UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

LAWRENCE SANCHEZ, Complainant,	*	
v.	*	CFTC Docket No. 02-R50
BRUCE NORMAN CROWN, LORI ANN DENN, INVESTORS TRADING GROUP, LC, and TECHNET TRADING, INCORPORATED, Respondents.	*	

INITIAL DECISION
(Corrected)

Before: Philip V. McGuire

Appearances: Lawrence Sanchez, Pueblo, Colorado, *pro se*
Bruce Norman Crown, Miami, Florida, *pro se*
R. Lawrence Bonner, Esq., Miami Florida, for Denn, ITG and TNT

Introduction

Lawrence Sanchez, a 67-year-old semi-retired laborer, alleges that Lori Ann Denn defrauded him out of a lion's share of his life savings by guaranteeing that he could make huge profits if he followed her trading advice, which involved the purchase of high-risk, deep-out-of-the-money options. Sanchez also alleges that Bruce Norman Crown perpetuated Denn's fraud by failing to supervise Denn and by similarly guaranteeing huge profits when he tried to convince Sanchez to part with the remainder of his life savings;[1] that Investors Trading Group is liable for the violations of its agents; and that Tech Net Trading is liable as the guarantor of ITG. Sanchez seeks to recover his out-of-pocket losses: $24,396. Respondents deny that they guaranteed

[1] The complaint was served on Denn, ITG and TNT on August 20, 2002. Crown was added as a respondent, after the first round of discovery, on December 10, 2002.

profits, and assert that they provided "complete oral and written risk disclosures" and that they gave "good faith trade recommendations."

The findings and conclusions below are based on the parties' documentary submissions and oral testimony,[2] and reflect my determination that Sanchez's version of events was significantly more plausible and compelling than respondents' version. Thus, as explained below, it has been concluded that Sanchez has established that respondents intentionally defrauded Sanchez by providing a heavily lopsided picture of the relative risks and rewards of following their trading advice and by pushing the purchase of numerous deep-out-of-the-money options in order to generate excessive commission income, and that Sanchez is entitled to an award of $24,396, plus prejudgment interest and costs.

Factual Findings

The parties

1. Lawrence Sanchez, a sixty-seven year-old resident of Pueblo, Colorado, was semi-retired with modest life savings of about $42,000, and with annual income under $10,000, when Lori Denn persuaded him to open his account. Sanchez has a high-school equivalency diploma, and for all of his life has worked at a series of blue-collar jobs: ammunition handler at the U.S. Army depot in Pueblo, mess attendant at the U.S. Air Force Academy, and construction laborer.

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[2] The principal documents and items in the evidentiary record include: (1) Sanchez's: (a) complaint (filed March 27, 2002), (b) addendum to complaint (filed June 25, 2002), and (c) replies to respondents' interrogatories; (2) Crown's answer (filed December 26, 2002); (3) TNT, ITG and Denn's joint answer (filed August 15, 2002); (4) Denn's affidavit (filed September 25, 2002); (5) Gregory Marshall's 1st, 2nd and 3rd affidavits (filed September 25 and December 2, 2002, and January 17, 2003, respectively); (6) Stuart Rubin's affidavit (filed September 25, 2002); (7) two tape cassette recordings: the first a recording of the account-opening "compliance review" (produced as an exhibit to the joint answer); and the second a recording of Sanchez's authorizations for the trades in his account (produced September 25, 2002); and (8) the following documents: (a) ITG phone bills (produced September 25, 2002); (b) ITG phone log (exhibit F to joint answer); (c) Sanchez's account statements (attachment to addendum to complaint, and exhibit G to joint answer); (d) equity runs (produced February 10, 2003); (e) account-opening documents (attachment to addendum to complaint, and exhibits A-E to joint answer); and (f) the TNT-ITG clearing and guarantee agreements (produced September 25, 2002). *See* orders dated August 28, October 25, November 12, and December 11 and 30, 2002. In addition, the CFTC Division of Economics produced relevant futures and options price information from the NYMEX database at my request (Appendix).

The most that Sanchez ever made was in the mid-1980's, when he "almost made $25,000," about which Sanchez testified: "Well, to me that's a high bracket." (Page 33 of hearing transcript.) In the year just before he opened his account with respondents, Sanchez had saved about $42,000, and owned his residence worth about $40,000. Sanchez had never owned any property other than his principal residence. Due to his modest financial situation, Sanchez continued to work part-time, but in the year before he opened his account with respondents had only earned a little under $3,000 working for the Air Force Academy, and approximately $4,000 working as a construction laborer. As described below, ITG's compliance officer would induce Sanchez to inflate grossly the stated income on his account application to a still modest "$25,000, plus," and to inflate his liquid net worth by including the value of his residence. Sanchez's investment experience was limited to a four-year investment in a conservative mutual fund. Sanchez did not subscribe to, or regularly read, any investment, financial or business publications, and did not regularly view any business or investment TV shows. Sanchez generally understood that some risk was attached to all investments, but knew nothing of the specific risks associated with commodity options before he saw the infomercial that produced the lead for his account. [*See* pages 6-12, 17, 27-37, and 75-78 of hearing transcript; and Sanchez's replies to interrogatories 8, 9, 10 and 13.]

2. Tech Net Trading ("TNT"), located in Fort Lauderdale, Florida, was registered as a futures commission merchant from January 1999, to June 2002. TNT guaranteed the legal and financial liabilities of Investors Trading Group, which introduced the Sanchez account. Investors Trading Group, L.C. ("ITG"), located in Miami, Florida, was registered as an introducing broker from October 1997 to May 2002. [NFA records; and TNT-ITG clearing and guarantee agreements.]

Gregory Marshall was a 30% shareholder and director of TNT, and 90% shareholder and director of ITG. Marshall had ultimate control of ITG's finances; was signatory of ITG's corporate checking account; signed ITG employees' pay checks; established the compensation paid to, and had final hiring and firing authority for, ITG's administrative and supervisory staff, including Crown; and approved the commission rates and compensation scheme established by Crown.[3] [Marshall's second affidavit.] Marshall, and the other registered principals of TNT -- Stuart Rubin (president and owner), Steven David Schwartz (owner), Patrick Todd Parker (owner), and Melvin Paul Kanowitz (compliance director) -- all have worked for a chorus line of firms that have been put out of business by the CFTC or the NFA for fraudulent sales and trading practices and that have been named in numerous reparations complaints.[4] Marshall did not testify at the hearing. [NFA records; Rubin's affidavit; Marshall's first and second affidavits; ¶¶ 13, 19, 21, 22 and 25 of Bruce Crown's answer; Crown's testimony at pages 6-12, 17, and 27-37 of hearing transcript; and Dennis Rogers' testimony at pages 229-243 of hearing transcript.]

Dennis Rogers, the other registered principal of ITG, has been registered since 1984, and also has worked for several firms that have been put out of business by the NFA for fraudulent

[3]Respondents charged about $8,000 in commissions to Sanchez's account, which consumed about a third of his total investment. [*See* account statements.]

[4] Marshall has been associated with the following sanctioned firms: Chilmark Commodities Corp. and Concorde Trading Group. Rubin has been associated with the following sanctioned firms: Barkley Financial Corp., First National Monetary Corp., First National Trading Corp., FSG International, and Multivest Options. Schwartz has been associated with the following sanctioned firms: Barkley Financial Corp., Chilmark Commodities Corp., Commonwealth Financial Group, First National Monetary Corp., First National Trading Corp., FSG International, and International Futures Strategists. Kanowitz has been associated with the following sanctioned firms: Apache Trading Corp., Barkley Financial Corp., Chilmark Commodities Corp., FSG International, and International Futures Strategists. Parker has been associated with the following sanctioned firms: Barkley Financial Corp., Concorde Trading Group, and First Commodity Corp. of Boston. Rubin, Schwartz, and Parker are currently registered as principals of Barkley, and Kanowitz is currently a registered associated person with Barkley. Marshall is currently a registered principal of First Choice Futures and Options. In addition, Rubin, Schwartz, and Kanowitz have been individually sanctioned by the NFA for fraudulent sales and trading practices. *In re Barkley Financial Corp., et al.*, NFA case number 02-BCC-1 (NFA Decision March 27, 2003).

sales and trading practices.[5] Rogers, who is not currently registered, has been described variously as ITG's "compliance director" and "compliance consultant." Rogers was responsible for reviewing promotional materials, designing and supervising the account-opening compliance procedures, and monitoring the activities of brokers. Based on his review of the trading activity and the tape-recorded compliance review for the Sanchez account, Rogers determined that "[Sanchez] answered every question necessary in order to have his account approved, and he answered as it should be answered." (Page 244 of hearing transcript.) However, Rogers did not overhear any of Denn's conversations with Sanchez, and did not speak to Sanchez until after he had instructed that the account be closed. Rogers' testimony that ITG provided a special deep-out-of-the-money risk disclosure for all out-of-the-money option trades indicates that he knew that ITG was routinely recommending the purchase of either deep-out-of-the-money options or substantially out-of-the-money options. In this connection, respondents have produced no evidence indicating that ITG's customers had typically enjoyed overall profits trading deep-out-of-the-money options. [*See* pages 229-247 of hearing transcript.]

