out. See Exhibits G and I.

[12] Just before the oral hearing, Udiskey's counsel must have had some free time on his hands. Apparently to fill that void, he filed, on behalf of his client, a motion to amend Udiskey's complaint. Complaint's Motion to Amend Complaint, filed July 7, 1998. Udiskey sought leave to amend one of the Complaint's headings, but assured the Court that "[n]o new allegations [were] being made" as a result of the proposed amendment. Id. Because

(continued..)

oral hearing, the Court heard the testimony of complainant Udiskey, his fiancé, Muskus, and respondents Charles Eliot Steinhacker ("Steinhacker") and Kleinman. The parties have filed post-hearing briefs and the matter is ripe for decision.[13]

Steinhacker's Seminar

One day in the summer of 1995, Udiskey read a community adult education flier "that's sent to every resident of Fairfield and Westport," Connecticut.[14] One course struck his fancy.

> **"UNDERSTANDING THE COMMODITY FUTURES MARKETS (2 SESSIONS)**
>
> 1. How to open and trade your own commodity futures account.
>
> 2. How to utilize a prudent, business-like approach to trading the markets.

(..continued)

the motion sought to introduce no new allegations, among other reasons, the motion is **DENIED**.

[13] Complainant's Post Hearing Brief, dated August 19, 1998 ("Complainant's Brief"); Post-Hearing Brief of Respondents Commodity Resource Corp., George Kleinman and Charles Steinhacker, dated September 15, 1998 ("Respondents' Brief").

[14] Tr. at 11 (Udiskey).

3. How to convert this conservative, low risk methodology into the ideal business.

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

Charles Steinhacker is the editor of the BLUE CHIPS TRADES NEWSLETTER and has been a commodity futures trader for the past 20 years.
TWO SESSIONS: September 22, 29

Charles Steinhacker	Monday
TMS	7:30-9:30
106	

COURSE FEE: $35 FOR ALL PARTICIPANTS"[15]

Steinhacker, the course's instructor, is a 61-year old graduate of Dartmouth College, with a masters degree from New York

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[15] Exhibit A (emphasis in original). In examining Steinhacker, Udiskey's counsel expressed some confusion as to whether the course that Udiskey attended ran for two or three sessions, and whether, if it ran for three sessions, Udiskey skipped one of them. Tr. at 163, 194-198 (Steinhacker). It so happens that Udiskey took Steinhacker's commodity course in Stamford, Connecticut, while his fiancé, Muskus, took Steinhacker's course in Fairfield, Connecticut sometime later. Tr. at 197-98 (Steinhacker). Steinhacker's unchallenged testimony establishes that the Stamford course ran for three sessions while the Fairfield course attended by Muskus ran for two. Tr. at 198. It appears that Udiskey's counsel (who also represents Muskus in her reparation action) confused her flier with Udiskey's in their case submissions. See Exhibit A (containing handwritten notation "Fairfield Continuing Ed."). Nonetheless, all of Steinhacker's courses were promoted with "the same synopsis." Tr. at 198 (Steinhacker). Lastly, the synopsis was outdated in identifying Steinhacker as "the editor of the BLUE CHIPS TRADES NEWSLETTER." The newsletter had ceased publication in 1993. General Response at 5; Tr. at 173 (Steinhacker) (characterizing the course description as prepared "back in 1993").

University.[16] He is a professional photographer of some distinction.[17] He also finds the subject of futures trading "extremely fascinating," so much so Steinhacker "decided that [he] wanted to teach it in the continuing education program."[18]

Originally an AP for Eiger Futures Management, Inc., Steinhacker became an AP for respondent CRC around the time he taught Udiskey's class.[19] As a CRC AP, Steinhacker received 40 percent of the gross commissions for all customers he referred to the firm.[20] Steinhacker had a dream of expanding the scope of his seminar and trader referral business to encompass "large seminars in major cities."[21] He associated with CRC, at least in part, because its owner, Kleinman, expressed an interest in

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[16] Tr. at 160 (Steinhacker).

[17] Tr. at 160 (Steinhacker) ("I have been a photographer all my life. I have worked for National Geographic and Life magazines and have been on assignment for most of the major magazines. I have published four books of photographs.").

[18] Tr. at 160-61 (Steinhacker). The continuing educational institutions paid him "10 to 20 dollars an hour" for teaching his seminar. Tr. at 180-81 (Steinhacker).

[19] Commodity Futures Trading Commission Registration Records. See Tr. at 161 (Steinhacker) ("I was also registered as an AP and there was some possibility of some of the students being clients.")

[20] Tr. at 180 (Steinhacker).

[21] Tr. at 178 (Steinhacker).

funding Steinhacker's hoped-for expansion. However, Kleinman's interest in investing in Steinhacker's seminars depended on Steinhacker's modest beginnings proving successful.[22]

Udiskey testified that he was prompted to take Steinhacker's futures course by the flier's lure of a "low risk methodology" for trading.[23] On this score, the Court has little reason to doubt Udiskey. Indeed, Steinhacker had intended this effect in composing his course synopsis for the flier.[24]

Steinhacker's "fascination" with commodities trading was matched by his optimism. Promoting a "low risk" trading approach to his seminar participants, he explained,

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[22] Such success was not to be. As it happens, over "600 or more" students attended Steinhacker's seminars over a five-year period, yet the seminars generated only 15 to 18 trading referrals. Tr. at 163-64 (Steinhacker); Tr. at 168 (Steinhacker) ("I wasn't too successful in bringing in new accounts"). Of these 15 to 18 total referrals, Steinhacker referred only "about five" to Kleinman and CRC. Tr. at 218 (Kleinman). As a consequence, Kleinman and CRC never funded Steinhacker's classes and eventually terminated their relationship with him. Tr. at 212 (Steinhacker); Tr. at 252 (Kleinman).

[23] Tr. at 12.

[24] Steinhacker testified that he discussed his "low risk methodology" for trading "only the last few minutes of the entire course." Tr. at 183. When asked why he selected that topic as one of only four bullets describing his course in the flier, Steinhacker explained, "We want -- I guess it helps to get people in the class. One of the reasons would be that there was a way to look at commodity futures trading other than just as a plain gamble." Tr. at 184.

> "I felt that there were two ways to approach the commodity futures market, with a gambler's mentality, with a desire for action, and that includes almost a greedy man. There was a[nother] manner, a prudent, conservative business-like approach which had to do with very disciplined and mechanical money market approach. I felt there were two different ways of approaching the same landscape and I felt that if [the students] were going to stand any chance of succeeding with trades, they would have to choose the latter."[25]

Steinhacker taught his students a remarkably simple strategy. He advocated the concurrent placement of an order to enter into a position and a stop-loss order[26] placed at approximately 95 percent of the value of the underlying position.[27] In the event that the market moves adversely and the value of the position declines by five percent, the stop-loss order becomes a market order and the investor normally is

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[25] Tr. at 173-74.

[26] A stop-loss order is "an order that becomes a market order when a particular price level is reached." The CFTC Glossary: A Layman's Guide to the Futures Industry 38 (Jan. 31, 1997).

[27] Tr. at 174-77 (Steinhacker) ("I would tell them that they would enter their position, they should enter the stop at the same time.").

Steinhacker noted that each investor should determine their own threshold limit for losses but, for the sake of an example, he used 5 percent in class. Tr. at 176.

liquidated from the position before more significant losses can accrue.[28] Conversely, should the market move favorably, the investor need not limit his gains to five percent, but instead, should "let the profits run"[29] (i.e., to a point in excess of five percent). In this manner, the speculator hopes to offset, and ultimately eclipse, any of the accumulated five-percent losses.

Although Steinhacker understood that his cut-the-losers-and-ride-the-winners strategy did not eliminate the relatively high risk inherent in trading commodities futures and options contracts,[30] he nonetheless promoted his "low risk" strategy as a

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[28] Tr. at 176 (Steinhacker) ("If you had $10,000 invested then you shouldn't lose, I guess, [more than] $500 on a single trade.").

Steinhacker credibly testified that he explained to seminar participants that a stop-loss order did not guarantee that a position would be liquidated at the desired price. Tr. at 176-77.

[29] Tr. at 128 (Muskus).

[30] Steinhacker indicated his knowledge of the risks inherent in futures trading in the following exchange.

> The Court: "[I]s there any low risk methodology of futures [or] options trading or just a lower risk?"
>
> Steinhacker: "It's a lower risk."

(continued..)

promising pastime -- even as an occupation.[31]

(..continued)

> The Court: "It is still a relatively high risk?"
>
> Steinhacker: "Yes."

Tr. at 175-76.

[31] Steinhacker expounded further on the meaning of flier bullet number three, "How to convert this conservative, low risk methodology into the ideal business."

> The Court: "If I get this correct, you just answered that question, how to promote this commodity low risk methodology into an ideal business, you put that in there to attract people [to] the class?"
>
> Steinhacker: "There were a lot of people who had been downsized out of corporations who are looking for self-employment at that time, things to do from their homes. This is something that was appealing to those people, I would think, if properly done."
>
> The Court: "I am confused. There are a lot of unemployed people looking to employ their spare time by trading futures?"
>
> Steinhacker: "There are a lot of people who came to this course because they would like to do something other than be a consultant from their home with their computer. That was one of the things they could do."
>
> The Court: "Make a living speculating off a screen at home?"
>
> Steinhacker: "Yes."

(continued..)

Trading With Kleinman And CRC

As the seminar progressed, Udiskey approached Steinhacker about opening a trading account.[32] Udiskey followed-up by calling Steinhacker,[33] who then sent sets of the CRC account forms to both Udiskey and Muskus.[34] The pair's enthusiasm, however, was bounded by caution. Upon receiving the account-opening documents, Udiskey "hesitated," as "something inside of me said maybe I shouldn't [trade]."[35] Although Udiskey filled

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Tr. at 184-85.

[32] Tr. at 195-96 (Steinhacker).

[33] Tr. at 168-69 (Steinhacker).

Muskus opened her account after discussing the course with Udiskey, reading the course materials provided to Udiskey, and engaging in a number of telephone conversations with Steinhacker. Tr. at 139, 151-52 (Muskus). She took Steinhacker's course after she had started trading. Tr. at 139 (Muskus).

[34] Tr. at 28 (Udiskey) ("It had two articles, I guess, about George Kleinman. It had the risk disclosure statement, I believe a tax statement, W-4 or W-9, one of them. It had a fee structure in it. It was like a folder with a business card stuck in.").

[35] Tr. at 31 (Udiskey).

out the forms on November 18, 1995,[36] he did not feel comfortable forwarding them to Kleinman. As he explained,

> "I started to get cold feet and basically didn't do anything. I was reading articles on trading to get some background information on my own. I checked with the CFTC about Mr. Kleinman and found out there was some kind of thing going on in 1989."[37]

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[36] Udiskey signed and dated his account-opening documents November 18, 1995. See Exhibits 2-6.

[37] Tr. at 30.

During the oral hearing, Kleinman provided his version of the 1989 "goings-on."

> James B. Koch (Koch"): "[H]ave you ever been named in any arbitration or reparations action prior to Mr. Udiskey and Ms. Muskus?"
>
> Kleinman: "Yes."
>
> Koch: "That was an NFA [National Futures Association] sanction [sic]?"
>
> Kleinman: "Yes."
>
> Koch: "What was the nature of that, do you recall the allegations against you?"
>
> Kleinman: "It was a client that basically put out his own trades and he accused me of putting the trades on for him. It was a non-discretionary account, he lost money, tried to shake me down and get the money back."
>
> Koch: "What was the result of the arbitration?"
>
> Kleinman: "I won it."

(continued..)

Finally, after a short period of research and rumination, Udiskey and Muskus took the plunge. By the end of November 1995, each had opened separate, managed accounts with Kleinman and CRC with separate, $10,000 deposits.[38]

In a November 29, 1995 introductory letter received by Udiskey and Muskus, Kleinman described his technique for trading managed accounts.

> "We are pleased you've decided to open a managed account with us and are looking forward to a long and mutually rewarding relationship.
>
> . . . .
>
> [W]e are quick to cut our losers, and we try to never let a reasonable profit, once achieved, turn into a loss.

(..continued)

> Koch: "Is it fair to say that you have never been in any other arbitration or reparation action?"
>
> Kleinman: "That's correct."

Tr. at 220-21.

[38] Monthly Account Statements; Tr. at 90-91 (Udiskey); Tr. at 145, 151 (Muskus).

> We use risk points (stops or options) on every trade to limit our loss if the trade is not working. Many of our trades may result in only a modest profit or loss. The reason for this has to do with the fact we look to limit our loss or 'lock in a break-even' on each trade as soon as feasible. Additionally, if there is any 'danger signal,' whether the trade is profitable or not, we have found it better to exit the trade as soon as possible. (Hoping is not a recipe for success in our business.)
>
> If our trading methods are working properly, there will be a small number of 'significantly' profitable trades each year. These will be the trades which will allow us to achieve our major objectives. We've found through experience that we cannot always predetermine which trades these will be, but when they come, these few trades should more than offset the numerous losers."[39]

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[39] Exhibit F at 1.

