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SONIA SASSE, and STEPHEN A. SASSE,
Complainants,

v.

LARRY ALAN KAHN;
FERDINAND JOSEPH YOUNG; and
SOUTH COAST COMMODITIES, INC.,
Respondents.

CFTC Docket No. 06-R027

INITIAL DECISION

Appearances

Sonia and Stephen Sasse, complainants, *pro se*, Hixson, Tennessee

Ferdinand Young, respondent, *pro se*, Miramar, Florida

Vivian Drohan, Esq., Drohan & Drohan, New York, New York,
for respondents South Coast Commodities and Larry Kahn, Plantation, Florida

Introduction

Sonia and Stephen Sasse allege that Ferdinand Young fraudulently induced them to open a joint non-discretionary options account with a combination of misrepresentations, omissions and half-truths. The Sasses assert that Young conveyed the false message that -- if they acted quickly and followed Young's advice – they would realize tremendous profits, at reduced risk, for a moderate commission charge. They also allege that Larry Kahn, Young's supervisor and co-owner of South Coast, concealed and perpetuated Young's fraud by means of South Coast's deceptively scripted account-opening "compliance review" and trading authorization procedure.[1]

The Sasses raise three key allegations. One, they allege that Young and South Coast deceptively convinced them that respondents would charge a $240 commission per transaction, when in reality respondents charged a $240 commission per contract and collected thousands of dollars in commissions per transaction, because they routinely recommended multi-contract trades. Two, they assert that Young made confident claims of past profits and confident profit projections that outweighed South Coast's generic risk disclosures and distorted the relative risks and rewards of trading with Young and South Coast. This distortion included concealment of the reality that almost all of Young's and South Coast's customers had consistently suffered substantial losses, principally because Young and other South Coast brokers routinely recommended trading strategies designed to generate onerous commissions, which in turn invariably consumed trading profits and equity. Three, they assert that respondents used the scripted account-opening compliance review and trading authorization procedure "to get the responses they needed to protect themselves and make it look like they were straightforward with us."

In response, Young filed an answer, and Kahn and South Coast filed a joint answer. Respondents generally deny any violations. Respondents assert that they never literally

[1] The Sasses initially asserted two inter-related reasons for Larry Kahn's liability. One, they asserted that Kahn directly perpetuated Young's fraud during the scripted account-opening review and trade authorizations, because Young had told them that it was Kahn who would be personally conducting the review and authorizations, as well as supervising Young, and monitoring the Sasses' account. (During the recorded review and authorizations, the South Coast representative had identified himself, not by name, but as "The Trading Desk.") Two, they asserted that Kahn, in his capacity as chief executive and Young's supervisor, had violated his duty to supervise Young and South Coast, because he had presumably approved the abusive trades recommended by Young, and had presumably approved the scripted and account-opening compliance review and scripted trade authorization procedure, which deceptively downplayed and obscured the high risks and high costs specifically associated with the trades routinely recommended by Young and other South Coast associated persons. After South Coast had belatedly produced the recording of the account-opening compliance review and trade authorizations, Kahn asserted for the first time that it was not his voice on the recording -- which I have confirmed. As a result, the Sasse's claim against Kahn is based solely on the alleged failure to supervise Young and South Coast.

guaranteed profits and assert that they adequately disclosed the risks and costs through their written account-opening documents and through their scripted account-opening compliance review and trade authorization procedure.[2]

After carefully reviewing the documentary record and the parties' oral testimony, I have concluded that the Sasses have established that Young defrauded them during the solicitation and trading of their account, that Kahn failed to adequately supervise Young and South Coast, and that the Sasses are entitled to recover $16,752 in damages. This conclusion reflects my determination that Sonia Sasse's testimony was generally more sincere, plausible and reliable than Young's and Kahn's testimony.