3. Bruce Norman Crown supervised Lori Denn, and tried unsuccessfully to convince Sanchez to invest the remainder of his life savings. Crown was ITG's president and general manager, and was a registered associated person with ITG from February 1998 to March 2001.[6] Crown's duties included closely supervising ITG's associated persons, establishing the compensation for ITG's APs, and actively and regularly reviewing the trading activity in accounts handled by ITG's APs.[7] In this connection, Crown's testimony establishes that he

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[5] Rogers has been associated with the following sanctioned firms: JCC, Inc., First Investors Group of the Palm Beaches, and Universal Commodities Corporation.

[6] Before working for ITG, Crown had been associated with Universal Commodity Corporation. After working for ITG, Crown was associated with Commodity Investment Group, Risk Capital Trading Group, Inc., First Investors Group of the Palm Beaches, and Worldwide Commodity Corporation, where he is currently employed as a principal.

[7] Crown also had the final authority for hiring and firing ITG's associated persons; had the final authority to investigate, reprimand and discipline ITG's brokers; reviewed and approved ITG's sales and trading practices;

reviewed Sanchez's account application, and was familiar with the trading activity in Sanchez's account:

> *Judge:* You reviewed the trades in Ms. Denn's thirteen accounts?
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> *Crown* I'm sure that I did. Yes. When I was manager, I was familiar with every account we had.
>
> *Judge:* So, that means you reviewed the trades in Mr. Sanchez's account. Is that correct?
>
> *Crown:* I would definitely have been aware of them and reviewed them. Yes.
>
> *Judge:* So you reviewed the trading activity on a regular basis?
>
> *Crown:* Yes, I did.
>
> *Judge:* So you were aware that Denn had advised Sanchez to purchase deep-out-of-the-money options?
>
> *Crown:* Yes.

[Page 142 of hearing transcript.] Crown was principally compensated by receiving approximately $85 per contract for each trade placed by customers that he had solicited, and $7 per contract for each trade placed by the customers of the other brokers at ITG. In 1999, Crown solicited eight accounts and received a share of commissions in another 64 accounts. In 2000, he solicited three accounts and received a share of commissions in another 403 accounts. In the first quarter of 2001, he solicited 17 accounts and received a share of commissions in another 129 accounts.

Crown's testimony about the performance of these accounts was sufficiently evasive and unconvincing to support the inference that few, if any, ITG customer accounts successfully realized meaningful net profits:

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reviewed and approved ITG's account-opening compliance review; and was responsible for implementing, carrying out, monitoring and enforcing ITG's supervisory policies and procedures for reviewing trading activity and for reviewing reports prepared by ITG's compliance director, Dennis Rogers. [*See* Crown's testimony at pages 135-144 of hearing transcript, and ¶¶ 6-15 of Marshall's third affidavit.]

Judge: So on the 50 accounts that you solicited in 1998, what was the approximate number or percentage that eventually would close with a net profit?

Crown: I would have no figures or numbers. I couldn't possibly tell you.

Judge: I'm just asking for your recollection.

Crown: My best recollection would be – again -- it would be difficult. Some people would realize a quick and substantial profit and they would ask for their money to be returned home, which I did that very day. And other people seemed to enjoy trading commodities, and they traded, you know, rather actively. And a number of them were successful, and a number of them were unsuccessful. But I would have no percentages.

Judge: I assume you were intimately involved in advising these customers and knew whether they made or lost money. And I don't think it's unreasonable for you to have some sense for how your customers performed. And I would certainly think that you would remember if more than 10 percent of them had made money. Let's go to 1999. Let me ask you the same question.

Crown: Sure.

Judge: You had eight accounts that you solicited. Did they all realize profits?

Crown: I don't know.

Judge: You have no idea?

Crown: I don't know.

Judge: How about 2000?

Crown: I do not believe certainly that eight out of eight would have achieved profits, or eight out of eight would have lost monies. I would imagine that it was somewhere in between. And, again, I don't have access to those records and I don't remember the particular clients, quite honestly.

Judge: In 1999, I'm talking about the 64 accounts for which you received a share of the commissions. Could you, in good faith, tell me that more than 10 percent of those accounts were closed with net profits?

Crown: I would have no way of knowing when they closed and whether they closed with net profits or not.

Judge: I don't know about that. If you can't remember how your customers have done in the past, you better be restrained in what you promise your customers today.

[Pages 138-140 of hearing transcript. *See* NFA records; Marshall's first, second and third affidavits; ¶ e of Denn's affidavit; 22nd paragraph, on page 8, of TNT, ITG and Denn's joint answer; ¶¶ 7-21, and 25-28 of Crown's answer; and pages 135-148 and 158 of hearing transcript.]

4. Lori Ann Denn convinced Sanchez to open his account and to invest a total of $32,000. Denn recommended the first two option trades in the Sanchez account, which generated $6,950 in commissions, and realized total net losses of $23,346. Denn was a registered associated person with ITG from October 1999 to June 2001. She currently is a registered associated person with Ken Wolf Commodities and a registered principal with Zenghe, Inc. Denn was principally compensated by receiving approximately $75 per contract for each trade placed by customers that she had solicited. Denn received the second largest cut out of the $8,000 in commissions charged to the Sanchez account: about $2,417. Before Sanchez had opened his account, Denn had opened 13 accounts. Four of these accounts had been opened for just two weeks, and just two of the accounts had liquidated values greater than the investment amount. [NFA records; ¶¶ b and c of Marshall's first affidavit; ¶ c of Marshall's second affidavit; ¶ 27 of Crown's answer; ¶ a of Denn's affidavit; account statements; and pages 174-177, and 207-214 of hearing transcript.]

5. Paul Willard Brown, a registered associated person with ITG from April 1999 to August 2001, convinced Sanchez to make the last trade in his account, which realized a net loss of $1,050, and which generated $1,050 in commissions, out of which Brown received a modest cut of $135. Brown was not called as a witness, and currently is not registered.

Determining Brown's role in Sanchez's account has been complicated by the variety of confusing, inaccurate and incomplete submissions by both sides. Sanchez would not mention

Brown until he filed the motion to add Crown as a respondent, in which he stated merely that Brown had "contributed to the cause." Denn, ITG and TNT, who were best situated to set things right about Brown, muddied matters from the beginning by asserting in their joint answer that, on March 29, 2000, the Sanchez account had been transferred from Denn to Crown, an assertion that Denn would repeat in her affidavit. Also, although they had multiple opportunities, Denn, ITG and TNT never mentioned Brown – let alone explained his role -- in any of their submissions, except to state that he had received a small $135 cut of the commissions charged to the Sanchez account. As a result, when TNT, ITG and Denn produced a copy of the phone log which showed a change in handwriting in the entries after March 29, it became the operating assumption that the entries after March 29 had been made by Crown. Subsequently, Crown filed his answer in which he averred that he had spoken to Sanchez just one time, on March 16, 2000. The first time that Sanchez described Brown's role was at the hearing, when he testified that Brown had taken over as his account executive around April 1, 2000, and advised him that the only way to recoup his losses on Denn's heating oil trades was to accept a silver trade that Brown recommended. Neither Crown nor Denn could remember any meaningful details about the transfer to Brown. A closer scrutiny of the phone log then revealed that someone had placed a barely discernable "PB" at the end of the phone log. Thus, based on the most reliable evidence – *i.e.*, Sanchez's testimony, and the fact that Brown had received a modest cut of the commissions -- it is found that Brown became Sanchez's principal contact at ITG after March 29, 2000, that Brown recommended the last trade, and that Brown shared with Denn the account executive's cut of the commissions on the last trade. [See pages 61-66, 158, 207-208, 213-214, and 222 of hearing transcript.]

The parties' testimony

6. As is typical in cases involving allegations of fraudulent solicitation and trading advice, the complainant's version of events has focused on respondents' purported promises of low-risk profits, while the respondents' version has emphasized, almost exclusively, their purportedly fair and rigorous risk disclosures. However, in sharp contrast to respondents' version of the facts, Sanchez's version actually jibes with the overall evidentiary record, including the fact that respondents recommended high-risk trading strategies that generated huge commission charges; the fact that Denn disingenuously faxed to Sanchez the signature pages, without the complete customer contract or risk disclosure statement the same day that she convinced him to wire $20,000 and approve the first trade; and the fact that ITG's tape-recording established that the ITG compliance officer: induced Sanchez to falsify his financial status; deceptively downplayed the high risks associated with deep-out-of-the-money options; falsely implied that trading with ITG was safer than investing in mutual funds; grossly misrepresented the commission costs for first trade; disregarded the fact that Denn had obviously not disclosed to Sanchez the fact that she had recommended a trade with a remote profit potential; and disregarded the fact that Sanchez obviously knew nothing about the intricacies and complexities of trading commodity options. Although Sanchez's testimony was hindered by his lack of sophistication, by the fact that he never mastered options or commodities terminology, and by his confusion about the exact chronology of conversations, his testimony convincingly reflected the underlying reality that Sanchez was not "savvy," as asserted by Denn, and that respondents disregarded Sanchez's best interests by providing a heavily lopsided picture of the relative risks and rewards of following their trading advice and by pushing the purchase of deep-out-of-the-money options in order to generate excessive commission income.