From this letter, Udiskey understood that Kleinman shared Steinhacker's basic technique, "take the quick loss and let the profits run, basically." Tr. at 35 (Udiskey).

At the hearing, Kleinman generally described his quest to outperform the market.

> "I have been trading for 20 years. Basically, I tried to form a fundamental opinion first. I do a lot of research, reading. There are services that I pay for, for example, the Stark's Service, the Resource Revco. I take all the information, I put it together, I try to form an opinion as to where I think the market is going to go based on the information that is out there. Once I form an opinion, I start to develop a strategy. I get into a position and I base that on some technical indicators that I use. I personally like moving around. That's what I use to help determine the trade, the market numbers, the fundamentals and if trends

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The trading for Udiskey and Muskus began. From the very beginning, Kleinman generally assumed positions in the futures market and hedged each position with a corresponding option.[40] Using this strategy, Kleinman attempted to generate gains on either position sufficient to overcome any losses incurred on the other. At the outset, this approach proved successful for Udiskey and Muskus.

(..continued)

> appear to be moving my way. I looked at the old positions. When the trend turned against my fundamental opinion, the fundamentals appear to change. I would lose the position."

Tr. at 229-30.

[40] Monthly Account Statements. For example, on January 16, 1996, Udiskey's account acquired a long position of five March corn contracts at a price of 3.61 and, on January 19, a corresponding short position of one March call with a 3.60 strike price. In February, Udiskey liquidated the March corn positions for a loss of $106.24 on the futures position, and a $230 gain on the option. Id.

Kleinman also assumed naked futures positions (presumably protected by stops). For example, in January 1996, alone, he entered and offset futures positions in crude oil, wheat and Swiss francs for gains ranging from $5 to $406. This practice continued into February when Kleinman started trading copper and coffee futures. Id.

After the first month of trading, Udiskey's $10,000 investment had increased to $12,450. Upping the ante, Udiskey deposited $5,000 on January 5, 1996, $5,000 on January 9, 1996, and $10,000 on January 25, 1996.[41] As Kleinman continued to execute profitable trades, Udiskey deposited an additional $10,000 on February 20, 1996. By March 29, 1996, Udiskey's $40,000 investment had grown to $47,538. Udiskey subsequently deposited an additional $8,000 on April 8, 1996.[42]

Beginning in April 1996, Udiskey's account value experienced a slow, steady decline that continued until Udiskey closed his account in February 1997. By the end of April 1996, Udiskey's $48,000 investment declined to $41,311.[43] By the end of June

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[41] As Kleinman explained,

> "Both Mr. Udiskey and Ms. Muskus wanted to be aggressive in the account initially when things were going well, trade additional contracts. I told them they didn't have enough money in the account. . . . I said when your account is up to $30,000 then we will get to the next level . . . ."

Tr. at 255.

[42] Monthly Account Statements.

[43] In April 1996, Kleinman liquidated three July coffee futures contracts for a loss of over $6,300. As a result of this loss and the decline in value of a substantial hedged position in November soybeans and a short futures position in December corn, (continued..)

1996, the account value declined to $31,035.[44] At that point, Kleinman had closed all open positions.[45] Although Kleinman was

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this was the first month in which Udiskey's account value dropped below his sum deposits. Id.

[44] In May, the losses continued to escalate. In what appears to have been an attempt to offset the growing losses in his position of 30 December corn contracts, Kleinman assumed a position in 30 July corn contracts, that he quickly offset for a $4,000 loss, while concurrently offsetting the 30 December corn contracts (carried over from April) for a $3,600 loss. Id.

Similarly, the value of Udiskey's 70 long November soybeans contracts continued to decline from its high in April. Kleinman offset 20 of them for nearly $11,500 in profit. Note, however, that, by the end of May, the remaining 50 futures contracts and the corresponding 14 calls written by Kleinman to hedge those futures totaled an unrealized loss of over $7,000. On May 31, Udiskey's account value totaled $37,876. Id.

Throughout June, Kleinman liquidated Udiskey's November soybean positions. By the close of business on June 13, Kleinman had liquidated all of the November soybean options and 25 of the 50 futures contracts for approximately $3,500 in gains. And on June 26, Kleinman liquidated the remaining November soybean futures contracts for a loss of over $16,000. At the end of June, Udiskey's account value totaled $31,035. Id.

[45] Kleinman traded all of his managed accounts alike. Tr. at 255 (Kleinman) ("I treat all the [managed] accounts the same, if an account had 53 contracts or one contract"); Tr. at 231 (Kleinman) ("I said that this is a discretionary account. Basically, I said that is what I think, this is what I am doing. You should agree with the trading, if you don't you don't have to -- you can close the account."). Accordingly, Muskus also began to lose money as the summer approached. By early June, Muskus had enough, and closed her account after losing $14,393. Tr. at 153 (Muskus). At the time, Kleinman was surprised that Udiskey continued to trade. Tr. at 257 (Kleinman) ("Frankly I was surprised when Ms. Muskus

(continued..)

able to slightly increase the value of Udiskey's value to $36,744 by the end of July,[46] losses continued to mount. By September, the account value had decreased to $24,326, and to $15,637 by the end of December.[47]

After the losses continued for more than nine months, Udiskey decided to close his account. On February 6, 1997, pursuant to Udiskey's request, CRC remitted a check of $12,352.31 to Udiskey for the remaining balance.[48] A year later, on

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closed the account that he didn't call the same day and close it as well, because they were basically kind of a team."); see also Tr. at 153-54, 156-57 (Muskus). As Udiskey explained, "She had lost confidence in Mr. Kleinman, I [still had] confidence in him. That's the difference." Tr. at 102.

[46] Monthly Account Statements.

[47] For the remainder of 1996, Kleinman did not alter his general trading strategy. He continued to trade in a number of markets. Kleinman assumed many small-volume, long futures positions hedged with options in Swiss Francs, cattle, silver and crude oil. He also assumed larger-volume naked futures positions in both November soybeans and December corn. Only when the losses continued to exceed the gains did the size of his positions diminish. By the end of December, he was trading only one contract at a time. Id.

[48] In the Complaint, Udiskey claims that he closed his account on January 31, 1997. Complaint, ¶¶41, 46. However, his account statements indicate that Kleinman carried three open option positions into February. Monthly Account Statements. It appears that Kleinman subsequently liquidated those positions on February 3 and 4, and then directed the futures commission merchant to remit a check to Udiskey on February 6, 1997. Id.

February 9, 1998, both Udiskey and Muskus filed individual reparations complaints. In the end, Kleinman's efforts to "cut[] the losses"[49] and "let[] the profits run"[50] resulted in Udiskey losing a total of $35,647.69.

Udiskey Failed To Establish That Steinhacker Fraudulently Misrepresented The Risk Of Trading

The core of Udiskey's claim focuses on alleged misrepresentations made by Steinhacker during his multi-day seminar. Although not clearly articulated in his Complaint,[51]

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[49] See supra note 44.

[50] Id.

[51] In this regard, the lawyering by Udiskey's counsel certainly could have been better. Nonetheless, despite some missteps in the Complaint in stating the nature of Steinhacker's promoted trading strategy, see e.g. Respondents' Brief at 2, and some inartful pleading that appears to confuse fraudulent inducement with unauthorized trading, Complaint at Count III, the Complaint provided respondents with sufficient notice to defend against the claims discussed herein. See Lehoczky v. Gerald, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,441 at 42,921 (CFTC June 12, 1995) (In determining whether an issue has been properly raised and litigated by the parties to a proceeding, the Commission has followed a pragmatic approach that balances notice and a fair opportunity to defend. (citations omitted)). The Commission also recognizes that complainants, like Udiskey, may abandon claims as the proceeding progresses. Id. (citing Morris v. Stolter & Co., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,080 at 38,049 n.28 (CFTC June 27, 1991)).

Udiskey's primary claim for recovery is that Steinhacker misrepresented the risks associated with his "conservative" strategy of trading futures and options and, in so do, materially misled Udiskey into undertaking his ill-fated trading with Kleinman and CRC.

What did Steinhacker convey to Udiskey about the risks of trading? There is no dispute that Steinhacker was an unabashed optimist in promoting his "conservative" approach to trading futures and options. His flier promoted his trading methods as "low risk," and he stood by this characterization at the hearing.[52] He even touted commodities speculation as an "appealing" business opportunity for his students seeking new employment -- "if properly done."[53] Without more, however, these

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[52] Tr. at 183.

> The Court: "I notice here [the flier] says 'low risk' methodology. It doesn't say 'lower risk.' Was that a mistake?
>
> Steinhacker: "No."
>
> The Court: "I was 'lower,' it wasn't 'low risk?'"
>
> Steinhacker: "It was [a] low risk methodology."

Id.

[53] Tr. at 184-85.

claims and opinions remain too vague, general, soft and subjective to constitute actionable fraud.[54] Even the term "low risk" has little definite meaning (either as an opinion, conclusion or a claim) unless evaluated within the larger context in which it used and explained.[55]

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[54] Howard v. Haddad, 962 F.2d 328, 331 (4th Cir. 1992) (Powell, J., sitting by designation) (finding that statements such as "the stock was a good investment" and "the stock was a good opportunity" are puffery and are not actionable under the securities laws); accord San Leandro Emergency Med. Plan v. Philip Morris, 75 F.3d 801, 811 (2nd Cir. 1996) (finding statements such as Philip Morris is "'optimistic' about its earnings" and Philip Morris "'expected' Marlboro to perform well" are "puffery [which could not have] misled a reasonable investor" and are not actionable as fraudulent misrepresentations); Raab v. General Physics Corp., 4 F.3d 286, 289-290 (4th Cir. 1993) (finding that statement such as "the DOE Service Group is poised to carry the growth and success of 1991 well into the future" is simply a "mere expression of optimism from company spokesmen" and is a statement which lacks materiality); Indemnified Capital Invs. S.A. v. R.J. O'Brien & Assocs., Inc.,, 12 F.3d 1406, 1413 (7th Cir. 1993) ("[T]he representation of the O'Briens' 'highly successful trading ability,' made in the context of soliciting a customer, can be construed as nothing but an opinion and not a false statement of material fact. If actions for fraud could be successfully maintained every time someone optimistically represents his or her trading abilities, then our courts would be hopelessly deluged with fraud suits."); LaScola v. US Sprint Communications, 946 F.2d 559, 568 (7th Cir. 1991) (ruling that statements such as: "the company has a lucrative compensation plan;" "the executives are 'straight shooters;'" and "US Sprint is ethical and committed to conducting business in accordance with the law" are not actionable as fraudulent misrepresentations).

[55] See Levine v. Refco, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,488 at 36,115 n.5 (CFTC July 11, 1989).

At the hearing, both Udiskey and Muskus testified as to Steinhacker's representations as to what "low risk" meant. They testified that Steinhacker characterized his method of trading as no more risky than the stock market.[56] According to Udiskey and Muskus, Steinhacker quantified the expected profit and risk associated with his method of stopping-out losers and riding winners: annualized returns of 0-300 percent could be expected, and losses on any given trade would be limited to five percent.[57]

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[56] Tr. at 20 (Udiskey) ("He said it was as risky or less than the stock market and that basically he would manage the risk. It was low risk."); Tr. at 128 (Muskus) ("It was lower risk than the stock market, because the risk was going to be managed.").

[57] Tr. at 20-22 (Udiskey).

> Alex F. Arreaza ("Arreaza"): "How was the low risk characterized, were there characteristics of it?"
>
> Udiskey: "Basically this came in the questions. Basically the questions were put to him directly, asking what are the potential profits, what was the expected rate of return. He said 0 to 300 percent."
>
> . . . .
>
> Arreaza: "Did he speak about any potential loss?"
>
> Udiskey: "They would be small or minimal. That was the whole key to the thing, the money management technique limited the losses by getting out of the position very quickly and also limiting your position by five

(continued..)

Steinhacker, however, disputes Udiskey's and Muskus's version of what he told them. He denied equating the risk of commodities trading to equity trading.[58] He testified that, in his seminar, he discussed risk "[a]ll the time,"[59] and that he explained to his students how leverage made futures and options much more risky than stocks.[60] Steinhacker also testified he never guaranteed that trading losses could be limited to five percent and, in asserting the contrary, Udiskey and Muskus grossly distorted his discussion of stop-loss orders as a risk management device.[61] Steinhacker insisted that while he was (and

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(..continued)

> percent. That was another facet to the whole program."

Id. See also Tr. at 75 (Udiskey); Tr. at 128 (Muskus) ("The very most that you could ever lose was the five percent."), Tr. at 129 (Muskus) ("[Y]ou could expect supposedly 0 to 300 percent in a good year on your investment. This all sounded very good to me."); Tr. at 141-42 (Muskus).

[58] Tr. at 177.

[59] Tr. at 167.

[60] Tr. at 167 ("They know perfectly well what risk is. We go into, discuss [that] leverage is a double-edged sword, what makes the commodity futures trading so risky compared to stock trading.").

[61] Tr. at 176-77.

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Koch: "Did you ever tell Ms. Muskus that you can only lose five percent of the amount of the investment that she invests in a market or position?"