Young conceded that he could not recall the specifics of his conversations the Sonia Sasse, with the exception of the initial conversation in 2005, when she told him that she regretted missing out on a recent move in oil prices.[3] Otherwise, Young merely referred to entries in his telephone log or recalled his "stock way of approaching clients . . . looking at the possibility of some profitable investments." At times, Young's testimony was particularly implausible: such as when he insisted that he had no idea how his brief conversation with Stephen Sasse could have resulted in Stephen insisting to Sonia that they should increase their investment from $5,000 to $30,000, because this was a "once in lifetime opportunity to make good money."

Kahn had initially asserted in a pre-hearing affidavit that he did not recall any conversations with Young about the Sasse account.[4] However, at the hearing, he testified that, upon receipt of the Sasses' signed account application and check for $30,000, he became concerned about the size of their investment relative to their net worth and income, and in view of their inexperience, and made sure that Young would pursue a "somewhat conservative" and

[2] Respondents raised no affirmative defenses.
[3] Young testimony at pages 66-69 of hearing transcript, and page 10 of Young's supplemental affidavit.
[4] Paragraph "s" of Young's supplemental affidavit.

"diversified" trading strategy.[5] This testimony appeared especially unconvincing when viewed in light of the deceptive and reckless manner in which the Sasse account was handled after Kahn had issued his instructions to Young:

- During the scripted South Coast account-opening compliance review – which was approved by Kahn -- the risk of substantial or total loss was deceptively presented as a generic, worst-case scenario, rather than a highly representative scenario for South Coast customers.

- Kahn's and Young's "diversification" was basically a sham. Respondents technically reduced the risk by spreading the Sasses' exposure in three different markets: heating oil, T-bonds and gold. However, the trades recommended by respondents – large, multi-contract, positions in out-of-the-money options and option spreads -- were not remotely conservative, because they were patently designed to generate onerous commissions, which would inevitably consume large portions of trading profits and equity. As a result, diversification merely delayed the inevitable demise of the account.

- During the scripted South Coast trade authorizations – which also were approved by Kahn – the actual commission costs were deceptively downplayed and obscured.

- Respondents delayed Sonia Sasse's discovery of their deceptions about the true size of the commissions by convincing her to commit the entire $30,000 deposit to three quick trades in three straight days, before she would receive the account statements from the carrying broker. Sasse had expected the commissions to total $720, and promptly protested to Young upon receipt of the written statements, which reported that the commissions and fees had totaled $9,120.

Kahn's assertion that the Sasses "were proactive in the trading activity conducted in their account . . . [and] continued to authorize and request trades even after losses" was particularly absurd, and completely contradicted by the facts. First, the only time that Sasse was proactive was when she decided to the close the account, upon discovering that Young and Stein had deceived her about the commissions. Otherwise, the recorded account-opening review and trade authorizations clearly showed that Sasse totally relied on Young to select trades and to determine when to enter and exit trades. Second, Sasse never requested trades after losses. Rather, she

[5] Kahn testimony at pages 87-88 of hearing transcript.

approved a total of three trades, in the first three days of the account; and three weeks later, after she protested the size of the commissions, she instructed Young to close out two of the trades, but to leave open one trade because it had already lost most of its value and Young had told her that it was a long-term trade.

Finally, Kahn and Young both failed to offer a coherent or convincing rationale for their focus on large positions in out-of-the-money options. Both also failed to acknowledge that their focus on large positions in out-of-the-money options generated a substantially increased stream of revenue – an apparently ingrained mindset that permeated their dealings with the Sasses. When asked to justify the propensity of South Coast brokers like Young to recommend out-of-the-money ("OTM") options when comparable in-the-money options ("ITM") were available, Kahn did not even attempt to offer a general justification for preferring OTM options over ITM options.[6] Nor did he attempt to justify the selection of OTM options for the T-bond and heating oil trades. Kahn merely offered that the profitable outcome for the gold trade justified Young's recommendation to buy gold calls that were twelve strike prices out of the money. However, two facts indicate that they were substantially worse off with OTM options. One, the Sasses could have saved $600 in total costs, saved $1,680 in commissions, and faced a substantially smaller break-even rate – 11% versus 44% -- if Young had recommended three ITM April gold calls, instead of twelve substantially out-of-the-money April gold calls. Two, the $2,400 commissions consumed two-thirds of the gross profit, *i.e.*, the net premium collected. As a result, although it was the Sasses' money that was at risk, their share of the profits was only half that of respondents' share.[7]