Crown's testimony was generally unconvincing, and at times brazenly mendacious. As noted above, his testimony about the past performance of ITG's customer accounts was evasive and implausible. Crown's testimony that Sanchez "completely" understood the specific risks of the trading strategies recommended by respondents -- and that at the hearing Sanchez was acting less knowledgeable and sophisticated than he had when he traded with respondents -- was contradicted by the fact that Sanchez's education was limited to a high school equivalency degree, the fact that Sanchez's investment experience was limited to a conservative mutual fund, and the fact that the tape-recorded compliance review revealed that Sanchez lacked even a rudimentary understanding of the risks and mechanics of the dubious trading strategies recommended by respondents. [*See* Crown testimony at pages 152-161 of hearing transcript.] Finally, Crown's testimony that he had intended to comply with a subpoena was contradicted by his conduct. First, before Sanchez filed a motion to amend the complaint to add Crown as a respondent, Crown had refused to cooperate with TNT, ITG and Denn in preparing pleadings and discovery replies. Second, Crown failed to respond to a subpoena issued by the undersigned, and then, after his reply deadline had passed, Crown dodged several follow-up phone calls by the undersigned. Crown's testimony indicated that while his refusal to help TNT, ITG and Denn was partially the product of bad blood between him and Marshall, his failure to reply to the subpoena and related phone calls manifested an unmistakable intention to ignore the subpoena. [*See* Paragraph 6 of TNT's, ITG's and Denn's "Notice of Compliance with Order" (September 25, 2002); 2nd footnote of Order dated December 11, 2002; ¶ 28 of Crown's answer; and pages 144-148, and 158 of hearing transcript.]

Denn's credibility was undercut by the fact that her answer was based on a form answer that has been filed by her counsel for a variety of clients in several other cases.[8] That answer contains only general denials and assertions that respondents did not misrepresent the risks of trading options; a dry recitation that Denn and ITG explained the mechanics of trading options; and general assertions that ITG provided adequate risk disclosure through the written risk warnings and their tape-recorded account-opening compliance review, and that each trade recommendation had a reasonable basis. Since the answer had not provided a meaningful description of the conversations when she convinced Sanchez to open the account and to approve her recommended trades, Denn was asked to describe specifically what had been said in these conversations, including what she specifically said about the upside and the downside of the trading strategies she recommended. In response, Denn submitted an affidavit that is a cut-and-past version of the answer, with a few added details. Thus, Denn described a purported conversation so dominated by dry recitations and downside disclosures that it was difficult to believe that anyone looking for a reasonable chance of any return could have been persuaded to open an account with ITG. Denn's oral testimony also essentially stuck to the same unconvincing script, often with absurd results. For example, her testimony that she had provided a "complete" description of the mechanics and risks, and that Sanchez "seemed very knowledgeable and kind of savvy in regards to investing," was belied by the taped compliance review which established that he was far from knowledgeable or sophisticated, and belied by Denn's admission that she never explained to Sanchez the fact that she was recommending the purchase of deep-out-of-the-money options. [*See* pages 179, and 218-221 of hearing transcript.]

[8] *See, e.g., Hall v. Acocella*, Order dated October 22, 2002 (CFTC docket no. 02-R053); and *McGuire v. deSantis*, Order dated Fevruary 22, 2002 (CFTC docket no. 02-R005).

Rogers testimony that "there is no such thing as a definition of a deep-out-the-money option" (page 232 of hearing transcript) shows that he is not aware of the fact that NYMEX rule 300.10(B)[9] defines a deep-out-of-the-money option "as an option whose strike price is more than X strike prices distant from strike price closest to the price of the underlying futures contract, here X equals two plus the number of calendar months remaining to option expiration. . . ." Rogers' testimony that Denn's recommendation to buy deep-out-of-the-money unleaded gas options was justified because the "energy markets" are "traditionally thinly traded" (page 238 of hearing transcript) was undercut by the fact that in 1999 and 2000 the trading volume in the NYMEX energy options (Sweet Crude Oil, Natural Gas, Heating Oil and Unleaded Gas) was in fact not light. In 1999 and 2000, trading volume in those contracts, as measured by the number of contracts traded, was exceeded only by the volume in the Three-month Euro and Ten-year T-note options, and was comparable to other traditionally heavily traded options, such as the S&P 500 Index, Japanese Yen, 5-year T-note, Soybean, Corn, Gold, Sugar and Coffee options. Finally, Rogers' testimony that Sanchez was pretending to be inarticulate and unsophisticated at the hearing was contradicted by the recording of Sanchez's conversations with ITG's compliance officer that demonstrated no observable deviation in Sanchez's comprehension or demeanor. [1999 and 2000 CFTC Annual Reports; *see* Crown's testimony at pages 143-144, and Rogers' testimony at pages at pages 228-234 of hearing transcript.]

[9] CFTC rule 33.4(b)(2) requires that designated contract markets adopt rules identifying and governing deep-out-of-the-money options. *See* 46 Fed. Reg. 54,500, 54,505 (November 3, 1981) (Such rules are compelled because of "the potential for misleading and deceptive practices in the sale of such options.") The heating oil and silver options purchased by Sanchez are traded on the NYMEX.

The solicitation, account opening and initial trade

7. In late February 2000, Sanchez viewed a television infomercial that discussed how various widely reported news events had affected the commodity markets, and that conveyed a message that over-emphasized profits and downplayed risk. The infomercial provided only a low-keyed, boilerplate risk disclosure, claimed that options traders could take advantage of knowledge of weather patterns, political events and historical pricing trends and make huge profits, emphasized that options provided an opportunity for unlimited profit potential with limited risk, and emphasized that a penny move in the price of the cash commodity would translate into a profit of several hundred dollars. The commercial provided a toll-free number to call, but did not identify ITG, and did not mention that callers would be referred to a firm that would routinely recommend the purchase of high-risk deep-out-of-the-money options and would charge substantial commissions. [10]

After Sanchez called the toll-free number, an ITG employee called his home phone and left a message with ITG's toll-free number. Sanchez then called ITG, and spoke with Denn, who over the course of several conversations essentially repeated the message of the commercial that ITG could consistently pick highly profitable option trades that were "safe" and that were certain to generate tremendous profits. Denn focused on news stories about the gasoline market and explained how Sanchez would make huge profits if he bought unleaded gas options. Denn reinforced the message in the advertisement about how just a penny move in the cash market would translate into hundreds of dollars in profits on an option trade. When Sanchez hesitated

[10] Respondents did not rebut Sanchez's description of the infomercial. Respondents' purported unfamiliarity with the television infomercial that generated the lead for the Sanchez account appears to be at odds with their obligations under NFA compliance review rules 2-29 and 2-9, that bar misleading advertisements and that impose on NFA members a supervisory duty to ensure that their agents and employees do not purchase leads from firms that use fraudulent advertising practices. *See* NFA Notice "NFA's Review and Approval of Certain Radio and Television Advertisements" (March 28, 2000) (members may not evade their supervisory duty by obtaining leads from "blind" ads that do not identify the member firm and invite the viewer to call a toll-free number for more information.)

because he was having difficulty understanding Denn's explanations, she assured him that she would "educate" him as she traded his account. Denn asked very little about Sanchez's financial status. For example, she made no meaningful effort to determine how much of his savings actually qualified as risk capital. Denn also did not explain that ITG would be recommending the purchase of high-risk deep-out-of-the-money or substantially out-of-the-money options, or disclose that the trades recommended by ITG would generate substantial commissions that would consume a substantial portion of his investment. And, after several conversations, Denn did not correct Sanchez when he told her that it sounded like a "good investment" because "I'm putting so much money here and I stand to make a lot, but at the same time I'm not going to lose anything." (Page 21-22 of hearing transcript.) Denn suggested that the minimum investment was $15,000, and said that she would send an account-opening package by Priority Mail. [*See* Sanchez's testimony at pages 12-24 and 78-87 of hearing transcript; Denn's testimony at pages 177-195, 217-220, and 224-227 of hearing transcript; ¶¶ b and c of Denn's affidavit; and second through eighth paragraphs, on pages 1-3, and twenty-third and twenty-fourth paragraphs, on pages 8-9, of joint answer.]

8. The next day, Denn called Sanchez before the account-opening package had arrived at his house. Denn told him that the unleaded gas market was hot, and urged him to go to his bank and wire $20,000, so that he could begin making big money.

Sanchez went to his bank and called Denn, who then faxed to the bank a series of 14 pages from newspaper articles and from the account-opening package. However, Denn did not fax a complete account-opening package.[11] The transmission data on the top of the faxed pages

[11]The complete account-opening package had 30 pages, and included the following pertinent documents: a TNT cover sheet; a two-page risk disclosure statement; a table of contents; a TNT notice regarding trade confirmation statements; a three-page TNT account application; a five-page TNT customer agreement; a separate signature page for the customer agreement; an ITG additional risk disclosure; and an ITG fee disclosure.

shows that Denn did not fax the following crucial documents: the table of contents; the customer agreement; or the first page of the risk disclosure statement that contained the core warnings about the risks of trading options.[12] The transmission data also shows that Denn faxed the following documents, in this order: various newspaper articles (four pages); the cover sheet; the signature page of the risk disclosure statement; the customer application; the individual account designation, the arbitration agreement; the separate signature page for the customer agreement; and the ITG additional disclosure, fee disclosure,[13] and the electronic trade disclosure. Denn then instructed Sanchez where to sign these documents, and instructed him to report as his current annual income the most he had ever made, which had been $25,000, in 1985, and instructed him to exaggerate his liquid net worth by adding the $40,000 value of his residence to his $40,000 in savings, so that he could qualify and begin making money. Sanchez then wired his initial deposit, and faxed the signed pages back to ITG. Denn never suggested to Sanchez that he carefully review the actual account package once he received it. Moreover, on this record, it cannot be determined whether he actually ever received the complete package. When asked why she had faxed pages of newspaper articles, but not the complete risk disclosure statement and complete customer contract, Denn merely replied: "The only reason that I can think of is that [Sanchez] requested it." [Page 220 of hearing transcript; *see* Sanchez's testimony at pages 23-39, and 89; Denn's testimony at pages 185, and 187-190; and Crown's testimony at pages 147-152 of hearing transcript.]