Steinhacker: "No. The only time I mentioned five percent was in class. It was one figure you could put on risk. In other words, you could decide that you wanted to risk five percent of your investment and therefore you will stay out of serious trouble if you make sure that your stop was no further away than that."

Koch: "I am not sure I understand. I am asking if you recall X amount of money invested, how was this five percent raised?"

Steinhacker: "If you had $10,000 invested than you shouldn't lose, I guess, [more than] $500 on a single trade. This is for people who are trading their own accounts.

Koch: "How would that five percent be effected?"

Steinhacker: "By putting a stop that protected the other 95 percent of your funds."

Koch: "Was there any discussion about whether stops still fail?"

Steinhacker: "Of course, stops are run all the time. I mentioned that to the students, there is no guarantee that you are going to do that, it's just what you would plan to do."

Id.

is) optimistic about the prospects for trading his system,[62] he

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[62] Tr. at 190-91.

> Arreaza: "Is it safe to say that you would have to explain now the risk involved with commodities?"
>
> Steinhacker: "Yes and that's what I did."
>
> Arreaza: "You also said that you are teaching, you told them this was a high risk in class?"
>
> Steinhacker: "Of course I did."
>
> Arreaza: "That it was a volatile area of trading commodities?"
>
> Steinhacker: "I don't understand what you are saying."
>
> Arreaza: "You spoke about the high risk involved in commodities, is that what you are saying?"
>
> Steinhacker: "Yes, over and over again."
>
> Arreaza: "You also talked about [a] prudent approach, how to do this in a low risk?"
>
> Steinhacker: "Yes, how to minimize the risk."
>
> Arreaza: "How do you reconcile the two?"
>
> Steinhacker "I don't have any problem with it myself. I'm telling them how they might if they trade themselves go about minimizing the risk."

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never guaranteed its success.[63]

(..continued)

> Arreaza: "You taught them how to be in this volatile area and how to trade in a more conservative manner, is that correct?"
>
> Steinhacker: "That's at the very end of the course, yes."

Id.

[63] Tr. at 203

> Arreaza: "Going back to the prudent system that you were teaching, what were the safeguards that you talked about to make it low risk?"
>
> Steinhacker: "Basically it was very important to use very strict disciplined money management techniques where you employed stops that conserved those [positions], that you employed the stops at the same time that you put in your initial position so that there was no fudging it."
>
> Arreaza: "The stops?"
>
> Steinhacker: "The stops, yes."
>
> Arreaza: "Did you speak about the possible running through the stops?"
>
> Steinhacker: "Yes, that's always a possibility. No guarantees in futures trading, it was something that was the theme of the course."

Id.

It is here that the Court begins its fact-finding labors. In seeking to determine what message Steinhacker conveyed in his seminar, the Court (not surprisingly) is confronted by competing versions of the truth. Did Steinhacker make material misrepresentations of fact concerning the risks and profitability of trading (as Udiskey and Muskus claim)[64] or merely express a non-actionable general opinion[65] as to the hoped-for success of his favorite trading approach (as Steinhacker claims)?[66] This inquiry requires the Court to assess the credibility of the witnesses, and evaluate their reliability in light of the record

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[64] A finding of actionable fraud requires a finding of materiality. A statement is "material if it is substantially likely that a reasonable investor would consider the matter important in making an investment decision." Sudol v. Shearson Loeb Rhoades, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,748 at 31,119 (CFTC Sept. 30, 1985). Misrepresentations concerning risk and profit are material as a matter of law. In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,928 (ALJ June 5, 1998), aff'd in part rev'd in part, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 (CFTC Dec. 18, 1997); Sudol, ¶22,748 at 31,119; Gordon v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,016 at 23,981-82 (CFTC Apr. 10, 1980).

[65] See supra note 54.

[66] Albeit a pollyannaish opinion. See In re R&W Technical Services, Ltd., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,193 at 45,727 n.75 (CFTC Dec. 1, 1997) (discussing efficient market model); In re Staryk, ¶26,701 at 43,931 & n.96.

viewed in its entirety.[67] As discussed below, this assessment favors Steinhacker's testimony over that of Udiskey and Muskus.[68]

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[67] Secrest v. Madda Trading Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,627 at 36,696-97 (CFTC Sept. 14, 1989). This task requires the Court to make both "testimonial" and "derivative" inferences. The former are made from direct observations of the demeanor of the witness while the latter are drawn from the substance of the evidence. See Ryan v. CFTC, 145 F.3d 910, 918 (7th Cir. 1998).

For Udiskey to prevail, he must establish his version of the truth by the preponderance of the evidence. In re Citadel Trading Co., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,082 at 32,190 (CFTC May 12, 1986) ("The judge must carefully review the record in an effort to separate appearance from reality. The issue is not what could have happened, it is rather what the preponderance of the evidence shows most likely did happen."); see also, King v. First London Commodity, Ltd., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,201 at 29,102 (CFTC May 25, 1984). The burden of proof on all material issues lies with complainant. This burden extends to issues of credibility. See Guiberson v. United States, Case No. 76-34-C2, 1978 WL 1250, at *5 (D. Kan. Dec. 13, 1978) (unreported op.); Ackerman v. Medical College of Ohio Hosp., 680 N.E.2d 1309, 1311 (Ohio Ct. App. 1996). In addition, the Court is not obligated to find one side or the other to be more credible. Indeed, there may be occasions when two witnesses, or groups of witnesses may be equally credible or incredible. Under those circumstances, the Court need only find that complainant has failed to establish his version of the facts with requisite certainty. Guiberson, 1978 WL 1250, at *5; Ackerman, 680 N.E.2d at 1311. In other words, a tie in credibility goes against a complainant.

[68] Interest in the outcome of litigation may of course motivate a witness to testify falsely. John Henry Wigmore, Evidence in Trials at Common Law §§945, 948-49, 966 (1970). Interest takes many forms, pecuniary and non-pecuniary. See United States v. Cole, 41 F.3d 303, 309 (7th Cir. 1994); United States v. Dees, 34 F.3d 838, 844 (9th Cir. 1994). Every witness in this proceeding has an obvious stake in the outcome of the litigation sufficient to bias or color the testimony of all but the most scrupulously

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Steinhacker Did Not Guarantee Returns Of Zero To 300 Percent, Guarantee That Losses On Individual Trades Could Be Limited, Or Represent That Commodity Trading Could Be Less Risky Than Equity Trading

Udiskey's and Muskus's general incredibility undermines their claim concerning Steinhacker's misrepresentations of profit

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honest. Udiskey, Steinhacker and Kleinman are parties to this proceeding, and Muskus is a party to a proceeding raising identical and related facts. In these proceedings, the four are wrestling over tens of thousands of dollars. Moreover, as Udiskey's fiancé, Muskus has a personal stake in his well-being.

The Court evaluates Udiskey, Muskus, Steinhacker and Kleinman all to be mortals of the normal sort. As might be expected, each testified in a manner that was generally true to his or her interest. In these circumstances, the Court runs the risk of crediting the testimony of "[]plausible liars." Carr v. Cigna Securities, Inc., 95 F.3d 544, 547 (7th Cir. 1996) (Posner, C.J.). To minimize this risk, the Court approaches the testimony of each with the healthy level of skepticism that such self-serving testimony rightfully merits. This skepticism generally takes the form of a search for consistency, both within and without. This consistency has several dimensions: (1) internal consistency, (2) consistency with prior statements, (3) congruity with other, more reliable evidence, and (4) harmony with the proven surrounding circumstances. In its search for the truth, the Court supplements the results of this exercise with inferences drawn from observation of demeanor. See In re Staryk, ¶27,206 at 45,811.

It is an uncommon case where the fact-finding undertaking compels a conclusion with epistemological certitude. This case is no such rarity. However, when all testimonial and derivative inferences are considered, the Court finds Udiskey and Muskus to have testified no more credibly than Steinhacker and Kleinman. Indeed, they were less credible. Accordingly, their testimony fails to establish complainant's version of the facts disputed in this case.

and risk. At the oral hearing, both Udiskey and Muskus repeatedly labeled themselves as a "conservative" investors[69] unwilling to invest in, what they now know to be, inherently high-risk financial instruments.[70] These self-portraits are

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[69] Tr. at 11 (Udiskey)

> Arreaza: "What kind of investor would you consider yourself?"
>
> Udiskey: [No response.]
>
> Arreaza: "Are you conservative?"
>
> Koch: "Objection, your honor."
>
> The Court: "Sustained, vague and also leading."
>
> Arreaza: "What kind of investor --"
>
> Udiskey: "I would consider myself conservative, index fund, other people doing the managing for me, blue chip stocks."

Id. See Tr. at 13 (Udiskey) ("I'm a conservative person, a conservative investor"); Tr. at 19 (Udiskey) (stating he wanted "conservative style of investing"); Tr. at 93 (Udiskey) (claiming that, in his opinion, he is "a conservative investor"); Tr. at 124 (Muskus) ("[W]e are very conservative people."); Tr. at 128 (Muskus) (" . . . I'm a conservative person. I never made a risky investment in my life. I wanted to be sure the risk was very low."); Tr. at 151 (Muskus).

[70] Tr. at 24-25 (Udiskey).

> Arreaza: "Going back to the class and your making your decision to trade commodities or not, if [Steinhacker] had discussed what you know now, the high risk involved in
>
> (continued..)

incongruous with a record that establishes the two auditors as sophisticated, careful and knowledgeable concerning their decisions to engage in commodities speculation. They are not easily reconciled with the undisputed evidence that Udiskey and Muskus possessed a mass of printed information, provided to them by Steinhacker himself, that starkly contradicted the alleged guarantees of profit.[71] They stand at odds with Udiskey's signed acknowledgments that he read CFTC-required risk disclosures, understood them and "recognize[d] that guarantees of profit or freedom from loss are impossible."[72] In addition, they are in conflict with Udiskey's demonstrated conduct in opening and trading the account.

To begin with, the course materials, that Steinhacker provided to Udiskey, repeatedly highlight the risks associated

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> commodities, would you have pursued investing in commodities?"
>
> Udiskey: "I would not even have taken the class and I definitely would not have invested in commodities."

Id.

[71] Or at the very least, no losses. Tr. at 21-22 (Udiskey) ("0 to 300 percent").

[72] Exhibit 2, ¶12.

with trading commodity contracts. These materials, "Understanding the Commodity Futures Markets," consisted of three parts. The first class addressed Part One, a NFA primer[73] on futures contracts, trading, markets and their participants. The booklet discusses the risks associated with trading commodity contracts in a manner plainly in tension with any simplistic guarantees that profits could be made by use of Steinhacker's (or any other) trading approach, that stop-loss orders are fail-safe, or that commodities speculation is no more risky than equity investing.[74] Given Udiskey's and Muskus's sophistication and

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[73] Tr. at 165, 214 (Steinhacker). Steinhacker had received permission from the NFA to photocopy the booklet for use in his seminar. Tr. at 161-62 (Steinhacker).

[74] For example, the booklet's introduction states

> "Speculation in futures contracts, however, is clearly not appropriate for everyone, just as it is possible to realize substantial *profits* in a short period of time, it is also possible to incur substantial *losses* in a short period of time. The possibility of large profits or losses in relation to the initial capital stems principally from the fact that futures trading is a highly *leveraged* form of speculation. Only a relatively small amount of money is required to control assets having a much greater value. As we will discuss and illustrate, the leverage of futures trading can work for you when prices move in the direction you anticipate or *against* you when prices move in the opposite direction."

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NFA Booklet at 2 (italics in original). Elsewhere, the booklet warns,

> "Futures trading thus requires not only the necessary financial resources but also financial and emotional *temperament*. For example, it can be one thing to have the value of your portfolio of common stocks decline from $200,000 to $190,000 (a five percent loss) but quite another, at least emotionally, to deposit $20,000 as margin and end up losing half or more of it as the result of only a five percent decline."

Id. at 7 (italics in original). See also id. ("If you cannot afford the risk, or even if you are *uncomfortable* with the risk, then the only sound advice is *don't trade*. Futures trading is not for everyone." (italics in original)); id. at 11 (*In no event, it bears repeating, should you participate in futures trading unless the capital you would commit is risk capital*. That is, capital, which in pursuit of larger profits, you can afford to lose." (italics in original)); id. at 11-12 ("You should also understand that, because of the leverage involved in futures, the profit and loss fluctuations may be wider than in most types of investment activity and you may be required to cover deficiencies due to losses over and above what you had expected to commit to futures.").

On the topics of risk management and stop-loss orders, the booklet cautions,

> "[W]hile there are a number of steps which may be taken in an effort to limit the size of possible losses, there can be no guarantees that these steps will prove effective. Well-informed futures traders should, nonetheless, be familiar with available risk management possibilities."

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level of care, it is improbable that they would have been lulled into a contrary understanding by Steinhacker[75] or, that if he had

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Id. at 19.

More specifically,

> **"There can be no guarantee, however, that it will be possible under all market conditions to execute the** [stop-loss] **order at the price specified. In an active, volatile market, the market price may be declining (or rising) so rapidly that there is no opportunity to liquidate your position at the stop price that you have designated. Under the circumstances, the broker's only obligation is to execute your order at the best price that is available."**

Id. at 20 (emphasis in original).