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[6] Exchange data supplied by the CFTC Office of the Chief shows that, for each of the trades in the Sassee account, ITM options were available, at a substantially lower commission cost and a significantly lower break-even rate, on the days that Young steered Sasse into OTM options.

[7] Kahn testimony at pages 88, and 91-94, of hearing transcript.

Young asserted that ITM options are generally "prohibitively expensive," and just as risky as OTM options, and asserted that OTM options offer greater leverage.[8] However, exchange data shows that for each trade Young could have recommended ITM options at substantial savings for the Sasses. Moreover, Young produced no evidence to substantiate his assertion that these ITM options were just as risky as the OTM options.

Factual Findings[9]

The parties

1. Sonia and Stephen Sasse indicated on their account application that they were in their fifties, were retired, had a joint income between $50,000 and $75,000, and a joint net worth between $75,000 and $100,000, and had five years experience trading stocks and bonds, but no experience trading commodity futures and options. Stephen Sasse had worked as a nuclear lab technician until he suffered a disabling brain injury in a work accident.[10] An annuity established by Stephen's grandfather provides the Sasses' principal source of income. Sonia had worked in real estate, but at the relevant time her main job is with La Paz de Dios, a non-profit organization that helps immigrants learn English and acquire life skills.

During the solicitation, Ferdinand Young would call Sonia Sasse at home and at Sonia's workplace. He exclusively spoke to Sonia, with the exception of one brief conversation with

[8] ¶¶ 9-14 of Young's supplement to answer, and pages 5-7 of Young's supplemental affidavit.
[9] The findings and conclusions are based on: (1) Sonia Sasse's and Young's oral testimony; (2) the Sasse's complaint and addendum to the complaint; (3) Stephen Sasse's affidavit; (4) Kahn's and South Coast's joint amended answer, and Kahn's affidavits; (5) Young's answer, supplement to the answer (titled "supplementary answers"), and supplemental affidavit; (6) the broker notes (option client card, and comments log); (7) the account-opening documents, account statements, and equity runs (produced by Comtrust, Inc., the carrying broker); (8) two affidavits by Timothy Redding, the president of Comtrust; (9) the order tickets for the trades in the Carlson account; (10) the tape recording of the account-opening compliance review, and the trade authorizations on December 13, 14 and 15, 2005; (11) National Futures Association records; (12) price data from the CFTC Office the Chief Economist; and (13) the Consent Order of Permanent Injunction in *CFTC v. Worldwide Commodity Corporation, et al.*, No. 2:04-cv-3641 (E.D. Pa. September 19, 2006).
[10] Stephen Sasse's disability includes grand mal seizures, speech and language deficits, and paralysis of the right side of his face, and his right leg, arm and hand. As a result, he cannot speak clearly and fluently, and did not offer oral testimony. *See* the Sasses' Amended Complaint, and Stephen Sasse's affidavit.

Stephen that concluded with an excited Stephen telling a reluctant Sonia that he wanted to increase their investment from $5,000 to $30,000. For the account-opening compliance review, and for the authorizations to initiate the three trades, Young would call Sonia at her workplace, which was a noisy and distracting environment. Since Sonia Sasse handled all but one of the communications with South Coast agents Ferdinand Young and Mitch Stein, all references are to her, unless otherwise noted. [Sasse testimony at pages 5-10, 30-31, and 54-55, of hearing transcript; Stephen Sasse affidavit; and account application.]