[12] The withheld first page of the disclosure statement contained paragraphs 1 through 5 of the generic disclosure statement set out in Appendix A to CFTC rule 155(c).
[13] The ITG fee disclosure included a disclosure that the chance of a deep-out-of-the-money option "becoming profitable is ordinarily remote." However, since Denn did not advise Sanchez that she would be recommending the purchase of deep-out-of-the-money options, she assured that Sanchez would be unaware of the disclosure's significance.

9. Denn then told Sanchez that she had a gas trade that would be "safe" and would make huge profits. Other than promising huge profits, Denn did not mention a specific profit target, or an expected duration for the trade; did not disclose that the trade would generate a total of $4,700 in commissions; and did not mention that the trade involved deep-out-of-the-money options.

Set out below is Denn's testimony concerning her recommendation to buy deep-out-of-the-money options:

> *Judge:* Okay. Could you describe to me in your own words what are the specific risks that are associated with buying deep out of the money options?
>
> *Denn:* Well, in buying deep-out-of-the-money options, it's very unlikely for those positions to become profitable.
>
> *Judge:* That's it?
>
> *Denn:* Well, you have to take a look at what the expectations of the market are, but also the expiration dates, but it's a very remote possibility if they're held through the expiration date. Obviously, the point in buying options -- any options -- is to buy and then sell as soon as you're looking at a profit that you're happy with, and not get anywhere close to the expiration date, because the closer you get to the expiration, the more dangerous it is that you're going to expire worthless because the market is very volatile.
>
> . . . .
>
> *Judge*: According to Mr. Sanchez, you characterized the trades you'd be recommending as very safe. And you were highly confident that gas was going to soar and skyrocket, because demand was outstripping supply. Do you deny saying anything like that?
>
> *Denn*: Well, Mr. Sanchez was the one that actually brought up OPEC and supply and demand. I discussed it with him. I never advised him that the investment was very safe. I did advise him that he could lose the entire amount of the investment.
>
> *Judge*: Now, when he called you, was he already focusing on the petroleum markets?
>
> *Denn*: Yes, he was.
>
> *Judge*: Okay. So, he was already primed [by the infomercial] to trade the petroleum

markets?

Denn: He's the one that brought it. That's what he was interested in. Yes.

Judge: Okay. And that just happened to coincide with the trades your firm was recommending?

Denn: Yes. Well. It was all over the news and all over the newspapers considering what was going on with OPEC and the price of unleaded gasoline.

. . . .

Judge: <u>Did you tell him before he decided to open the account and sign the account opening statements that you would be recommending the purchase of deep-out-of-the-money options?</u>

Denn: <u>No</u>, sir.

Judge: When you recommended the deep-out-of-the-money options, what did you tell him about the specific risk associated with those options, because they were deep-out-of-the-money options?

Denn: Well, the risk -- <u>I advised him that the recommendation coming from the firm was to buy these particular options because even though that the chance of them becoming profitable was remote, it seemed as if the market would be going up substantially because of what was happening, you know, with the supply and the demand</u> and he agreed with me. <u>And I did advise him, you know, that it was his choice whether or not he wanted to buy deep-out-of-the-money options or not, but that he could actually purchase more options for the funds that he had sent in, as opposed to fewer options that were, you know, at-the-money or in-the-money.</u>

Judge: Okay. For your affidavit, I had asked you to describe what his investment objectives were, that he had expressed to you, and that you had ascertained. You essentially repeated what you said in the answer, which was: <u>"I asked complainant why he wanted to invest in commodity options and he told me he wanted to speculate in the markets in order to attempt to make a return on his investment."</u> Is that it? About his investment objectives as you understood them?

Denn: <u>As far as I knew, he wanted to speculate in order to make a return on his investment. That he wanted to make money in these markets.</u>

Judge: Did you discuss his risk tolerance?

Denn: Yes, I did. I asked him if he understood the risks. I asked him if he had any other investment experience. He said that he had about four years in bonds, he had an account with Oppenheimer, but he had closed that account. He seemed very knowledge and kind of savvy in regards to investing. He seemed, he was like, "oh I've done real estate and stocks and bonds and Oppenheimer, but I closed that account." I remember his attitude was that it was kind of flippant about closing that account. He wasn't making enough money.

Judge: Do you recall discussing what his specific profit objectives were?

Denn: Specifically?

Judge: Yes. Did you work out any percentages or dollar amounts or was it left open-ended?

Denn: It was left open-ended.

Judge: What exactly is it that made you think he was "savvy?"

Denn: Um, the way he was kind of rattling off information regarding, oh, Oppenheimer, stocks and bonds, talking about OPEC.

Judge: That's it?

Denn: Well, his overall attitude about, you know, calling me, wanting to open up an account.

. . . .

Judge: Okay. You've already, in your affidavit, stated you didn't remember the basis for your trade recommendations. Now, when you recommended these trades, did you tell him that these are deep-out-of-the-money options?

Denn: Did I specifically advise him of that? I believe that was explained to him in the compliance.

Judge: So, the answer is no, you did not explain to him?

Denn: I did not.

Judge: -- [Sanchez] certainly seems surprised when [he learns during the subsequent, tape-recorded compliance review] that the possibility of profit is "remote." His reaction is one of surprise. But then, of course, he acquiesces. So, you're saying you didn't mention that to him.

Denn: I'm sure I advised him that they were out-of-the-money options, but not deep-out-of-the-money options at the time. But that the premiums for in-the-money and at-the-money options were very highly priced.

Judge: But for the same amount of money he could have bought maybe, what, one or two in-the-money options?

Denn: I -- I do not have the specific information available to me at this time as far as what premiums were on those contracts.

Judge: Could he have bought at least one option?

Denn: I'm sure he could have bought at least one option.

Judge: And, of course, his commissions would have been a lot smaller. Okay, so did you tell him that the commission on this would total $4,700 on his first trade?

Denn: I advised him with commissions and fees broke it down for him specifically the cost of the option, the cost of the commissions, the cost of the fees, the total cost of one option, and multiplied it for him, advising him what the total amount would have been, and explained to him how much the actual cost of the option was, how much the actual commissions were paid, and how much for the actual fee.

Judge: Did you tell him that the commissions would total $4,700?

Denn: Yes -- yes, to the best of my knowledge.

Judge: Now, before this, when you talked to him about the kind of advice you were going to give to him, did you tell him that he should expect that the commissions would consume about a third of his investment?

Denn: No.

[Underlining added for emphasis. Pages 212-213, and 217-222 of hearing transcript; *see* Sanchez's testimony at pages 40-44; Crown's testimony at pages 149-152; and Rogers' testimony at pages 232-242 of hearing transcript]

10. Denn then told Sanchez that the last step before he could buy the gas options would be the tape-recorded account-opening review and the trade authorization. Although the ITG compliance officer began by stating that the purpose of the review was to assure that he "completely understand the investment [he] was about to make," and that he had the "financial ability to handle the risks involved with this investment," the manner in which the review was formatted and conducted shows that it was really an artifice designed to gloss over, rather than

cure or detect, the omissions and misrepresentations made by Denn. For example, although Sanchez was asked if Denn had adequately explained the risks and whether Denn had "guaranteed" profits, he was not asked to describe what Denn had specifically said about the relative risks and rewards of trading with her and ITG. Nor was Sanchez asked to describe his understanding of those risks and rewards.

Sanchez testified that he cooperatively answered the leading questions because he "trusted" Denn. In this connection, the ITG compliance officer unhesitatingly accepted "Yes" answers when she knew that the correct answer was "No." For example, despite the fact that she knew that Sanchez had not received the customer agreement or the most important part of the risk disclosure statement, she accepted Sanchez's affirmative reply when she asked if he had read and understood those documents.

As can be seen from the quoted passage below, the ITG compliance officer: induced Sanchez to exaggerate his financial status; glossed over the fact that Denn had not provided the complete risk disclosure and customer contract; implied that trading with ITG was safer than Sanchez's previous mutual fund investment; undercut the few references to risk with assertions that the risk was limited; promised to "keep an eye on the account" so that it would not be "overtraded;" did not disclose that the commissions on the first trade would total $4,700; disregarded the fact that Denn probably had not disclosed to Sanchez that the recommended trade had "remote" profit potential; and then falsely represented that the substantial risk associated with deep-out-of-the-money options could be negated simply by not holding them all the way to the May 25th expiration date:

> *ITG:* Okay. Today is February 29, 2000. And I am speaking with Mr. Lawrence C. Sanchez. Correct?
>
> *Sanchez:* Yes.

ITG: Okay. The purpose of this telephone call is just to make sure that you completely understand the investment that you're about to make, and also that you have the financial ability to handle the risks involved with this investment. With your permission, <u>I'd like to go over your application, which I have in front of me</u>. Okay?