Part Two of the materials, addressed during the seminar's second class, covers contract specifications, the mechanics of placing orders, and statement information. Tr. at 162, 165, 214 (Steinhacker). Part Three, discussed on the third night, illustrates certain trading strategies and provides historical examples. Exhibits B-D; Tr. at 214 (Steinhacker).

[75] The undisputed evidence shows that Udiskey and Muskus were simply too smart to be that dumb. Udiskey, who previously had taken other enrichment courses, Tr. at 60 (Udiskey), decided to enroll in Steinhacker's commodities course, not only to learn about Steinhacker's "low risk" trading approach, but also to learn how futures can be used to "hedge[] your stock and bond portfolio." Tr. at 56-57 (Udiskey). Having attended Steinhacker's seminar, his decision to trade was far from impulsive. It was made in a measured and painstaking fashion.

To begin with, Udiskey sought the counsel of his M.B.A.-degreed fiancé, Muskus. Udiskey kept Muskus "informed on a

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current basis with the Steinhacker course by briefing her on the substance of his lectures and sharing with her all of the course materials." Complaint, ¶9; Tr. at 139 (Muskus). In the words of Muskus, "I read all the materials that Frank had had." Tr. at 139. She read them "from start to end." Tr. at 148 (Muskus). In addition, Muskus later briefed Udiskey "on the substance of" the course that she took with Steinhacker. Complaint, ¶14.

After discussing the seminar with Udiskey and reviewing the course materials, Muskus then proceeded to have "a number of conversations" with Steinhacker. Tr. at 152 (Muskus). Still skeptical, Udiskey "was reading articles on trading to get some background information on my own" and checked out Kleinman with the CFTC before they opened their accounts. Tr. at 30 (Udiskey).

All of the above is directly at odds with Udiskey's self-portrayal as a foolish pawn so mesmerized by Steinhacker's purported tales of rags-to-riches that he failed to attend to the course materials.

> Arreaza: "Mr. Steinhacker started to teach the class right from the beginning?"
>
> Udiskey: "Right."
>
> Arreaza: "What happened go into detail?"
>
> Udiskey: "Basically, the first thing that happened, because of the presentation package [anecdotes] that he gave the class, there was an introduction into how he got involved in commodities. He basically said that by chance or -- I don't know exactly -- he was hanging around an airport and somehow he bought a couple of contracts of silver. He related it back to the Hunt brothers. Miraculously it went up every day, this is great, this is great. Then it came to the conclusion where it amounted to $200,000. He said my wife cashed in and we bought a house. He claimed they just walked in and bought a

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> house and shortly after the market crashed and everybody lived happily ever after."
>
> Arreaza: "What if any explanation did he give you?"
>
> Udiskey: "He didn't give any explanation. He was a very outgoing, very out -- it was a live show, very entertaining. It made an impact. I thought about it all the way home."
>
> Arreaza: "Why did it make an impact?"
>
> Udiskey: "Because it put the seed this could happen to you, maybe you can have a dream, you know, go out and do something like this, you can have a house too. It could happen to you, basically that was the message."

Tr. at 15-16.

When Part One of the class materials were discussed, Udiskey claims that he "just didn't absorb it." Tr. at 110. Between the first and second class, he "perused" the Part One materials that spoke of risk, but inattentively so, because "[m]y mind was still on the [Hunt brothers] story." Tr. at 18. It appears that, in employing the term "perused," Udiskey misapplied it, intending a meaning akin to "skimmed." "Perused" properly means "to read through, as with thoroughness or care" or "examine in detail." The Random House College Dictionary 992 (1973). See also Tr. at 66 ("I was still basking in the glow of the Hunt brothers to tell you the truth.").

This IRS agent's narrative of being absolutely spellbound by a tale told by an unfamiliar adult education instructor is simply ridiculous. The Court observes that Steinhacker's spell over Udiskey was nowhere to be found when Steinhacker sent the account-opening documents to him. Udiskey signed the documents, but delayed in sending them in. He got "cold feet" because he "was just uncomfortable with the commodity investment." Tr. at

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attempted to so do, they would have continued to vest their trust in him as they did in accepting his referral of their business to Kleinman.

Moreover, also before opening their accounts, Udiskey and Muskus both received and signed the CFTC-required risk disclosures and the Futures Commission Merchant Customer Agreement.[76] The risk disclosure statements are unequivocal in echoing the cautionary approach of the NFA booklet: transactions

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30 (Udiskey). He "was reading articles on trading to get some background information on [his] own," and had Steinhacker's recommended broker, Kleinman, checked out with the CFTC. Id. It would be odd indeed that Udiskey would undertake additional research on commodities trading while remaining oblivious to the contents of course materials that Steinhacker provided to him. In light of this, as well as the undisputed attention that Udiskey and Muskus gave to sharing and discussing the course materials, Udiskey's claimed unfamiliarity with their contents is incredible. On this point, the Court finds Muskus considerably more candid in testifying as to the attention that she gave to the risk disclosures in the course materials. Tr. at 148.

The Court's findings are additionally buttressed by its Court's unfavorable assessment of Udiskey's demeanor in testifying. See Respondents' Brief at 19 ("[testimony] meant for the Theatre District, not federal court"). Indeed, the testimony of Udiskey and Muskus -- in contrast to that of respondents -- frequently appeared more coached than candid. In sum, the record provides the Court with ample cause to discredit Udiskey's and Muskus's testimony that Steinhacker guaranteed profits or misrepresented the risks of trading.

[76] Exhibits 2-3; Tr. at 143-44 (Muskus).

in futures and options both "carry a high degree of risk."[77] This message is then repeated once more in the Customer Agreement.[78]

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[77] Exhibit 3 at 1. Moreover, they once again warned them that stop-loss orders may not always be effective in limiting risk.

> **"2. Risk-reducing orders or strategies**
>
> "The placing of certain orders (e.g. 'stop-loss' orders, where permitted under local law, or 'stop-limit' orders) which are intended to limit losses to certain amounts may not be effective because market conditions may make it impossible to execute such orders. Strategies using combinations of positions, such as 'spread' and 'straddle' positions, may be as risky as taking simple 'long' or 'short' positions."

Id. (emphasis in original).

[78] Exhibit 2, ¶12.

> "**RISK ACKNOWLEDGEMENT.** Customer acknowledges that investment in futures contracts is speculative, involves a high degree of risk and is suitable only for persons who can assume risk of loss in excess of their margin deposits. . . . Customer represents that he is willing and able, financially and otherwise, to assume the risks of futures trading. . . . Customer also acknowledges that he has received, read and understands the separate CFTC Rule 1.55 risk disclosure statement relating to the risks in trading futures contracts, the separate CFTC Rule 190.10 disclosure for non-cash margin, and the separate CFTC Rule 33.7 options disclosure statement."

Id. (emphasis in original).

Additionally, in signing the agreement, both Udiskey and Muskus both acknowledged that each

> "recognizes that guarantees of profit or freedom from loss are impossible in futures trading, acknowledges that he has received no such guarantees from Refco or from any of its representatives, and has not entered this agreement in consideration of or in reliance upon any such guarantees or similar representations."[79]

Proof that a customer signed a risk disclosure acknowledgement triggers the rather sensible presumption that the customer read and understood the disclosure statement's contents.[80] Udiskey seeks to overcome this presumption by his testimony that he signed the risk disclosure statements and **"RISK ACKNOWLEDGMENT"**[81] without reading them.[82] Why? Udiskey testified

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[79] Id.

[80] McNally v. Gildersleeve, 16 F.3d 1493, 1499 (8th Cir. 1994); Waters v. International Metals Corp., 172 F.R.D. 479, 486 n.3 (S.D. Fla. 1996). The rationale underlying this rule would support the similar rule that customers who sign certain contractual acknowledgements would be presumed to have acted and have knowledge in accordance with the acknowledgement.

[81] Exhibit 2, ¶12 (emphasis in original).

[82] When pressed on cross-examination, Udiskey waffled.

> Koch: "When you looked at this document, did you see in bold print Risk Acknowledgment?"

(continued..)

that he "trusted Mr. Steinhacker"[83] and Steinhacker expressly told him that the disclosures "will scare the hell out of you and no one in their right mind would sign it."[84] The Court does not

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> Udiskey: "Not in particular."
>
> Koch: "You skipped that part?"
>
> Udiskey: "Basically the reason I skipped it because Mr. Steinhacker said this thing will scare the hell out of you and no one in their right mind would sign it."
>
> Koch: "You skipped reading the risk disclosure acknowledgment, is that your testimony?"
>
> Udiskey: "I don't know what particular -- what paragraphs I read three years ago."

Tr. at 68-69.

[83] Tr. at 119.

[84] Tr. at 68. See also Tr. at 26.

Respondent's use of the colorful "scare the hell out of you" phrase is not in dispute.

> Koch: "Did you ever tell anybody that the risk in trading should scare the hell out of you?"
>
> Steinhacker: "When you see these risk disclosure documents they should scare the hell out of you, yes. That's what I said, yes."

(continued..)

credit Udiskey's explanation. His blind trust in Steinhacker is contradicted by other testimony that Udiskey provided.[85] In addition, it simply strains credulity to believe that he would sign the account-opening documents and hold up forwarding them, precisely because of his concerns about risk, without having carefully read them.[86]

Additionally, once Udiskey and Muskus opened their accounts, Kleinman's unchallenged and fully credited testimony reveals them as a couple that was keenly attentive to commodities trading. Both Udiskey and Muskus spoke with Kleinman "very frequently . .

(..continued)

> Koch: "Did you ever say to the students, [the risk disclosures] would scare the hell out of you, don't read them?"
>
> Steinhacker: "Of course not. You have to read them if you are going to sign your name. You have to read it, of course. I never said that."

Tr. at 167-68. Kleinman's account-opening materials contained similar language. See Exhibit E at 2(b) ("On the other hand, Kleinman readily allows, 'the risk disclosure in my prospectus will scare the hell out of you.'").

[85] Tr. at 30.

[86] On this point too, Muskus more candidly admitted that she read the risk disclosures contained in the Customer Agreement. Tr. at 144.

. many times multi-times in a week."[87] Sometimes, the conversations were three-way.[88] They discussed the accounts' status, the positions taken, and "the markets they were in."[89] Kleinman explained,

> "They asked hundreds of questions. They asked about the market, what the market did today, why do think it went up, why do you think it went down, what the fluctuation of the market was, what did the report say. Increasingly as we got into April, May, June they both were particularly interested in the market, particularly Ms. Muskus. We knew she was doing her own research, she started quoting other people, what they said about the market. She started telling us what the weather reports were going to be."[90]

Indeed, Udiskey was so "impressed with commodity trading"[91] that he approached Kleinman about employment either with his firm or elsewhere in the industry.[92]

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[87] Tr. at 228 (Kleinman).

[88] Tr. at 227 (Kleinman).

[89] Tr. at 228 (Kleinman). See also Tr. at 232 (Kleinman).

[90] Tr. at 231.

[91] Tr. at 170-71 (Steinhacker).

[92] Tr. at 258 (Kleinman); Tr. at 170 (Steinhacker). By the time that he asked Kleinman about employment, Udiskey's trading account had already begun to suffer net losses. Tr. at 232 (continued..)

In short, the conduct of the two auditors, Udiskey and Muskus, further belies that they were of the sort to be bamboozled by some adult education instructor into believing the specious claims that they have attributed to Steinhacker. For all the above reasons, the Court credits Steinhacker's testimony on this issue, over that Udiskey and Muskus, and finds that Steinhacker did not guarantee Udiskey returns of zero to 300 percent or guarantee that stop-losses could not fail or represent that commodity trading could be less risky than equity trading.

Udiskey Failed To Establish That He Relied On The Misrepresentations That He Attributed To Steinhacker

As discussed above, Udiskey seeks compensation based on alleged fraudulent representations made by Steinhacker concerning profit and risk. Also, as discussed above, Udiskey has failed to prove that Steinhacker made the misrepresentations that Udiskey would have this Court attribute to him. Although fatal to the success of his primary theory of recovery, this is not the only shortcoming in Udiskey's proof.

(..continued)

(Kleinman) ("[Udiskey] really enjoyed the market even though he wasn't doing well at the time.").

Under the antifraud provisions of Section 4b of the Commodity Exchange Act ("Act")[93] and Commission Regulation 33.10,[94] recovery depends on more than proof that a respondent made a misrepresentation involving a material fact. Recovery additionally depends on complainant establishing, by the preponderance of the evidence, that the material misrepresentation

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[93] 7 U.S.C. §6b. Section 4b of the Act states, in relevant part:

> "It shall be unlawful . . . (2) for any person, in or in connection with any order to make, or the making of any contract of sale of any commodity for future delivery, made, or to be made, for or on behalf of any other person . . .
>
> (i) to cheat or defraud or attempt to cheat or defraud such other person . . . ."