2. Ferdinand Joseph Young was registered as an associated person with Worldwide Commodities Corporation, and its successor South Coast Commodities, from August 2002 to March 2006. Young had no previous futures or options experience before being hired by Larry Kahn. Young has not been registered since August 2006.

Young's compensation at Worldwide and South Coast was based on a 35% to 40% cut of the commissions charged to his customers' accounts, rather than the performance of those accounts. In this connection, during his three-and-a-half year tenure at Worldwide and South Coast, Young's customers consistently lost money. In 2005, Young was assigned 20 accounts, only three of which enjoyed overall net profits. These 20 account in aggregate realized about $99,500 in net losses, and generated about $104,975 in commission and fees. Thus, Young's customer accounts achieved an aggregate gross profit that was obliterated by commissions.

When Young first cold-called Sonia Sasse in late 2004, he was employed by Worldwide Commodities. When he called Sasse back, and convinced her and her husband to open the account with a deposit of $30,000, he was employed by South Coast. Young acted as the Sasses' account executive for the ten-week life of the account. [Sasse testimony at pages 59-60 of hearing transcript; Stephen Sasse affidavit; Young testimony at pages 61-66, and 81-83, of hearing transcript; ¶¶ 1, 3 and 4 of Young's supplement to the answer, and pages 1-4 of Young's supplemental affidavit; Redding affidavit; January 27th Notice; and NFA records.]

3. Larry Kahn, a co-owner of Worldwide and South Coast, was first registered in 1985. Kahn's registration has been suspended for failure to pay a reparations award.

Before starting up Worldwide, Kahn had been registered as a principal of six firms that have been closed by the CFTC or the NFA for fraudulent sales practices. Kahn and his co-owner Steve Labell[11] jointly controlled all aspects of Worldwide and South Coast operations. In that capacity, Kahn: controlled the firms' finances; was co-signatory to corporate accounts; established the compensation scheme; set the commission rates; hired and fired brokers; had the power to investigate, reprimand and discipline brokers; supervised Young's sales and trading activities; implemented the procedures ostensibly designed to detect, cure and prevent fraudulent sales practices, which included the scripted account-opening compliance review and the scripted trade authorization procedure conducted by Mitch Stein; and supervised Stein. [Kahn testimony at pages 84-91 of hearing transcript; Kahn affidavit and supplemental affidavit; Young supplemental affidavit; and NFA records.]

4. Mitchell Howard Stein was a registered principal with Worldwide and South Coast from December 1998 to March 2006. Previously, Stein had been registered at two tainted firms -- Universal Commodity Corporation, and Global Atlantic Management -- at the same time as Kahn and Labell. [NFA records.]

Stein regularly conducted the Worldwide and South Coast scripted account-opening compliance review and trade authorization procedure. In this connection, Sasse credibly testified

[11] Steven Labell, the other co-owner of Worldwide/South Coast, was first registered in 1986. Before starting up Worldwide, Labell similarly had been registered as an associated person with six firms that have been closed by the CFTC or the NFA for fraudulent sales practices. Labell had worked as a branch office manager at two of the firms and had been registered as a principal at one. Labell had been associated at three of these tainted firms – JCC, Inc., Universal Commodity Corporation, and Global Atlantic Management – at the same time as Kahn.

that Young had told her that Kahn was the gentleman who would be conducting the account-opening compliance review and the trade authorizations, and who would be supervising Young and monitoring their account. Kahn and South Coast belatedly produced a tape-cassette recording of these four conversations. During these conversations, the South Coast agent never stated his name, but merely identified himself as the "South Coast Trading Desk."