Sanchez: Yes.

. . . .

ITG: All right. Have you received any inducements or any guarantees of any sort for making these transactions?

Sanchez: No.

. . . .

ITG: Okay. <u>You've listed your annual income at $25,000, and a net worth of $80,000.</u> Correct?

Sanchez: <u>Uh, well, my, I was talking to Lori --</u>

ITG: Um hum.

Sanchez: -- who's my broker. But, I deal sometimes in real estate property.

ITG: Okay.

Sanchez: Although you don't really come up with the amount of money that you split

ITG: Okay. <u>Because I was going to ask you about the annual income. So, can we put a range on here? Are you saying it's more than $25,000? 'Cause the $25,000 is an awful</u> -- hold on a second, quick second. (indiscernible discussion)

Sanchez: I work. <u>I still work and I'm employed</u>.

ITG: Um hum.

Sanchez: I work the building and construction trade --

ITG: Right.

Sanchez: General construction.

ITG: <u>Because $25,000 is kind of low for somebody that's investing $20,000</u>. And I'll get into it further on in the compliance. But, while we're at this point in time in the compliance, <u>I'd like to make sure that the $20,000, I mean that's a whole year of income, that you can afford to do this</u>.

Sanchez: Um hum. Oh, well, I um, I have made, I work for the building and construction trade.

ITG: Um hum.

Sanchez: And, one year, one year I ended up in a very high bracket.

ITG: Okay. Sir, I'm going to put down here gross value income $25,000, and I'll just put a plus sign. Okay?

Sanchez: Yes.

ITG: Okay. So we've established that there's more of an income than what you're investing.

Sanchez: Well, I don't know how to classify this. It's not money. It's --

ITG: Okay. So it's "$25,000-plus," and the net worth of "$80,000-plus."

Sanchez: But, my uh, see I have uh, I got, I did get into some power of real estate.

ITG: Um hum.

Sanchez: And then I was working to (indiscernible).

ITG: Okay.

Sanchez: And did invest in properties. But I did manage to get properties that were low.

ITG: Okay.

Sanchez: And were a very good buy. And they did appreciate well.

ITG: Okay. So, in other words you can afford to make this investment? Is that what you're saying?

Sanchez: Well, yes, I've been with other, I've been in investments here a little while.

ITG: Um hum.

Sanchez: And I had all my money in there.

ITG: Okay.

Sanchez: I didn't have $20,000. I had all of it.

ITG: Okay.

Sanchez: So, but I, I was often I'm (indiscernible) and I got out here because it wasn't bringing in anything. So, I just said well, I'm just taking it out.

ITG: Okay. So, the $20,000 is risk capital that you've put aside for investment?

Sanchez: Yes.

ITG: Okay?

Sanchez: I would say more or less. Well, I guess you can call it that.

ITG: Excuse me?

Sanchez: Yes, I guess you would call it that.

ITG: Well, I need to know that because this is an impor-- this is why we're going through this compliance. I need to be sure that you understand what you're doing, number one. And number two, that and again, as I said, we're going to get into this later on in the compliance. But, this has to be risk capital because it's possible you could lose this $20,000.

Sanchez: Yes.

ITG: I just need to know you're aware of that, you know --

Sanchez: Yes, I'm aware of that.

ITG: Okay. Because, I mean, most companies won't do this. But, in our company, we care about our clients to the extent that I don't want to take, we don't want to take food off your table. We don't want you to, if you should lose this investment, which again, I'm going to say, it's possible that it's not going to affect your lifestyle.

Sanchez: Well, it's not going to leave me on the street, that's for sure, or anything. I'm not putting up anything like my house --

ITG: Um hum.

Sanchez: -- are you suggesting savings? These are monies that I have saved. And I, but like I said, I have invested this money before.

ITG: Okay.

Sanchez: And these other people didn't go that much into anything like this. They just --

ITG: They just take your money and run.

Sanchez: The contract does say the same thing you're telling me.

ITG: Okay.

Sanchez: If you read the contract it says there is risk.

ITG: Okay. . . . All right. I have in front of me signed acknowledgements and they state that you've read and understand the customer agreement and disclosure statements for this options account. Is that correct?

Sanchez: Yes.

ITG: Did you read the documents before you signed them?

Sanchez: Well, I haven't received the documents.

ITG: You haven't received the documents.

Sanchez: Oh, that one, not unless it was the ones we did yesterday.

ITG: The documents that you signed.

Sanchez: Yes.

ITG: Okay. Did you read them?

Sanchez: Yes.

ITG: Okay. That's what I wanted to know.

Sanchez: Yes, that's what I've been, there wasn't that much on there.

ITG: Okay.

Sanchez: Um hum.

ITG: But I want to confirm with you that what you read and what you signed is in compliance with what your broker told you.

Sanchez: Yes.

ITG: Okay. So there's nothing contrary to what she told you to what you read.

Sanchez: No, not that I –

ITG: Okay. All right. And what I would like you to do is when you get the rest of the package, I mean, you signed the acknowledgements and that's fine. That's what we need, I mean compliance-wise. You know, when you get them, read everything. But it looks to me like you have everything here.

Sanchez: Yes.

ITG: I mean I have your whole file in front of me and it looks like you've read and signed everything.

Sanchez: Yes.

ITG: So there is, I don't know what you're thinking there's more, but there isn't, so, we're okay with that.

Sanchez: I was, I says well, maybe there was something else that I –

ITG: Well, there's some graphs and charts and stuff, but that's not, that doesn't apply to the acknowledgements and disclosures. Right now we're fine. The customer account application is fine. . . . . Fine. Okay. And, now, getting back into -- Do you understand that by buying a put and an exchange-traded option or any other limited risk option strategy again is a speculative investment. [*sic*] And what that means is your entire equity is at risk. And, as I said before, it is possible for you to lose all or a substantial portion of your investment. Okay?

Sanchez: Yes.

ITG: Okay. And do you also understand you can only lose the amount of your investment and will not be liable for any additional monies.

Sanchez: I believe so, but (indiscernible).

ITG: You could lose all, part of, but not a penny more. Okay?

Sanchez: Not any more than what I put in.

ITG: Right. 'Cause we're dealing in options and not futures here. And there's a limited risk. Okay?

Sanchez: I see, yes.

ITG: Okay. If that should happen, again, as we were talking about before, if that should happen, if you should lose your entire investment, would it substantially change your present lifestyle?

Sanchez: No.

ITG: Okay.

Sanchez: No.

ITG: I know we went over that again, but, okay, fine. And do you also understand that you will be charged a round-turn commission of $200 plus costs and fees, $25.18 per round term. And this includes your national futures association exchange and for fees for each option that's purchased for your account. And that these charges will be debited from your account. Okay?

Sanchez: Yes.

ITG: All right. Do you understand that?

Sanchez: I know there's a commission. And

ITG: Okay. The commission is $200 on a buy, on a, and there's a $25.09 cost of fees that has nothing to do with us. That's the NFA and exchange fees. And then on an offset when you sell a position, there's a 9 cents NFA fee, and that's it. Okay?

Sanchez: I believe so.

ITG: Okay.

Sanchez: Well there has to be something in there. I'm not too familiar with these percentages, but I know what percentage is.

ITG: Okay. <u>But the most you're going to be charged is the $225.09.</u>

Sanchez: <u>Um hum.</u>

ITG: <u>Are you sure? I mean it sounds like you're not too sure about it.</u>

Sanchez: <u>I'm not too familiar with the options</u>. But I'm not familiar with the --

ITG: Okay. I mean –

Sanchez: I know that there has to be a certain amount that goes to your broker --

ITG: Right. I'm telling you that the commission, the brokerage commission at most is going to be $200. Is that okay with you?

Sanchez: Yes.

ITG: All right. I just want to make sure. And do you also understand that in order to achieve a profit on an options transaction, you must first overcome the cost of the option, plus commissions and fees.

Sanchez: Yes.

ITG: Okay. Do you? I mean --

Sanchez: Yes, yes.

ITG: All righty. And do you understand that the option premiums do not necessarily move in tandem with the underlying futures contracts. They don't always move point for point.

Sanchez: Um, I believe so, yes.

ITG: Okay. All right. And, finally I just want to confirm with you that neither your broker nor anyone else has told you or suggested to you in any manner how to answer the questions I've just asked you. Is that correct?

Sanchez: No.

ITG: Okay. Good. All right, now also, it's company policy to read this very brief NFA Rule 2-30 additional risk procedure for anybody that hasn't dealt with commodity options before, who has a low net worth or annual income. And it talks about options and futures. And I will clarify it at the end of the brief statement. Okay.

Sanchez: Um hum.

ITG: And what it states is "one, that you should be aware that the risk of loss in trading commodity, futures or options contracts can be substantial. You may sustain a total loss of your initial margin fund and any additional funds that you deposit to establish or maintain a position. In addition, market conditions may be such that your account can incur a negative balance. In this event, you'll be liable for any deficit in your account. You should also be aware that the exercise of a long option contract or the assignment of a short option contract will result in a futures position." And, what we're concerned with here is that you're trading in options only. And I would suggest that you stay with options only. . . . Since the risk factor is high, only genuine risk funds should be used. Okay?

Sanchez: Yes.