[94] 17 C.F.R. §33.10. Commission Regulation 33.10 states:

> "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 or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction."

was reasonably relied upon and the proximate cause of his trading losses.[95] Given Udiskey's failure to prove a material

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[95] Proximate causation and reliance are both concerned with the connection between the misrepresentations and the loss. "The concept of proximate causation restricts tort liability to those whose conduct, beyond falling within the infinite causal web leading to an injury, is a legally significant cause." Rodriguez-Cirilo v. Gracia, 115 F.3d 50, 52 (1st Cir. 1997)); Id. at 54 (Campbell, J., concurring) ("Causation in tort law is generally divided into two concepts: causation in fact . . . and proximate causation."); Fedorczyk v. Caribbean Cruise Lines, Ltd., 82 F.3d 69, 73 (3rd Cir. 1996) ("Causation includes cause in fact and legal causation, which is often referred to as proximate cause. Courts have often conflated cause in fact and legal causation into 'proximate cause,' but the two are distinct."). In determining the existence of proximate causation, the Commission looks to whether respondent's violative conduct was a substantial factor in bringing about complainant's loss and also to whether the loss was a reasonably probable consequence of respondent's conduct. Sansom Refining Co. v. Drexel Burnham Lambert, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,596 at 36,562 (CFTC Feb. 16, 1990).

Moreover, in order to succeed, a complainant must prove that he actually relied on the alleged misrepresentations and that the reliance was justified. Steen v. Monex Int'l, Ltd., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,245 at 38,726 (CFTC Mar. 3, 1992) (Gramm, Chairman, concurring) ("However, in order to prevail in a case involving deception or misrepresentation, the customer must . . . prove that he relied on any misrepresentation to his detriment, *and* that such reliance was justified." (italics in original)) (citing Haralson v. E.F. Hutton Group, Inc., 919 F.2d 1014, 1025 (5th Cir. 1990) and Royal American Managers, Inc. v. IRC Holding Corp., 885 F.2d 1011, 1016 (2d Cir. 1989)); Minasian v. Standard Chartered Bank, PLC, 109 F.3d 1212, 1215 (7th Cir. 1997) ("In New Jersey, as in most other states, a person claiming to be the victim of commercial fraud must show that he justifiably relied on the other party's false statement."); Indosuez Carr Futures Inc. v. CFTC, 27 F.3d 1260, 1264-65 (7th Cir. 1994); Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020, 1032 (2d Cir. 1993); Atari Corp. v. Ernst & Whinney, (continued..)

misrepresentation, there is no need to address these additional elements.[96] However, the question of causation merits some discussion based on the facts of this case.

(..continued)

970 F.2d 641, 645-46 (9th Cir. 1992). "Justifiable reliance is not a theory of contributory negligence; rather it is a limitation on a[n] . . . action which insures there is a causal connection between the misrepresentation and the plaintiff's harm. Only when the plaintiff's conduct rises to . . . [reckless] conduct . . . will reliance be unjustifiable." Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1516 (10th Cir. 1983) (citations omitted). A finding of non-reliance suggests the customer would have acted no differently had he known the truth. See Schreider v. Rouse Woodstock, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,196 at 32,514 (CFTC July 31, 1986); Vetrono v. Manglapus, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,702 at 30,984-985 (CFTC Aug. 6, 1985); Jakobsen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,812 at 31,392 (CFTC Nov. 21, 1985) The Court does not assume that, because misrepresentations preceded a transaction, the misrepresentation induced the transaction. Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,225 at 38,650 (CFTC Jan. 7, 1992) ("It is self-evident that every customer loss does not result from injurious conduct . . . . It is also evident . . . that not all violations of the Act cause harm to customers. Even when a statutory violation and customer losses are present in the same set of circumstances, a cause-and-effect relationship is not automatically assumed.").

[96] Recovery under Section 4b of the Act and Commission Regulation 33.10 also requires a showing that a respondent's wrongful representations were committed intentionally or with a reckless disregard for his duties under the Commodity Exchange Act. See In re Staryk, ¶27,206 at 45,810-11; Hammond v. Smith Barney, Harris Upham & Co., Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,617 at 36,659 (CFTC Mar. 1, 1990).

In determining whether a customer justifiably relied on a misrepresentation, the Court must consider the information to which the customer had access. More to the point, "a plaintiff may not reasonably or justifiably rely on a misrepresentation where its falsity is palpable."[97] As discussed above, both the Steinhacker course materials and the risk disclosure statements that Udiskey possessed plainly contradict Steinhacker's alleged oral misrepresentations: that returns of zero to 300 percent were guaranteed, that losses on individual trades could be absolutely limited and that commodity trading could be made safer than the stock market. Having found that Udiskey carefully read both the course materials and the risk disclosure statements, the Court further concludes that Udiskey was not free to "close his eyes to a known risk" and "passively accept[] the contradiction" between Steinhacker's oral statements and these documents.[98]

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[97] Holdsworth v. Strong, 545 F.2d 687, 693 (10th Cir. 1976), cert. denied, 430 U.S. 955 (1977). The "palpably" false requirement ensures that complainants are not subjected to a contributory negligence rule. See Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522, 527-29 (7th Cir. 1985); Zobrist, 708 F.2d at 1517.

[98] Indosuez Carr Futures, 27 F.3d at 1265-66 ("Generally, 'an investor cannot close his eyes to a known risk'"); Brown, 991 F.2d at 1032; Kennedy v. Josephthal & Co., Inc., 814 F.2d 798, 805 (1st Cir. 1987) ("When they closed their eyes and passively accepted the contradictions between Sinclair's statements and the

(continued..)

Moreover, the Court finds that there was another event -- one that occurred prior to Udiskey's initiation of trading and broke any causal chain between Steinhacker's alleged misrepresentations and Udiskey's losses. Before granting to Kleinman discretion to trade Udiskey's account, Kleinman fully discussed the risks that his trading method would entail. According to Kleinman's fully credited testimony, Udiskey called him to discuss opening an account after attending Steinhacker's

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(..continued)

offering memorandum, appellants could not be said to have justifiably relied on the misrepresentations.").

Indeed, under certain circumstances, the palpable falsity of a misrepresentation may stem from a disclosure document that a trader has in its possession, but did not actually read. Cf. Brown, 991 F.2d at 1032. See Kessenich v. Rosenthal & Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,181 at 24,862 n.4 (CFTC Mar. 24, 1981). In general, a trader is charged with constructive knowledge of disclosure documents that a broker provided, even if the trader proved that he did not actually read the disclosure. Myers v. Finkle, 950 F.2d 165, 167 (4th Cir. 1991); Edington v. R.G. Dixon and Co., No. 90-1274-C, 1992 WL 223822, at *5 (D. Kan. Aug. 7, 1992) ("What is imputed is only the knowledge of that information 'actually . . . disclosed' and not the inferences which a knowledgeable investor would draw from the information."). When knowledge of the disclosure is imputed, "the only consequence" is that the Court, in "determining justifiable reliance," "must evaluate the relevant factors as if the plaintiff were aware of the warnings found in the official statement." Id.

adult education seminar.[99] Kleinman followed his standard procedure of methodically discussing the account-opening documents with Udiskey for 30 to 45 minutes.[100] He testified,

> "[Since 1976] I always sit down with the client on the telephone, we go over what is involved in a commodity trading account. I do emphasize risks, because I feel that he should be aware of that, make sure the client is suitable for commodities. We talk about how the market works. I tell them there is no guarantee, if you make a lot of money in a short period of time you can also lose a lot of money in a short period of time. I tell them you are dealing with unknowns to some extent. We can't control that. I tell them I will do the best I can. I make sure they are only dealing with risk capital, that is money they can afford to lose. Is this money that you can afford to lose."[101]

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[99] Tr. at 222 ("The basic conversation was I attended Charles' course, I want to open an account and Charles referred me to you. . . .").

[100] Tr. at 224 (Kleinman).

Kleinman did not vary from this routine for those clients referred by Steinhacker. Tr. at 245 (Kleinman) ("When a client came to me from Mr. Steinhacker or any other source I always went through the same talk about risks, what to expect. I went through it with Mr. Udiskey just like any other customer, whether they came from Mr. Steinhacker or not.").

[101] Tr. at 219-20 (emphasis added).

In particular, Kleinman differentiated between discretionary and non-discretionary accounts,[102] addressed the cautionary language in both the Customer Agreement and the CFTC-required Risk Disclosure,[103] explained the potential for margin calls and described how stop-loss orders do not guarantee that an open position will be liquidated at a given price.[104] He related these risks in connection with an explanation of his general trading approach.[105]

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[102] Tr. at 244 (Kleinman).

[103] Tr. at 224-25 (Kleinman).

[104] Tr. at 226 (Kleinman).

[105] Tr. at 229-30 (Kleinman). Udiskey testified that he never spoke to Kleinman before filling out and mailing in the account-opening materials (including the power of attorney) along with the initial deposit. Tr. at 32-34, 74-76. He testified that saw no reason to do so, because he viewed Kleinman as "an extension of Mr. Steinhacker," whom he "ha[d] so much confidence in." Tr. at 32-34. Muskus too claims to have sent in her money to Kleinman without ever having talked to him. Tr. at 145. According to Udiskey, he did not speak to Kleinman until November 29, 1995, two days after CRC credited his account with a $10,000 deposit. Tr. at 34; see Monthly Account Statements. Indeed, Udiskey asserts that he and Kleinman never addressed the risks associated with trading commodities. Tr. at 85-86.

> Koch: "Is it your testimony that he never discussed with you any of the risk disclosure statements or any of the risks involved in trading commodities?'
>
> Udiskey: "To my best recollection, no."

(continued..)

Additionally, Udiskey's reliance on Steinhacker's alleged misrepresentations is belied by Udiskey's trading experience. When a customer is fraudulently induced to act, continued reliance depends upon whether the false nature of the statement becomes known to the customer.[106] More specifically, if a

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Id.

This all is, of course, directly disputed by Kleinman. Tr. at 251-52; see Tr. at 208-09 (Steinhacker). On these points, the Court credits the testimony of Kleinman over that of Udiskey and Muskus. It is most improbable that these two auditors would each forward $10,000 to Kleinman -- an individual whom they did not know -- and sign over powers of attorney to Kleinman, without first talking to him. The record does not reveal Udiskey and Muskus to be so trusting and disengaged. Moreover, it is inconceivable that, in all of his conversations with Kleinman, Udiskey never discussed "any of the risks involved in trading commodities."

As a side note, Udiskey claims to have been unaware that Steinhacker and Kleinman had a business relationship until sometime after he opened the account. Tr. at 34, 51. Udiskey pleads such ignorance despite the fact that Steinhacker "pitch[ed]" the class to see Steinhacker about trading, and that Steinhacker forwarded the CRC account-opening documents to Udiskey. Tr. at 26, 29 (Udiskey); see Complaint, ¶10 ("Steinhacker not only solicited his students to open commodity accounts to trade his commodity program but also asked his students, including Complainant, for referrals for this purpose"). Steinhacker claims that he fully informed all of his students at the outset of the course of his affiliation with Kleinman and CRC. Tr. at 194 On this point too, the Court credits Steinhacker's testimony, and finds that of Udiskey incredible.

[106] Muniz, ¶25,225 at 38,651.

customer is induced to trade, but the outcome of trading or some other event produces or conveys information that contradicts the fraudulent misrepresentations, then the customer's knowledge of the trading outcome or the other event would break the causal chain.[107] This is so because even if there was subsequent, actual reliance, such reliance would no longer be justifiable.

By the end of April 1996, Udiskey's $48,000 investment had declined to $41,311 (a decline of 14 percent).[108] Thus, Udiskey's five-month experience trading plainly informed him that, over the long-haul, trading in commodity contracts may be a money-losing endeavor. Indeed, this lesson was not lost on Muskus, who closed her account in early June after losing $14,393.[109] While she "lost confidence in Mr. Kleinman,"[110] Udiskey continued to trade

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[107] Puckett v. Rufenacht, Bromagen & Hertz, Inc., 903 F.2d 1014, 1020 (5th Cir. 1990) (quoting Clayton Brokerage Co. of St. Louis, Inc. v. CFTC, 794 F.2d 573, 578-79 (11th Cir. 1986)); Muniz, ¶25,225 at 38,651. Simply stated, a customer who (1) is mislead to believe there is no risk of substantial loss in trading, (2) traded, (3) suffered a substantial loss (even a paper loss), (3) learned of the loss and (4) subsequently traded, cannot recover for the subsequent trading losses. J.E. Hoetger & Co. v. Ascenio, 572 F. Supp. 814, 820 (E.D. Mich. 1983); O'Hey v. Drexel Burnham Lambert, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,754 at 31,142-43 (CFTC Sept. 23, 1985).

[108] Monthly Account Statements.

[109] Tr. at 153 (Muskus).

[110] Tr. at 102 (Udiskey).

and continued to lose. By the end of June 1996, his account value had declined to $31,035 (a net loss of 35 percent).[111] This "sharp contrast between the results" Udiskey claims he "was told to expect and the results he actually experienced raises substantially doubts" concerning Udiskey's continuing reliance on Steinhacker's alleged guarantees.[112]

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[111] Monthly Account Statements.

[112] Muniz, ¶25,225 at 38,651. While Muskus walked, Udiskey claims to have been transfixed into continued trading by the "lulling" of Kleinman. Citing the concurring opinion in Muniz, Udiskey seeks in this manner to justify his continuing reliance on Steinhacker's alleged misrepresentations, even after the mounting losses in his account clearly soured any expectations of guaranteed profits.