After he produced the recording, Kahn asserted, for the first time, that it was not he, but Mitch Stein, who had conducted the scripted compliance review and trade authorizations. After the hearing, I compared the Sasse tape with the tape submitted in another case – *Carlson v. Kahn, et al.* -- in which Stein had been reliably identified as the South Coast agent. The fidelity of the recordings is less than ideal, but the voice in both recordings seems sufficiently similar to find that it was Stein, not Kahn, who spoke to Sasse. The manner in which Stein conducted the compliance reviews and authorizations for both accounts shows that Stein was working off a script -- approved by Kahn -- that was craftily designed and conducted to downplay and obscure the risks and costs specifically associated with the trades typically recommended by South Coast associated persons, including those trades that Young recommended to Sasse.

5. The Sasses' account was introduced by South Coast Commodities from December 13, 2005 to February 24, 2006. Comtrust, Incorporated carried the account for South Coast.

South Coast was a relatively small firm with 11 registered associated persons, not counting the owners, at the relevant time. Eight of these 11 AP's had previously worked for firms that had been disciplined by the NFA or CFTC for fraudulent sales practices.[12]

South Coast, and its predecessor Worldwide, were Florida corporations and registered introducing brokers, located at the same address in Pembroke Pines, Florida, with the same set of

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[12] In this connection, Kahn testified that he did not train, or retrain, many of the brokers that he hired, because most of them "had experience." [Pages 85-86 of hearing transcript.]

owners, employees and customers. In this connection, first in late 2004, and then in late 2005, Young sent Sasse nearly identical packets of promotional and account-opening materials. For example, the "Timing is the key to good investments" cover letter for these packets was identical, with the exception that the first letter had Worldwide letterhead, and the second letter had South Coast letterhead.

On August 13, 2004 -- a couple of months before Young first contacted Sasse -- the CFTC filed an injunctive complaint with the United States District Court for the Eastern District of Pennsylvania alleging multiple violations of the anti-fraud provisions of the Commodity Exchange Act and CFTC regulations, by Worldwide and its owners, Larry Kahn and Steven Labell. Young testified that, in the wake of this complaint, Kahn and Labell did not modify any practices, but informed their brokers at a meeting that "the very viability and survival of the firm was at stake, and . . . that they would vigorously defend themselves as best they could, and until then, we should just get back to work, do the best we can, and let the process play out." [Pages 63-64 of hearing transcript.]

Subsequently, in 2006, the District Court would enter a consent order that permanently barred Worldwide, South Coast, Kahn, and Labell from registration and commodity-related activity, and imposed monetary sanctions. In that Order, the Court found that during the two years before Young first contacted Sasse -- from January 1, 2003, to August 1, 2004 – 98% of Worldwide's 341 customer accounts had lost money, with customers losing a total of over five million dollars, and Worldwide charging about 3.5 million dollars in commissions, which represented almost 70% of the losses. Data produced by Comtrust establishes that this dismal performance continued into 2005, when over 95% of the active South Coast accounts had suffered losses; no active accounts had enjoyed significant net profits; and South Coast customers had realized an aggregate net loss of over 1.5 million dollars, and South Coast charged about 1.25 million dollars in commissions, which represented over 80% of the losses. Thus, for three straight years, the commissions charged by Kahn's firms were by far the single largest contributing factor to his customers' substantial losses. [*See* Consent Order of Permanent Injunction; Redding affidavit; January 27th Notice; and NFA records.]

6. On January 31, 2005, just after Young had first contacted Sasse, Worldwide's co-owners, Larry Kahn and Steven Labell, engaged in a corporate shell game by shifting their operation from Worldwide to South Coast. Kahn and Labell transferred Worldwide's assets to Stephanie Dye, their receptionist and office manager, for no consideration. Two weeks later, Kahn and Labell purchased all of South Coast's stock back from Dye. With the exception of a switch in carrying brokers and a switch from guaranteed to independent status, this transformation resulted in no significant changes in company structure, leadership, compensation or business operations: Kahn and Labell remained 50/50 owners; South Coast operated in the same office space; all of Worldwide's associated persons transferred their affiliations to South Coast; all Worldwide accounts were transferred to South Coast; Kahn continued to supervise Young and Stein; and the customers continued to lose. Young's and Kahn's testimony indicates that Kahn initially kept a low profile, but by late 2005, when the Sasses decided to open the account, he was visibly back in charge. [*See* January 25th Notice; November 27th Redding affidavit, NFA records; Consent Order of Permanent Injunction; Young testimony at pages 61-65, and Kahn testimony at pages 84-87, of hearing transcript.]