ITG: And again, you know, I don't want you to over trade. We're going to keep an eye on this account. Again, because of your annual income, we don't want you to spend more than what you have. Okay?

Sanchez: Yes.

ITG: All right. Then, all right. So that was the initial compliance and you won't have to go through that again. Okay? And now I have a trade here for your account. . . . We're going to buy you twenty June unleaded gas, one dollar calls at 1.85 or better. They're going to cost you about $777 a piece. With again the $200 brokerage fee; $25.09 cost and fees bringing these in at approximately $1002 a piece. You're buying 20, bringing the total cost of this trade at about $20,040, which is a little bit more than what you've sent on. Okay? So if we get filled at that price, the account is going to have a deficit of $40. Are you aware of that?

Sanchez: All right. You just told me, yes.

ITG: Okay. So if, in fact, it doesn't come in any less, which we could get filled at less, but if it doesn't and there is a slight overage, can I, we need to have you drop a check in the mail when Lori tells you. Okay?

Sanchez: Yes.

ITG: For that amount. Is that going to be a problem?

Sanchez: No.

ITG: Okay. All right. Okay, Mr. Sanchez, these positions are going to expire on May 25th, 2000. And your break even on this is 103. Now, the break even is the price at which these underlying commodities must be trading on the day of expiration in order for you to recover what you paid for them. Again, this will include the cost of fees and the commissions that you have to overcome. All right? Now, the underlying futures contract on these positions is now trading at 84.80. Okay. So what you're purchasing here are deep-out-of-the-money options. And I want to make you aware that your potential for profit on the day of expiration is remote. So, did Lori explain that to you?

Sanchez: Remote?

ITG: Well, yeah, on that day. That's not to say that you *cannot* make money before then. But, on that day of expiration, on May 25th, you have to, the underlying futures would have to move over to 16 points. Okay? That's not to say it couldn't happen before that.

Sanchez: Oh.

ITG: All right.

Sanchez: Okay.

ITG: But I'm just saying on the day of expiration that's where these options have to be trading at is 103. Okay? And now they're at 84.80. Okay. <u>But if it moves before that, you'll be, you know, you could go into some profits</u>.

Sanchez: Oh, okay.

ITG: All right?

Sanchez: Yes.

ITG: And I will have Lori explain that to you a little bit further if you need it explained. Okay?

Sanchez: Yes.

ITG: All right. But, as I'm saying, that you know, it's a big movement.

Sanchez: Okay.

ITG: All right. Then we're just about finished with this. Do you have any questions for me, Mr. Sanchez?

Sanchez: No.

ITG: Okay. All right. Then let me be the first one to welcome you to Investors Trading Group.

[Underlining added for emphasis. *See* Sanchez's testimony at pages 28-44; and Crown's testimony at pages 146-149 of hearing transcript.]

11. The order to buy the twenty June heating oil $1.00 call options was filled at .0185 points.[14] For these options, Sanchez paid $15,154 in premiums, and $4,700 in commissions, for a total cost of $19,854. The resulting commission-to-premium-paid ratio was 31%.

[14]On February 29, 2000: the June heating oil future contract settled at 84.65; the in-the-money $.85 heating oil calls traded between .055 and .057 points; and the $1.00 calls purchased by Sanchez were 16 strike prices from the strike price ($.85) closest to the futures price.

Subsequent trades

12. On March 7, Denn told Sanchez that the June heating oil calls were doing really good, because they had doubled in value to $31,000, and she expected them to continue increasing in value. She advised him that he could either sell them for $31,000, or hold on longer for even greater profits.[15] Also, she urged him to buy more heating oil calls with promises of yet more profits. Sanchez decided to hold the June heating oil options and to send in another $12,120 to fund the purchase of ten deep-out-of-the-money July heating oil options, which were filled at .0235 points.[16] For these options, Sanchez paid $9,870 in premiums, and $2,251 in commissions. The resulting commission-to-premium-paid ratio was 22%. [See Sanchez testimony at pages 47-48, and 128-131; Denn's testimony at pages 199-207 of hearing transcript; pages 6-7 of Denn's affidavit; and 18th paragraph, on pages 6-7, and 21st paragraph, on page 8, of joint answer.]

13. On March 16, Denn told Sanchez that he should talk to her boss, Crown, who had a soybean trade that "looked good." Crown's first utterance was to ask Sanchez if he had another $60,000 to invest. Crown never asked Sanchez about his investment objectives, about his finances, about his understanding of the ITG's trading strategies, and otherwise disregarded ITG's earlier promise to not "overtrade" his account and to limit Sanchez's exposure to an amount less than his purported $25,000 annual income. When Sanchez replied that he did not have $60,000 left in his savings, Crown urged Sanchez to send in another $25,000, because he had a soybean trade that would make a $250,000 profit. Sanchez said that sounded like a good trade, and Crown abruptly transferred Sanchez to the ITG compliance department to approve a

[15] $31,000 represented the premium that would have been collected had the options been sold at the settlement price. However, the net profit would have been just $11,000.

[16] On March 7, 2000: the July heating oil future contract settled at 88.00; the $.88 in-the-money calls traded between .0625 and .0680 points; and the $1.05 heating oil calls purchased by Sanchez were 16 strike prices from the strike price ($.88) closest to the futures price.

trade that would have generated another $4,000 in commissions. Sanchez's reactions during the tape-recorded conversation indicate just how abruptly Crown had tried to push Sanchez into this trade, and then how even more abruptly he tried, without even a perfunctory consultation, to push Sanchez into selling heating oil options to fund a similar purchase when Sanchez appeared reluctant to send in more funds:

ITG: We're going to buy you 20 July soy bean, $6 calls at the market. Now market price --

Sanchez: <u>Wait a minute</u>. I talked to, I talked to Bruce here --

ITG: Hold on a second. Okay. (indiscernible) Hi, Mr. Sanchez. Sorry about that. We're so busy.

Sanchez: Yes. I know that, I talked to Mr. --

ITG: Okay. Let me read the trade to you. Okay?

Sanchez: Um hum.

ITG: <u>We're going to buy you 20 July soy bean, $6 calls at the market</u>. Again, market price means best available price at the time. I can't guarantee a specific price. I can guarantee we'll get it filled for you. We're estimating these are going to cost about 6 and a quarter with a $200 brokerage fee, $25 cost of fees, bringing these in at about 900 a piece. <u>You're buying 20 bringing the total cost of this trade about $18,000. Is that how you understand it?</u>

Sanchez: I believe uh, <u>he didn't explain that much, but I guess he</u>, he was talking about the um --

ITG: Okay. What didn't he explain, sir?

Sanchez: Uh, well he said there was uh, how much, he went through it and -

ITG: Okay. Sir, did he tell you the breakdown? Did he tell you how much you were going to pay for these?

Sanchez: Ah, yes, apparently -

ITG: Well, now I need to be sure that you're okay with this.

Sanchez: I um, the only thing I was talking to Mr. Crown. I said I didn't exactly tell him, but what it is, is that that's the only thing I have in reserve right now.

ITG: What is that, Mr. Sanchez?

Sanchez: I don't even have that much in reserve. But I don't know if I can even touch this money because --

ITG: Okay. Hold on a second (indiscernible).

Sanchez: Um hum.

ITG: Okay. Mr. Sanchez –

Sanchez: Yes.

ITG: Okay. We're not going to do that trade. Right? What we're going to do right now is . . . we're going to sell your 20 June gas $1 calls at the market. . . . Okay. When we get filled on that, we're going to turn around. We're going to buy you 15 July soy bean, 6 and a quarter calls at also at the market. Again, both these cases market price means best available price at the time. These positions are going to cost you about $500 a piece with a discount in brokerage fee of $150 plus costs and fees of $25.09 bringing these in at about 675. You're buying 15, bringing the total cost of this trade at approximately $10,500. Is that your understanding?

Sanchez: Uh, I guess. I don't know. From what he tells me, I guess I'm losing quite a bit on the (indiscernible) by going, I don't know what would, I'll be indebted I believe, yeah.

ITG: Well, is this what you want to do? I need to know that this is what you want to do. That you want to sell out your gas and buy soy bean.

Sanchez: I wonder if I should talk to Lori. I wonder if I should talk to Lori on this.

ITG: Okay. Hold on. I'm going to give you Lori. Hold on.

After Sanchez had decided not to make a trade, Crown left Sanchez alone. [*See* Sanchez's testimony at pages 48-60; Denn's testimony at pages 205-206; Crown's testimony at pages 152-161 of hearing transcript; page 7 of Denn affidavit; ¶¶ 26-27 of Crown's answer; and 20th paragraph, on page 7, of joint answer.]