> "Customers faced with [legitimate market] losses are often prone to make poor decisions in a desperate attempt to recoup losses. As losses can occur with astonishing speed, disoriented customers can be receptive to lulling or unreasonable recommendations by their brokers that lead to even more losses."

Complainant's Brief at 16 (citing Muniz, ¶25,255 at 38,653 (West, Commissioner, concurring)).

More specifically, Udiskey alleges that Kleinman convinced him to maintain his discretionary account after significant losses with unreasonable representations that the account would once again profit. Complainant's Brief at 15 ("Complainant was lulled into continued trading by excuses for particular drawdowns and representations that the account would be turned around for a profit.") (emphasis omitted).

Kleinman's "excuses," however, appear more properly termed "explanations" -- explanations that in fact provided Udiskey with

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This post-inducement knowledge that an earlier statement was false does more than break the chain of Udiskey's continued reliance. It is yet another piece of evidence that Udiskey never even initially relied on the misrepresentations that he attributes to Steinhacker.[113] Udiskey's later act of trading, when he knew Steinhacker's alleged misrepresentations to be false, provides a basis upon which to infer that had Udiskey not been misled as he alleges, he still would have traded.[114]

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additional notice that stops can be missed and markets can be volatile. Tr. at 156-57 (Muskus) ("Mr. Kleinman told us the stops were overrun and did not work. Because of that I lost $7,000 in two minutes and Frank lost $6,000 in two minutes. . . . [I]t was difficult to see whose fault it was."); Tr. at 40-42 (Udiskey) (claiming to have suffered a $16,000 loss because of "volatility in the market" and that Kleinman told him "it was beyond his control").

Moreover, Kleinman's continued optimism does not transform him into a guarantor of Udiskey's continuing speculation. Tr. at 233 (Kleinman) ("Well, we talked to recoup the losses. I am sure that was his hope, that was my hope. I don't like to see clients lose money. It doesn't help me. It doesn't help them, the client. I'm sure that's why he kept the account open, we were hoping for trades."). See supra note 54.

[113] See, e.g., McNally, 16 F.3d at 1501-02.

[114] Domenico v. CFTC, No. 87-7469, 1989 WL 18805, at *5 (9th Cir. Dec. 13, 1989) (unpublished disposition); McNally, 16 F.3d at 1501.

For all of these reasons, even if Steinhacker made the misrepresentations attributed to him by Udiskey, Udiskey's recovery would be barred by his failure to rely on them.[115]

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[115] Udiskey seeks to establish Kleinman's and CRC's joint liability for his losses under the theories that Steinhacker was the agent of CRC, and that CRC and Kleinman failed to diligently supervise Steinhacker. Complainant's Brief at 2, 18. 7 U.S.C. §2(a)(1)(A)(iii); 17 C.F.R 166.3. See Rosenthal & Co. v. CFTC, 802 F.2d 963, 966 (7th Cir. 1986); In re Collins, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,981 at 44,750 (CFTC Mar. 5, 1997). Having failed to establish Steinhacker's liability, the Court need not address these theories for reaching the other two respondents.

Udiskey initially claimed that respondents engaged in unauthorized trading. Complaint, ¶¶55-56. However, he did not include this theory in his post hearing brief and, thereby, abandoned the claim. Morris, ¶25,080 at 38,049 n.28; cf. In re Rosenthal & Co., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,221 at 29,169 (CFTC June 6, 1984). He also initially alleged churning, Complaint ¶¶57-59, but appears to have abandoned this theory as well. Since, Udiskey continues, however, to attach some unspecified significance to the fact that he paid over $22,000 in commissions, Complainant's Brief at 14, the Court briefly addresses this abandoned claim.

In order to recover commissions under a churning theory, a complainant must show that (1) the respondent controlled the level and frequency of trading in the account, (2) the overall volume of the trading was excessive in light of the complainant's trading objectives and (3) the respondent acted with intent to defraud or in a reckless disregard of the customer's interests. Hinch v. Commonwealth Financial Group, Inc., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,056 at 45,020 (CFTC May 13, 1997). Kleinman's discretionary authority to trade Udiskey's account satisfies the first element. However, having gotten to first base, Udiskey is stranded.

Udiskey has failed to prove that any of the respondents acted with an intent to defraud him or in reckless disregard of

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his interests. Moreover, there is nothing in the record to suggest that the overall volume of Kleinman's trading was excessive in light of Udiskey's objectives. The starting point of an excessiveness analysis is

> "delineation of the customer's investment goals, for those objectives that significantly illuminate the context in which the trading took place, and, indeed, form standards against which the allegations of excessiveness may be measured."

Gilbert v. Refco, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,081 at 38,059 (CFTC June 27, 1991) (quoting Costello v. Oppenheimer & Co., 711 F.2d 1361, 1368 (7th Cir. 1983).

Udiskey has not articulated any investment goals or strategies, except to "cut the losses" and "let the profits run". Udiskey understood and endorsed the notion that, as a result of this strategy, "that there would be a lot of trades." Tr. at 34 (Udiskey). See Gilbert, ¶25,081 at 38,060.

Moreover, Udiskey's cause is not helped by the fact that his commission payments constituted 46 percent of his $48,000 investment over the 14-month period of the account. Complainant's Brief at 14. Even if a percentage of commissions, alone, established churning (which it does not), this calculation, misses the mark. The relevant number is not the total commissions paid over 14 months, but rather the monthly commission-to-equity ratios. Halterman v. Eastern Capital Corp., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,222 at 35,036-37 (CFTC Apr. 15, 1988). The Court has taken the liberty of calculating the commission-to-equity ratio according to an average account value. Dividing the monthly commissions by an average of the beginning and monthly account values, the monthly commission-to-equity ratio ranged from 2.96 percent to 10.7 percent, with a non-weighted average of 5.07 percent. This frequency of trading fails to even support an inference of churning. See Levine, ¶24,488 at 36,116 n.10 (stating a monthly commission-to-equity ratio in excess of 18 percent "is not, standing alone, a sufficient basis for finding churning");

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Udiskey Failed To Establish That CRC Or Kleinman Violated The Commission's CTA Disclosure Rules

While claims of fraud predominated the oral hearing in this matter, Udiskey's case includes a charge that CRC and Kleinman were commodity trading advisors ("CTAs") and failed to provide the necessary disclosures.[116] This raises the question of whether any activity that could be properly characterized as the provision of advisory services occurred in connection with CRC's brokerage activity and Kleinman's employment as an AP and, thereby failed to trigger CTA registration and disclosure requirements. For the reasons set out below, Udiskey has failed to provide a basis for resolving this issue in his favor.

Rule 4.31(a) applies to CTAs who are registered under the Act or should be registered.[117] In addition, it seems to govern

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Halterman, ¶24,222 at 35,036 (stating monthly commission-to-equity ratios of 19 and 24 percent found to be "ambiguous when considered in the context of other relevant factors demonstrated on the record").

[116] Complainant's Brief at 19-20.

[117] 17 C.F.R. §4.31(a).

persons who are not CTAs but who are registered as such.[118] Strictly construed, Rule 4.31(a) requires a CTA, before it even utters the first word in soliciting to manage or guide a customer's account, to "deliver[] or cause[] to be delivered to the prospective client a [d]isclosure [d]ocument for the trading program pursuant to which the trading advisor seeks to direct the client's account or guide the client's trading."[119] When there is

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[118] Although the Commission defined the term "commodity trading advisor" in Rule 1.3(bb), 17 C.F.R. §1.3(bb), it has held that when it used the words "commodity trading advisor registered . . . under the Act" in its regulations, it really did not mean to describe a person who was a CTA and was also "registered." In re New York Currency Research Corp., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,233 at 45,914-15 (CFTC Feb. 6, 1998). Rather, the Commission held that the term "commodity trading advisor," when followed by the word "registered," sheds it Rule 1.3(bb) definition. Id. at 45,915. To be more precise, the modifier "registered" seems to change the meaning of "commodity trading advisor" to "person." See id. In other words, "commodity trading advisor . . . registered under the Act" really means "person[] registered as such." Id.

[119] 17 C.F.R. §4.31(a). See Adoption of Rules Concerning Commodity Pool Operators and Commodity Trading Advisors, 44 Fed. Reg. 1918 (1979), reprinted in, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,725 at 22,976 (CFTC Jan. 8, 1979) ("Adoption of Rules Concerning Commodity Pool Operators and Commodity Trading Advisors") ("Section 4.31 establishes disclosure requirements for CTAs that seek to control clients' accounts (*e.g.*, through managed accounts)" (italics in original)). The provision of the disclosure document must occur "at or before the time [the CTA] engages in the solicitation or enters into the agreement [to direct a client's commodity interest trading] (whichever is earlier)." Id. Since "before" the solicitation always, by definition under an assumption of linear time, precedes the time "at" which the solicitation

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no solicitation, the provision of the disclosure document must precede the execution of an agreement to direct or guide a client's account.[120] The disclosure document must contain "the information set forth in [Rules] 4.34 and 4.35."[121] These regulations require the inclusion of a substantial amount of information, some residing at the core of materiality, some lurking nearer to the fringe.

Rule 4.34 mandates that the CTA disclosure contain: (1) a table of contents;[122] (2) the CTA's name, address, telephone number, and "form of business organization;"[123] (3) the date at which the CTA "first intends to use the [d]isclosure

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occurs, Rule 4.31 seems to require disclosure before the solicitation. Fortunately, this case does not require the Court to determine if this requirement, unlike virtually every regulatory-based, Commission disclosure requirement, is applied in a manner that permits less than perfect compliance. See, e.g., Batra v. E.F. Hutton & Co., Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,937 at 34,286-87 (CFTC Sept. 30, 1987).

[120] 17 C.F.R. §4.31(a). See 17 C.F.R. §§4.34-.35.

[121] Id.

[122] 17 C.F.R. §4.34(c).

[123] 17 C.F.R. §4.34(d)(1).

[d]ocument;"[124] (4) "each principal of the" CTA;[125] (5) the FCM with which the customer must maintain its account or an indication that the customer is free to choose the FCM for that task;[126] (6) the IB that the customer must use to introduce its account or an indication that the customer is free to choose the IB through which to introduce the account;[127] (7) the business background of the CTA, the business background of each principal of the CTA who participates in making trading or operational decisions and the business background of each principal who supervises persons who make trading or operational decisions;[128] (8) a discussion of the "principal risk factors of [the CTA's] trading program;"[129] (9) a "description of the trading program," including the types of commodity interests the CTA intends to trade, the types of other interests the CTA intends to trade, and any restrictions or limitations on such trading;[130] (10) a

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[124] 17 C.F.R. §4.34(d)(2).

[125] 17 C.F.R. §4.34(e)(1).

[126] 17 C.F.R. §4.34(e)(2).

[127] 17 C.F.R. §4.34(e)(3).

[128] 17 C.F.R. §4.34(f).

[129] 17 C.F.R. §4.34(g).

[130] 17 C.F.R. §4.34(h).

"complete description" of each of the CTA's fees;[131] (11) a "full description" of certain "actual or potential conflicts of interest;"[132] (12) certain "pending or concluded" litigation;[133] (13) whether, if the CTA or a principal intends to trade for its own account, the customer will be permitted to inspect "such person's trading and any written policies related to such trading;"[134] (14) a cautionary statement set out in Rule 4.34(a);[135] (15) a risk disclosure statement prescribed by Rule 4.34(b);[136] and (16) other "material information . . . not specifically required" by Rule 4.34.[137]

Rule 4.34 also requires the disclosure of "[p]ast performance . . . as set forth" in Rule 4.35.[138] Rule 4.35 requires the disclosure of "the actual performance of all accounts directed by the commodity trading advisor and each of

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[131] 17 C.F.R. §4.34(i).

[132] 17 C.F.R. §4.34(j).

[133] 17 C.F.R. §4.34(k).

[134] 17 C.F.R. §4.34(l).

[135] 17 C.F.R. §4.34(a).

[136] 17 C.F.R. §4.34(b).

[137] 17 C.F.R. §4.34(o).

[138] 17 C.F.R. §4.34(m); see 17 C.F.R. §4.35.

its trading principals."[139] "[D]isclosure of past performance . . . under [Rule] 4.35 must include:" (1) the name of the trading program;[140] (2) the name of the CTA or other person trading the account;[141] (3) the date when the CTA or other person began trading funds;[142] (4) the date when client funds began being traded pursuant to the trading program;[143] (5) the number of accounts directed pursuant to the trading program;[144] (6) the total assets under management by the advisor;[145] (7) the total assets traded pursuant to the trading program specified;[146] (8) the largest monthly draw-down for the account or trading program

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[139] 17 C.F.R. §4.35(b).

[140] 17 C.F.R. §4.35(a)(1)(i). Rule 4.35 refers to "program" in the most general sense. In other words, "trading program" is not limited to trading based on the use of computer software or the mechanical application of a mathematical algorithm. See 17 C.F.R. §4.35(b); Amendments to Commodity Pool Operator and Commodity Trading Advisor Disclosure Rules, 60 Fed. Reg. 38146, 38162 & n.99 (1995); Revisions of Commodity Pool Operator and Commodity Trading Advisor Regulations; Delegation of Authority, 46 Fed. Reg. 26004, 26009 (1981).