14. After March 29, Paul Brown took over as Sanchez's account executive. Over several conversations, Brown told Sanchez that the June heating oil options were worth only $200,

which actually represented the liquidation value per contract, and not the total liquidation value for the 20 option contract. Brown also asserted that the only way for Sanchez to recoup his losses would be to sell the June heating oil options and buy silver options. On April 20, Sanchez approved the purchase of seven substantially out-of-the-money July silver 500 call options:

> *ITG:* At your request, . . . we're going to sell you 20 June unleaded gas $1 calls at 50 or better. Is that your order?
>
> *Sanchez:* I'm going with just, well that's whatever is left.
>
> *ITG:* At your request, . . . we're going to sell you 20 June unleaded gas $1 call's at 50 or better. Is that your order?
>
> *Sanchez:* I'm going with just, well that's whatever is left.
>
> *ITG*: Okay. Is that what you want to do? You want to sell these positions?
>
> *Sanchez*: <u>Well, apparently, I think we have to</u>.
>
> *ITG*: Okay. Well that's what I need to ask you. Is that what you want to do?
>
> *Sanchez*: Yeah, yeah.
>
> *ITG*: Okay.
>
> *Sanchez*: Because the others don't seem to be doing well, and we gotta go wherever we can --
>
> *ITG*: Okay. So you want to sell them?
>
> *Sanchez*: We're going to sell them.
>
> *ITG*: Okay. All right. Contingent on getting filled at that price, I have another order here. And you're going to buy at your request for the same account number 7 July silver, 5 and a quarter calls at 9 or better. Is that what you want to do?
>
> *Sanchez*: <u>That's what he said</u>.
>
> *ITG*: No, is that, no, no, no. Not what he said. I want to know if this is what you want to do?
>
> *Sanchez*: Um, I don't know. Like I told the man, I don't, <u>he explained that it would be a better</u>, this is probably

ITG: I know, but Mr. Sanchez --

Sanchez: Yes.

ITG: -- but the decision is yours. This is your account and I know he's made recommendations, and I'm not saying not to listen to him. I'm not saying that. I just need to know if this is what you want to do? Do you agree with him? Is that what you want to do? Is this by your choice?

Sanchez: Well, apparently I, it is not my choice because apparently the market on the gasoline isn't doing well. And he's recommending this because he said that in order to save the investment we, this probably is a better way to go.

ITG: Okay. I know he's making a recommendation to you.

Sanchez: Yeah.

ITG: And is this what you want to do? Please, I need a definite answer from you. I know he's recommending and the decision has to be yours.

Sanchez: Um --

ITG: This is your account.

Sanchez: Yes.

ITG: I mean I'm not trying to tell you not to do it or to do it. I just want you to tell me yes or no. If this is not what he wants you to do, just yes or no, whether you want to sell out your gas and buy silver. And if you want to, I'll continue with the trade.

Sanchez: Yeah. Well, we'll sell the gas.

ITG: Okay.

Sanchez: Go with silver.

ITG: Okay. Good. So let me finish then.

Sanchez: Okay.

ITG: Okay. So you're going to buy 7 July silver 5 and a quarter calls at 9. They're going to cost you 450 a piece approximately with a discounted brokerage fee of $125, $25.09 cost in fees. It's going to bring these options in at about 600 a piece. You're buying the 7, bringing the total cost of this trade at about $4200. Is that your understanding?

Sanchez: Apparently, yes.

ITG: Okay. They're going to expire June 9, 2000. Your break even on this is 537. Now, you know that the break even is the price at which the underlying commodity must trade on the day of expiration in order for you to recover what you paid for it. This includes the cost of your commissions and fees. Okay? Right now the underlying futures on July silver is trading at 509. So what that means is you're buying options that are deep out of the money. And what that means is that by definition that the potential for profit, if you hold them till the day of expiration is remote. Do you understand and accept this?

Sanchez: Um, um, well, as far as all this I'm not that familiar with it, but apparently I have to go with this because I don't have any more choices (indiscernible).

ITG: Okay. But is this what you want to do again? I mean --

Sanchez: Well, apparently --

ITG: You keep saying you have to. You don't have to do anything. This is something that you're going to do by choice.

Sanchez: Yeah. Well I don't know how much I would lose or how much I got left.

ITG: Okay. Would you like to go back to the broker and have him explain it to you, because I'm not comfortable putting the trade in if you're not sure. I want you to be sure.

Sanchez: Um --

ITG: So I mean if you want to continue, we'll continue. But, if you want to talk to the broker again and make sure, then I'll patch you back to him. Because I need, you know, you keep going back to you know, this is what I have to do.

Sanchez: Um, I guess I'll go back and talk to the broker a little more.

ITG: Okay. Hold on. And I'm going to hold these trades until you, I get you back on the phone.

Sanchez: Yeah.

ITG: Okay. Hold on. So you're going to buy 7 July silver 5 and a quarter calls at 911, everything at a deep into the money and where it's trading. And this buy order is contingent on getting filled on your gas. Is that correct?

Sanchez: Yes.

. . . .

ITG: Okay. Well, I'm going to sell the gas. And then if we get filled on the price that you and your broker discussed, we're going to buy the silver.
Sanchez: All right.

ITG: Is that what you want to do?

Sanchez: That's what we want to do.

For the silver options, which were bought at 8 points, Sanchez paid $2,800 in commissions, and $1,575 in commissions.[17] The resulting commission-to-premium-paid ratio was 55%. [*See* Sanchez's testimony at pages 60-66, and 128; Denn's testimony at pages 207-210 of hearing transcript; ¶ c, on page 8, of Denn's affidavit; and 22nd paragraph, on page 8, of joint answer.]

15. After Sanchez instructed on May 5th that the account be closed, the July heating oil and July silver options were sold, and the account balance returned to Sanchez.

Sanchez deposited a total of $32,162 ($20,000 on February 29, $12,120 on March 8, and $42 on March 10, 2000), and received back a total of $7,766 ($3,567 on May 8 and $4,199 on May 9, 2000), for a total net out-of-pocket loss of $24,396. Respondents charged $8,000 in commissions to Sanchez's account, which consumed almost a third of his total investment. Out of this total, TNT retained about $703, ITG received about $4,360, Lori Denn received about $2,417, Bruce Crown received about $185, and Paul Brown received about $135. [*See* ¶ b of Marshall's second affidavit, and the account statements.][18]

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[17] On April 20, the July silver futures contract settled at 516.9, and the in-the-money 525 July silver call option traded between 17 and 24 points.

[18] The account statements reported a total of $8,525 in commission debits ($4,600 on February 29, $100 on March 1, $2,250 on March 7, and $1,575 on April 20), and a $525 commission credit on April 24, for a net total of $8,000 in commissions charged to the Sanchez account. Respondents reported a slightly smaller $7,800 total in Marshall's second affidavit. In the absence of an explanation for respondents' method of calculation, the $8,000 sum derived from the account statements is deemed to be more accurate.

Conclusions

Denn's fraudulent solicitation and trading advice

The preponderance of the evidence establishes that Lori Ann Denn, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10,[19] and CFTC rule 33.7,[20] intentionally defrauded Sanchez during the solicitation, the account-opening, and the trading of his account by providing a heavily lopsided picture of the relative risks and rewards of following ITG's trading advice and by pushing the purchase of deep-out-of-the-money options in order to generate excessive commission income. Denn repeated the misleading message of the infomercial that ITG could consistently pick highly profitable option trades that were "safe" and that were certain to generate tremendous profits. Denn focused on news stories about the gasoline market and explained how Sanchez would make huge profits if he bought unleaded gas options, and repeated the infomercial's message that just a penny move in the cash market would generate hundreds of dollars in profits on an option trade. Denn failed to explain that ITG would be recommending the purchase of high-risk deep-out-of-the-money, or substantially out-of-the-money, options. Denn failed to disclose that the trades recommended by ITG would generate substantial commissions that would consume a substantial portion of his investment and significantly hinder potential profitability. And, at the conclusion of her solicitation, Denn did not correct Sanchez when he told her that it sounded like a "good investment" because "I'm putting so much money here and I stand to make a lot, but at the same

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[19] Section 4c(b) provides that: "No person shall . . . enter into or confirm the execution of any transaction involving any . . . option . . . contrary to any . . . regulation of the Commission." CFTC rule 33.10 provides that: "It shall be unlawful for any person directly or indirectly -- (a) to cheat or defraud or attempt to cheat or defraud any other person; (b) to make or cause to be made to any other person any false report or statement thereof or cause to be entered for any person any false record thereof; (c) to deceive or attempt to deceive any other person by any means whatsoever -- in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction."

[20] CFTC rule 33.7(a) provides that "no . . . introducing broker . . . may open . . . a commodity option account for an option customer unless the . . . introducing broker furnishes the option customer with a separate written disclosure statement."

time I'm not going to lose anything." It is "rudimentary" that these sort of misrepresentations and omissions about profit potential and risks are material. *In re JCC,* [1994-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,059 at 41,576 n.23 (CFTC 1994), *affirmed* 63 F.3d 1557 (11th Cir. 1995).

By principally compensating its account executives and branch office managers with a cut of the commissions, ITG supplied Denn, Crown and Brown with the necessary motivation to convince Sanchez to approve trading strategies that emphasized their interests over Sanchez's interests. Moreover, the fact that Denn, Crown and Brown had repeatedly urged Sanchez to invest more money and to make more trades indicates that pushing trades to generate commissions was a pervasive practice at ITG. As part of this commission-generating scheme, Denn recommended trades in positions that were deeply out of the money ("OTM"), even when comparable in-the-money ("ITM") positions were available. These trades exponentially increased respondents' commission income, because ITG charged Sanchez commissions based on the number of contracts traded, rather than the value of the position, and because more OTM options could be purchased since the premium for an OTM option is substantially lower than the premium for a comparable ITM option.