[141] Id.

[142] 17 C.F.R. §4.35(a)(1)(ii).

[143] 17 C.F.R. §4.35(a)(1)(ii).

[144] 17 C.F.R. §4.35(a)(1)(iii).

[145] 17 C.F.R. §4.35(a)(1)(iv)(A).

[146] 17 C.F.R. §4.35(a)(1)(iv)(B).

during the previous five calendar years and year-to-date;[147] (9) the worst peak-to-valley draw-down in the previous five calendar years and year-to-date;[148] (10) the annual and year-to-date rate-of-return, for the trading program specified, for the five most recent calendar years and the year-to-date;[149] (11) the number of accounts that were traded pursuant to the offered trading program and were closed, during the five most recent calendar years and the year-to-date, with a positive net performance;[150] (12) the number of accounts that were traded pursuant to the offered trading program and were closed, during the five most recent calendar years and the year-to-date, with a negative net performance;[151] and (13) a legend that states "PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS."[152]

As noted above, these disclosure requirements apply to CTAs who are not registered under the Act, but are required to be registered, as well those who are actually registered. The

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[147] 17 C.F.R. §4.35(a)(1)(v).

[148] 17 C.F.R. §4.35(a)(1)(vi).

[149] 17 C.F.R. §4.35(a)(1)(vii).

[150] 17 C.F.R. §4.35(a)(1)(viii)(A).

[151] 17 C.F.R. §4.35(a)(1)(viii)(B).

[152] 17 C.F.R. §4.35(a)(8) (capitalization in original).

requirement to make disclosures in the manner prescribed by Commission regulation is absolute.[153] In other words, liability is strict.[154] In the context of a reparations case, failing to comply with the risk disclosure provisions has serious consequences. Most notably, customer reliance upon the failure to make regulation-based disclosures is presumed.[155]

In general, those persons who meet the definition of CTA must register as such.[156] Section 1a(5)(A) of the Act defines a CTA, in part, as "any person who . . . for compensation or profit, engages in the business of advising others . . . as the value or advisability of trading in" certain contracts, including commodity futures and options contracts.[157] Section 1a(5) goes on

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[153] Batra, ¶23,937 at 34,286-87; Sher v. Dean Witter Reynolds, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,266 at 29,370 (CFTC June 13, 1984).

[154] See In re Armstrong, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,657 at 40,152-53 (CFTC Feb. 8, 1993).

[155] Batra, ¶23,937 at 34,286-87; Domenico v. Rufenacht, Bromagen & Hertz, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,642 at 30,726 (CFTC June 27, 1985); see In re Rosenthal & Co., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,221 at 29,176 (CFTC June 6, 1984).

[156] 7 U.S.C. §6m(1).

[157] 7 U.S.C. §1a(5)(A).

"[A]dvice" includes managing or directing the commodity futures or options account of another. Interpretation Regarding

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to exclude certain classes of persons from the definition of CTA and authorizes the Commission to provide additional exclusions "by rule, regulation, or order."[158] In its regulations, the Commission defines CTA in a manner that is virtually identical to Section 1a(5)(A).[159] In an exercise of its Section 1a(B)(5)(vii) authority and in an effort "minimize 'dual registration' obligations,"[160] the Commission exempts certain persons from the CTA registration requirement in Rule 4.14.[161]

No one disputes that CRC, through Kleinman in his capacity as an AP of CRC, directed the trading of Udiskey's account and

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Use of Electronic Media by Commodity Pool Operators and Commodity Trading Advisors, 61 Fed. Reg. 42146, 42152 (1996) ("Interpretation Regarding Use of Electronic Media"); see Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements, 48 Fed. Reg. 35248, 35276 (1983) ("Registration and Other Regulatory Requirements").

[158] 7 U.S.C. §1a(5)(B)-(C).

[159] 17 C.F.R. §1.3(bb).

[160] Registration and Other Regulatory Requirements, 48 Fed. Reg. at 35276; Adoption of Rules Concerning Commodity Pool Operators and Commodity Trading Advisors, ¶20,725 at 22,971 n.11. See 7 U.S.C. §1a(5)(B)(vii).

[161] 17 C.F.R. §4.14.

did so for compensation.[162] Similarly, there is no dispute that neither Kleinman nor CRC provided Udiskey disclosure that met the requirements of Rules 4.34 and 4.35.[163] The business activity of CRC and Kleinman each meets the basic definition of CTA.[164] Thus, the dispute boils down to the question of whether the registered

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[162] Tr. at 49-51, 74, 92 (Udiskey); Tr. at 224, 244 (Kleinman); Exhibit 4 at 1.

[163] Instead, Kleinman sent Udiskey an "Explanatory Statement" subtitled "Associated Persons Are Not Required To Be Registered As Commodity Trading Advisors." Exhibit 5. The Explanatory Statement reads, in part,

> "George Kleinman (the 'Trader') is authorized by the Discretionary Account Agreement to effect transactions for your account. The Trader is exempt from registration as a "commodity trading advisor" with the Commodity Futures Trading Commission ('CFTC') under the Commodity Exchange Act by virtue of CFTC Regulation 4.14(a)(3) and, therefore, is not required to furnish you with a disclosure document prepared in accordance with Part 4 of the CFTC Regulations. The Trader's exemption from registration as commodity trading advisor is due to his status as a registered associated person of an introducing broker and the fact that his trading advice is solely incidental to his business as an associated person. An associated person is subject to separate registration and qualification requirements."

Id. Udiskey signed the document along with the other account-opening documents. Id.; Exhibit 3 at 2; Exhibit 4 at 3.

[164] See supra note 157.

IB and its AP qualify for one of the Rule 4.14(a) exemptions from the CTA registration requirement or, more precisely, whether Udiskey has proven that they did not.

Rule 4.14(a)'s classes of exempted persons include those who are "registered under the Act as an introducing broker," provided that "the person's trading advice is solely in connection with its business as an introducing broker."[165] Similarly, registered APs do not have to register as CTAs if "the person's commodity trading advice is issued solely in connection with its employment as an associated person."[166] CRC was duly registered as an IB and Kleinman was registered as an AP of CRC. Accordingly, if their advisory activities occurred "solely in connection with" CRC's operation as an IB and Kleinman's employment as an AP, then neither was required to register as a CTA.

The Commission intended "solely in connection with" to be a qualification that is parallel to, but more precise than, the "solely incidental to" language of Section 1a(5)(C).[167] With

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[165] 17 C.F.R. §4.14(a)(6).

[166] 17 C.F.R. §4.14(a)(3).

[167] Registration and Other Regulatory Requirements, 48 Fed. Reg. 35252.

While the Commission intended the two terms to be roughly analogous, they differ significantly in what their plain meaning (continued..)

regard to registered brokers, the "solely incidental" requirement, does not seem to pose a substantial barrier to avoiding the CTA registration requirement.[168] However, given the

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seems to demand. "Solely incidental to" clearly implies a relationship, but one that is "subordinate [or] nonessential . . . in position or significance." Webster's Third New International Dictionary 1142 (1971) (defining incidental). Accordingly, when the Commission has considered whether the provision of trading advice was "solely incidental to" some other activity, it has considered the pervasiveness of advisory activity. In re Armstrong, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,657 at 40,149 (CFTC Feb. 8, 1993) (drawing a distinction between advice that was "'solely incidental' to [a respondent's] business" and advice that "was the very point of that business"). "Solely in connection with" also expresses a relationship. However, rather than modifying the relationship in terms that would seek to reduce the permissible level, "position or significance" of the advice, it seems to exclude, from its coverage, advice that is connected with "alternative or competing things." Webster's Third New International Dictionary 2168 (defining solely). Accordingly, in applying the language of Rules 4.14(a)(3)and 4.14(a)(4), exclusivity and not pervasiveness seems to be the preferable focus. See infra note 171.

[168] The Commission has stated that registered "introducing brokers who direct or guide a client's commodity interest account generally will not have to register as CTAs." Registration and Other Regulatory Requirements, 48 Fed. Reg. at 35276. Similarly, the Division of Trading and Markets ("Trading and Markets") has applied the parallel language, "solely incidental to," to FCMs, persons who engage in activities similar to that of IBs. Compare 7 U.S.C. §1a(12) with 7 U.S.C. §1a(14). Trading and Markets has opined that "solely incidental to" describes "a broad standard when interpreted in connection with the characteristics of the FCM's business." CFTC Interpretive Letter No. 95-82, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,558 at 43,487 (DTM Sept. 19, 1995).

lack of meaningful development in this area, "solely in connection with" requires some elaboration.[169] Here it goes. The "in connection with" language obviously requires a relationship between the provision of trading advice and the provision of brokerage services. The modifier "solely" narrows the scope of relationships, meriting exclusion, to trading advice that is not only directly related to the brokerage services that the IB actually provides and proximately related to those brokerage services, but is also exclusive in the sense that it depends on the existence of a broker-customer relationship.[170] What does

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[169] Whether a person is required to register is a circumstantial inquiry that considers the "nature of the overall business and the factual context in which advisory services are rendered." Interpretation Regarding Use of Electronic Media, 61 Fed. Reg. at 42150-52. However, a command to examine all relevant facts, even when it expresses no guiding analytic framework, does not amount to an invitation to engage in an inquiry that knows no bounds and follows no principles.

[170] An instance in which the requisite connections were not present is illustrated by the case of an IB that exercised discretion over accounts but also provided advice in other manners. CFTC Interpretive Letter No. 97-49, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,089 at 45,157 (DTM June 20, 1997). The IB provided commentary on agricultural markets over satellite transmission services. Id. Subscribers were not required to trade through the IB and the services charged a quarterly subscription fee that was completely unrelated to the provision of brokerage services. Id. The IB also provided radio and newspaper commentaries that were not directly compensated but that provided some publicity. Id. Trading and Markets found itself unable to conclude that the IB qualified for exemption from registration under Rule 4.14(a)(6) based on facts that the

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that mean? Simply stated, it means that an IB who provides advice to non-brokerage customers falls outside of the exclusion as does an IB that provides advice that is not directly and

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IB "receives a fee distinct from any fees charged its IB customers for some of its advisory services and provides its commentaries generally to the public and does not limit their availability to its . . . customers." Id. at 45,158.

The outcome of Trading and Markets' analysis comports with the Court's rule set out above. The IB's advisory services through the satellite transmissions and general media commentary were not directly or proximately related to the provision of brokerage services in that subscribers to the satellite transmissions and the audience for the public commentary did not appear to be required to use the IB's brokerage services to obtain the advice. Likewise, they do not appear to have generally availed themselves to the IB's brokerage services. Moreover, compensation for the advisory services was in no way linked to the provision of brokerage services. Accordingly, not only was the provision of advice not closely related to the provision of brokerage services, it was independent of it. Therefore, it cannot be said that it occurred "solely in connection with" IB activities.

A similar situation occurred in the case of an IB that provided a "hotline service" for clients, at no additional cost, and non-clients, at a cost of $1.50 per minute. CFTC Interpretive Letter No. 96-80, [Current Transfer Binder] Comm. Fut. L. Rep. ¶26,909 at 44,432 (DTM Nov. 1, 1996). In that case, Trading and Markets, drew a distinction between providing the service to clients and non-clients and opined the provision of advisory services to the latter, independent of the provision of brokerage services, precluded an exemption under Rule 4.14(a)(6). Id.

closely related to contracts as to which the broker actually accepts orders.[171]

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[171] For example, if an IB only accepts orders for contracts of a specific type or traded on a specific exchange and that non-full-service IB gives trading advice about products as to which the broker is unable to accept orders or, by policy and contract, does not accept orders, then the advice would tend to exceed the permissible scope of Rule 4.14(a)(6).

The Commission, when it drafted Rule 4.14(a)(6), recognized that the exemption made it possible for certain CTAs to register as IBs in order to provide advisory services while avoiding "their disclosure obligations." Registration and Other Regulatory Requirements, 48 Fed. Reg. at 35252. On that basis, it warned that it would "monitor the use of the new registration categories and, if it determines that CTAs are registering as introducing brokers to avoid their disclosure obligations, the Commission will take appropriate measures to remedy any problems that may result from such a practice." Id. To date, the Commission has not amended the rule's language or construed the rule in case law in a way that augments the connection requirement. Accordingly, this prospective warning that abuse might trigger a remedy appears to have remained just that.

Trading and Markets seems to have taken this language as something more concrete, marching orders. In its interpretive letters, Trading and Markets has used the Commission's warning as a basis to hold that, if an IB provides advice too often or to too many customers, it does not qualify for the exemption from CTA registration. See, e.g., CFTC Interpretive Letter No. 93-6, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,571 at 39,790 (DTM Jan. 27, 1993). It seems to reason that, beyond a certain point, the provision of trading advice becomes so pervasive that the basic nature of the firm changes from an IB giving advice to a CTA soliciting and accepting orders. There may be good policy reasons for circumscribing the registered IB exemption in that manner. However, Rule 4.14(a)(6) speaks only in terms of connections and the Commission has taken no action that changes that language or binds the Court to infer terms not expressed. Cf. New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7, 12 (2d Cir. 1995) ("The no-action letter, however, is

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an informal response, and does not amount to an official statement of the SEC's views. . . . In effect, they bind no one.").