Here, respondents' explanations that the purchase of deep-out-of-the-money options enabled Sanchez to buy a greater quantity of contracts regardless of quality, or that with the purchase he acquired increased leverage, cannot be justified for Sanchez whose trading objective included, at a minimum, a reasonable chance of profit with a reduced risk tolerance. First, the value of a low-priced option is almost always less responsive to price changes in the underlying commodity or asset. Second, the total premium value represents the amount of risk, regardless of the number of contracts. And third, the profit potential of an OTM option, as measured by its delta, is lower than that of an ITM option of the same type. *See Ferriola v. Kearse-McNeill*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,172, at 50,154-50,155 (CFTC 2000). For these reasons, the Commission has emphasized that "when customers are paying commissions on a per-contract basis, an account executive seeking to serve his customer's interests will purchase the lower-cost ITM position." *Id.*, at 50,155. Thus, Denn's promise of certain profits when she convinced Denn to trade deep-out-of-the-money options failed to reflect the reality that the strategy of buying OTM options, compared to buying comparable ITM options, was significantly more risky and less profitable, and that the only real guarantee was that respondents' stream of commission revenue would be unnecessarily increased.

Denn's promises of certain profits similarly failed to reflect the detrimental effect of ITG's burdensome commissions on profit potential. Here, the commissions and fees charged to Sanchez's account consumed nearly a third of his investment and resulted in a commission-to-premium-paid ratios of 31% and 22% for the trades recommended by Denn, and 55% for the trade recommended by Brown, which represented a formidable barrier to profit potential. Thus, Denn's unrestrained profit projections were materially deceptive:

> Because the size of a firm's commissions and fees affects the profit potential of an investment, it affects the kinds of representations that can be made about profitability. . . . All else being equal, customers of a firm with a high commission or fee structure will have a more difficult time making a profit than those who employ a less expensive firm. As a result, the firm charging higher commissions and fees is more limited in what it can claim regarding profit potential.

Johnson v. Fleck, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,957, at 37,502 (CFTC 1990) (Chairman Gramm concurrence).[21]

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[21] Similarly Brown's unrestrained promise to recoup losses with more trades was deceptive because it failed to reflect the fact that ITG's burdensome commissions significantly hindered profit potential and the fact that the recommended OTM options were more risky than comparable ITM options. Finally, in the absence of any justification from respondents, Brown's advice to sell the June heating oil options appears to have been primarily motivated by a desire to generate commission income from an account he had inherited. *See Hinch v.*

The intentional nature of Denn's fraud is underscored by her blatantly false and deceptive claims of trading expertise, her failure to provide a complete risk disclosure statement, her determination to convince Sanchez to invest additional funds in excess of his purported, but still modest, annual income, and her knowledge that Sanchez was an unsophisticated novice who was relying on her to provide fair and reasonable trading advice.

Crown's fraud and failure to supervise

The preponderance of the evidence establishes that Crown deceived Sanchez and perpetuated Denn's fraud, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10, and in violation of CFTC rule 166.3,[22] when he deliberately disregarded the fact that Denn had induced Sanchez to commit a large percentage of his retirement savings to purchase deep-out-of-the-money options and when he recklessly urged Sanchez to commit the remainder of his life savings in order to fund more high-risk, commission-generating trades. Although he had sufficient authority and knowledge to detect and cure Denn's fraud, Crown devoted his efforts exclusively to enriching respondents at Sanchez's expense. Crown reviewed and approved ITG's sales and trading practices and account-opening compliance review; was responsible for closely supervising ITG's associated persons; and established the compensation scheme that motivated ITG brokers to recommend commission-generating trades. Crown admitted that he had reviewed Sanchez's account application, and was familiar with the trading activity in Sanchez's account. As a result, Crown knew that Sanchez was an elderly, semi-

Commonwealth Financial Group, Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,056, at 45,021-45,022 (CFTC 1997). This conclusion is underscored by the fact that Brown convinced Sanchez to purchase substantially out-of-the-money options that generated exponentially more commissions than would have a purchase of comparable in-the-money options.

[22] CFTC rule 166.3 provides that: "Each Commission registrant . . . must diligently supervise the handling by its partners, officers, employees and agents . . . of all commodity interest accounts carried, operated, advised or introduced by the registrant . . . ."

retired, novice options trader with minimal investment experience, and that Sanchez's annual income was at most $25,000, and his net worth at most $80,000. Crown also knew that Denn had already convinced Sanchez to fund the purchase of high-risk deep-out-of-the-money options with an amount equivalent to his purported annual income and equivalent to a quarter of his purported net worth. Nonetheless, when he first spoke to Sanchez, Crown made no effort to ascertain Sanchez's investment objectives, let alone determine whether the Denn's dubious trades were consistent with Sanchez's trading objectives. Crown also made no effort to discover or cure the false mix of information provided by Denn, or to determine whether Sanchez could withstand a dramatic increase in risk exposure. Rather, Crown aggressively tried to separate Sanchez from the remainder of his life savings. In pursuit of this goal, Crown made an unrestrained promise of a ten-fold profit, which was grossly misleading given the dismal performance of ITG's customers. Although Crown did not successfully convince Sanchez to deposit more funds or approve the soybean trade, Crown did reinforce the false overall impression created by Denn that ITG consistently selected profitable, low-risk trades. Thus, Crown perpetuated and concealed Denn's fraud, and breached his duty to supervise Denn. *See Bishop v. First Investors Group of the Palm Beaches*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,004, at 44,841-44,842 (CFTC 1997).

The intentional nature of Crown's fraud is underscored by his knowledge that Sanchez was an unsophisticated novice relying on ITG to provide fair and reasonable trading advice, by his gross indifference to Sanchez's obviously modest financial status, by his reckless disregard of Denn's fraud, by his blatantly false claim of trading expertise, and by the abrupt manner in which he attempted to rush Sanchez into approving another trade that would have generated another $4,000 in commissions.

Reliance and proximate causation

Sanchez's decision to open the account and deposit additional funds was consistent with his testimony that he relied on respondents' emphatic message that he would make quick and large profits with minimal accompanying risk. The following factors support the conclusion that Sanchez reasonably relied on Denn's, Crown's and Brown's misrepresentations and omissions to his detriment: the fact that he had no previous experience in the futures and options markets, the fact that his investment experience was limited to four years with a mutual fund, and the fact that the temporary profit on the first trade appeared to validate Denn's guarantee. *See Ricci v. Commonwealth Financial Group, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,917 (CFTC 1996).

Respondents' written disclosures of general risks by themselves did not cure the false impression of guaranteed large profits created by Denn, and reinforced by Crown and Brown, where Denn failed to provide a complete risk disclosure statement and where the overall effect of respondents' intentionally deceptive statements substantially outweighed and vitiated the written risk warnings. *Ferriola,* at 50,153; *Bishop,* at 44,841; and *Levine v. Refco,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,488, at 36,115-36,116 (CFTC 1989). Similarly, ITG's perfunctory compliance review cannot be used as "advance exoneration" of Denn's, Crown's and Brown's fraud, where ITG's compliance review was obviously not designed or conducted to discover or to cure the sort of misrepresentations made by Denn, Crown and Brown. More significantly, the ITG compliance officer actively facilitated Denn's fraud by inducing Sanchez to exaggerate his financial status; glossing over the fact that Denn had not provided the complete risk disclosure and customer contract; and strongly implying that trading with ITG was safer than Sanchez's previous mutual fund investment. The ITG compliance officer also deliberately deceived Sanchez by undercutting the few references to risk with assertions that the risk was limited; by failing to disclose the total commissions; by disregarding the fact that Denn had not disclosed to Sanchez that the recommended trade had "remote" profit potential; and then by deceptively representing that any high risks could be easily negated simply by not holding the options for the entire three months to expiration. *See JCC, Incorporated v. CFTC,* [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,492, at 43,217-43,218 (11th Cir. 1995).

The fact that Sanchez at one time had decided not to sell the June options for a profit does not preclude Denn's liability for Sanchez's losses after that date, where she had created the impression that he could expect even larger profits with little risk, where she had urged him to invest additional funds, where she had never discussed a specific profit target or expected duration for the trade, and where the expiration date was over two months away. Brown's deceptive trading advice in connection with the third trade also does not cut off Denn's liability, since she shared in the fruits of Brown's deceptions and since Brown's deceptions closely resembled Denn's fraud, and thus was a reasonably foreseeable consequence of her solicitation. Accordingly, the proper measure of damages for Denn's fraudulent solicitation and trade recommendation is Sanchez's total out of pocket losses: $24,396.

ORDER

Lawrence Sanchez has established that: Lori Ann Denn violated Section 4c(b) of the Commodity Exchange Act and CFTC rules 33.7 and 33.10; that Bruce Norman Crown violated Section 4c(b) of the Commodity Exchange Act and CFTC rules 33.10 and 166.3; that these violations, separately and together, caused $24,396 in damages; that Investors Trading Group, LC is liable for the violations of Denn and Crown pursuant to Section 2(a)(1)(A) of the Act; and that TechNet Trading, Incorporated is liable as the guarantor of Investors Trading Group. Accordingly, Lori Ann Denn, Bruce Norman Crown, Investors Trading Group, LC, and TechNet Trading, Incorporated are ORDERED to pay to Lawrence Sanchez reparations of $24,396, plus interest on that amount at 1.23%, compounded annually from February 29, 2000, to the date of payment, plus $125 in costs for the filing fee. Liability shall be joint and several.

Dated May 16, 2003.

Philip V. McGuire,
Judgment Officer