Even if the Court were to apply the Trading and Markets pervasiveness qualification, CRC was not proven to have violated it. The only evidence on point is the word of Kleinman. In this proceeding, Kleinman provided uncontroverted testimony that "fifteen percent, maybe a little less" of CRC's clients in 1995 granted him discretionary authority to trade their accounts. Tr. at 225. In an unsuccessful attempt to contradict Kleinman, Udiskey relies on a statement made by Kleinman in response to a deposition on written interrogatories. In response to Interrogatory No. 14, Kleinman answered, "My trading advice is incidental to my business as an AP. Simply this is a main part of my business, that is offering commodity futures trading advice to clients." Response to Request for Interrogatories and Request for Documents, dated May 14, 1998. Recognizing the ambiguity of such a statement, Udiskey's counsel asked Kleinman, at the oral hearing, if he thought the answer was contradictory and Kleinman answered "no." Tr. at 254-55. Udiskey's counsel declined to explore why Kleinman did not think such a statement was contradictory and to further explore the percentage of discretionary accounts at CRC in 1995. Moreover, Udiskey did not serve any discovery requests which might otherwise demonstrate the percentage of discretionary accounts carried by Kleinman and CRC in 1995. See Complainant's Request for Production of Documents to Respondents George Kleinman, Charles Steinhacker, and Commodity Resource Corporation, dated May 1, 1998; Complainant's Interrogatories to Respondent Charles Steinhacker, dated May 1, 1998; Complainant's Interrogatories to Commodity Resource Corporation and George Kleinman, dated May 1, 1998. Accordingly, the Court has no basis upon which to find that Kleinman, in his capacity as a CRC AP, controlled the trading of more than 15 percent of CRC's clients. Such a low level of advisory activities would seem to satisfy Trading and Markets' pervasiveness standard. See CFTC Interpretive Letter No. 93-6, ¶25,571 at 39,790.

Because the Commission drafted Rule 4.14(a)(3)'s exclusion for registered APs in a fashion similar to the exclusion for registered IBs, the Court finds that the two exclusions have similar meanings. Moreover, by use of the language "solely in connection with his employment as an associated person," the Commission gave this limitation a substantive aspect that cannot be applied merely by looking for a relationship between the registered AP and the AP's employer.[172] In the case of an AP to

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[172] The Commission defines the term "associated person" in terms of certain solicitations and, in the case of IB and FCM APs, the acceptance of customer orders as well as certain supervisory activity. 17 C.F.R. §1.3(aa). Despite the apparent, substantive content of term "associated person," Trading and Markets, in determining whether the "solely in connection with its employment as an associated person" requirement is met, does not look primarily to a relationship between the advice and "employment as an AP." In determining whether an AP is exempt from registration, Trading and Markets considers factors such as:

> "(1) whether the advice provided is approved by the IB or consistent with other advice provided by the IB . . . (2) whether advice is furnished in the name of an individual AP or that of the IB; (3) whether there are substantial variations in the advice provided by APs . . . (4) whether the IBs provide guidelines to APs . . . when dealing with customers and whether APs follow such guidelines; and (8) whether the AP exercise[s] discretionary trading authority over customer accounts."

CFTC Interpretive Letter No. 96-67, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,793 at 44,295 (DTM Sept. 3, 1996). Thus, it scrutinizes connections between the AP's advice and the

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AP's employer. While not completely off-base, it would tend to be too liberal in one sense and too narrow in another. Trading and Markets' analysis is too liberal in the sense that seems to exempt persons who provide trading advice in a manner that is solely in connection with employment with the associated employer but not solely in connection with the person's employment as an AP. In other words, it overlooks the fact that Rule 4.14(a)(3) draws the exclusion in terms of "employment as" and not "employment with." An approach that focuses on "employment with" raises the obvious specter of excluding the advisory activities that are solely connected with employment "with" an employer but not "as" an AP.

For example, in the case of an IB that also meets the definition of CTA, because it provides advisory services, and must also register, because it gives trading advice to non-brokerage clients, an AP may give advice solely in connection with employment with the employer yet not solely in connection with employment as an IB. A non-supervisory AP of an IB/CTA acts as an AP of such a dual-status employer by associating with the employer in the following capacities involving: (1) "the solicitation or acceptance of customers' or option customers' orders (other than in a clerical capacity)" and (2) "the solicitation of a client's or prospective client's discretionary account." 17 C.F.R. §1.3(aa)(2), (4). If an AP of this dual-status firm provided advice to only the firm's non-brokerage, trading-advice subscribers, provided the advice in a representative capacity, provided advice that originated with the employer and provided advice in precisely the manner the employer required without deviation, it would be easy to conclude that the AP provided the advice solely in connection with its employment with the dual-status firm. The same could not be said with respect to meeting the plain-text requirements of Rule 4.14(a)(3). After all, if the advice was not accompanied by solicitations, it would not appear to be related to solicitation of orders or solicitation of the client's discretionary account. Similarly, it does not appear to have any relationship to the acceptance of customer commodity orders. Accordingly, it could not be said to have occurred "solely in connection with" the activities that define the AP as such and, therefore, "solely in connection with" employment as an AP.

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an IB that is also a CTA by virtue of exercising discretion over the accounts of its brokerage customers, "solely in connection with his employment as an" AP imposes certain limitations on the AP's provision of advice. First, the advisory activity must be limited to the employer's clients or prospective clients.[173] In addition, it must occur within one of two contexts: (1) involving the solicitation or acceptance of orders with respect to the futures and options contracts for which the employer

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In addition, Trading and Markets pays a great deal of attention as to how the advice is formulated and whether it reflects the employer's "party line." See, e.g., CFTC Interpretive Letter 95-85, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,540 at 43,381 (DTM Oct. 12, 1995). This seems too restrictive in a largely irrelevant way. In the case of an AP of an IB, advice that comes from any source would not seem to exceed the scope of "solely in connection with its employment as an" AP, provided the advice is given to brokerage customers, who were also the employing broker's customers, and was limited to products as to which the AP solicited and accepted orders. After all, independent thinking, reference to outside sources, innovation and the exercise of initiative are not, by definition, unconnected with employment, especially employment in a fiduciary capacity.

[173] This requirement embodies the "his employment" language, language that, given its plain meaning, limits advisory activity to the AP's actual employment, in whatever capacity.

actually accepts orders[174] or (2) involving solicitation of a discretionary account.[175]

In this case, there is no evidence that the trading advice of Kleinman and CRC lacked the necessary connections to exempt both from the requirement to register as a CTA and the regulatory requirements such registration triggers. There is no evidence that either respondent provided trading advice to persons that were not CRC brokerage customers and there is no evidence that either respondent provided advice as to commodity futures and options on futures products as to which CRC did not solicit and accept orders. Accordingly, the advice appears to have occurred "solely in connection with" CRC's "business as an [IB]" and Kleinman's "employment as an [AP]." Because Kleinman and CRC were exempt from registering as CTAs and did not do so, they had no Rule 4.31 requirement to disclose the information mandated by Rules 4.34 and 4.35. Thus, Udiskey failed to establish a violation of Rule 4.31 for failure to comply with it.[176]

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[174] See 17 C.F.R. §1.3(aa)(2).

[175] See 17 C.F.R. §1.3(aa)(4).

[176] Whether Udiskey claims that the obligation to disclose, the information set out in Rules 4.34 and 4.35, arises from Commission regulations only or from some general disclosure obligation is not entirely clear. He argues that the failure to make disclosure "pursuant to CFTC Reg. 4.31 . . . violates CEA (continued..)

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Sections 4o(1) and 4b(a)," general anti-fraud provisions. Complainant's Brief at 19. See 7 U.S.C. §§6b(a) and 6o(1). For that proposition, he cites In re Nelson, Ghun & Assocs., Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,395 (ALJ Feb. 22, 1982). In that case, respondents failed to provide CTA disclosure documents and, therefore, violated Rule 4.31 as well as Sections 4b(a) and 4o(1). Nelson, Ghun & Assoc., Inc., ¶21,395 at 25,897-99. No model of clarity, Nelson, Ghun & Assoc. does not explain whether the duty to disclose applied only to those that had a disclosure obligation under Rule 4.31 or reached beyond those persons registered or required to register as a CTA. Similarly, Udiskey is not clear as to whether the obligation should apply to respondents if they are not subject to Rule 4.31's requirements although, if asked at this stage of the proceeding and after reading the above findings, he would probably answer in the affirmative. If the Court were to read the argument as basing the duty to disclose the Rule 4.34 and Rule 4.35 information on Rule 4.31's applicability to respondents, it would fail for want of the necessary factual predicate. If, however, Udiskey is taken to be arguing that general, anti-fraud provisions impose a duty to convey that information, although such disclosure is not affirmatively required by the Act or Commission regulations and is not necessary to make proven, affirmative statements not misleading, his argument fails on legal grounds. The Commission expressly exempted IBs, who would otherwise fall under the definition of CTA but are exempt from registration under Rule 4.14(a)(6) and do not register as a CTA, from Rule 4.31(a)'s disclosure requirement. Registration and Other Regulatory Requirements, 48 Fed. Reg. at 35252 n.19; 17 C.F.R. §4.14(c). Udiskey has pointed to no Kleinman or CRC misrepresentation of fact that, in light of what was disclosed, required the disclosure of Rule 4.34 or 4.35 information to be rendered non-misleading. Accordingly, there was no implied obligation to disclose what CRC and Kleinman were expressly exempted from disclosing. See Lehoczky v. Gerald, Inc., [1994-1996 Transfer Binder] Com. Fut. L. Rep. (CCH) ¶26,441 at 42,923-34 & n.24 (CFTC June 12, 1995) (finding there is no obligation to disclose information, under general anti-fraud provisions, unless "triggered" by the statement of a "half-truth," when a "failure to disclose . . . could make [the half-truth] . . . misleading," or expressly required by regulation).

Conclusion

For the reasons set out above, the Court finds that Udiskey failed to prove, by a preponderance of the evidence, that respondents are liable to him, for violations of the Act or Commission regulations. Accordingly, the Complaint of Frank J. Udiskey against respondents Commodity Resource Corporation, George Kleinman and Charles Eliot Steinhacker is hereby **DISMISSED WITH PREJUDICE.**

IT IS SO ORDERED.[177]

On this 2nd day of April, 1999

Bruce C. Levine
Administrative Law Judge

[177] Under 17 C.F.R. §§12.10, 12.314 and 12.401(a), any party may appeal an Initial Decision to the Commission by serving upon all parties and filing with the Proceedings Clerk a notice of appeal within 20 days of the date of the Initial Decision. If the a party does not properly perfect an appeal -- and the Commission does not place the case on its own docket for review -- the Initial Decision shall become the final decision of the Commission, without further order by the Commission, within 30 days after service of the Initial Decision.

CERTIFICATE OF SERVICE AND FILING

I, Walter A. Bajak certify that on May 1, 1999, I caused to be served an original and one copy of the foregoing document by depositing the same with the United States Post Office in Hollywood, Florida ,First Class Postage pre-paid, on :

Proceedings Clerk, Office of Proceedings
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

And one copy to:

James B. Koch, Esq.
Gardiner Koch & Hines
53 West Jackson Street
Suite 1550
Chicago, IL. 60604

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Walter A. Bajak

Complainant seeks a 90-day extension of time to file his appeal brief. For good cause shown, a 45-day extension is hereby granted. Complainant shall file and serve his brief on or before July 5, 1999.

J. Douglas Richards
Deputy General Counsel
Commodity Futures Trading
Commission

Dated:

UNITED STATES OF AMERICA

Before The

COMMODITY FUTURES TRADING COMISSION

FRANK J. UDISKEY, Complainant, VS. COMMODITY RESOURCE CORPORATION, GEORGE KLEINMAN, AND CHARLES ELIOT STEINHACKER Respondents	Case No.: CFTC DOCKET NO. 98 R 081 **MOTION TO EXTEND TIME TO FILE APPEAL BRIEF**

COMPLAINANT'S MOTION TO EXTEND TIME TO FILE APPEAL BRIEF

NOW COMES COMPLAINANT, by his attorneys WALTER A. BAJAK, Esq. and ALEX F. ARREAZA, Esq. and for their Motion to Extend Time To File Appeal Brief hereby state as follows:

1. The Initial Decision was issued by Administrative Law Judge Bruce C. Levine on April 2, 1999.
2. The Notice of Appeal was filed on April 21, 1999.
3. The Appeal Brief is due on May 20, 1999.
4. The Initial Decision is comprised of eighty two (82) pages which will require extensive study.
5. Counsel for Complainant require additional time to prepare their Appeal Brief.

WHEREFORE , Complainant respectfully requests an extension of 90 days to August 20,1999 in which to file his Appeal Brief.

Respectfully Submitted,

FRANK J. UDISKEY

Dated: May 1, 1999

BY: Walter A. Bajak

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