Opening the Account

7. In late 2004, Young cold-called Sasse, and told her that his firm, Worldwide Commodities, specialized in trading commodity options, and that he had a great opportunity to

take advantage of an expected price hike in petroleum. Other than the price of gasoline at the pump, Sasse knew nothing about the petroleum market and knew nothing about commodity options, but agreed to review a package of documents that included risk disclosure statements and news articles about the cash markets for crude oil, unleaded gasoline and heating oil. Sonia reviewed the documents and discussed the matter with her husband. They decided that they were not interested in further discussions with Young, because their investment objectives were conservative, they were satisfied with the modest but steady income from their annuity, they were concerned about the references to risk in the documents, and they were reluctant to trust a stranger. When Sasse told Young that she was not interested, he suggested that she track the price of crude oil and gasoline and that, if the price went up in 2005, she would know that she had missed out on a great opportunity to make some big money. The Sasses forgot about Young, but started playing closer attention to the price of crude oil and gasoline as it fluctuated upward in response to various events. [*See* Sasse testimony at pages 9-14, and Young testimony at pages 66-74, of hearing transcript; and ¶ 4 of Young's supplement to the answer.]

8. A year later, in November 2005, Young called Sasse, and discussed news reports about events, like Hurricane Katrina, that had helped to drive up the price of crude oil. Sasse told Young that the news stories had spiked her interest in trading options. Young told her that she had missed out on great profits enjoyed by his other customers, but that he had a new opportunity to make some big money. Young did not explicitly tell Sasse that she had to act quickly. However, he exerted subtle psychological pressure by emphasizing that hurricane-induced production shortages continued and that now was a good time to buy options before winter demand drove up the price of energy products.

Young mentioned that trading options involved risk, but used a combination of technical truths to downplay risk. For example, he stated that "every investment has risk;" and that with options the risk was limited to the purchase cost of the commissions -- *i.e.*, the total cost of premiums, commissions and fees -- but "not a penny more." Young did not explicitly use the term "guarantee', but he effectively guaranteed profits by harking back to the purported lost opportunity earlier in 2005, and by confidently claiming that he had regularly made large profits trading options by exploiting knowledge about seasonal price cycles, worldwide strife and disasters, and other widely known factors that affect supply and demand. However, Young never told Sasse that knowledge of these widely known matters does not assure options profits, because the market has already factored these matters into the price of options. Similarly, Young never remotely alluded to the fact that his customers in 2005, and previous years, had uniformly experienced, not large profits, but large losses.

Young told Sasse that South Coast charged a $240 commission, with the clear implication that this was a per-transaction charge. Young never clearly revealed the fact that respondents would be charging thousands of dollars per transaction, because they charged the commissions, not on a per-trade basis, but on a per-contract basis, and they routinely recommended multi-contract trades involving cheap out-of-the-money options.[13] Similarly, Young never explained that the commissions would quickly consume a third of the Sasses' investment, and he never explained that the commissions would constitute over 40% of the purchase cost for each of the recommended trades in the Sasse account.

[13] Out-of-the-money options are cheap in the sense that the premium for an out-of-the-money option is smaller than the premium for an in-the-money option. However, they are an expensive proposition for customers of firms that charge commissions on a per-contract basis. For example, the Sasses' first trade, twelve OTM T-bond puts, had a total purchase cost of about $8,400 ($6,560 premium, plus $2,900 commission), and a break-even rate of over 40%. In contrast, Young could have recommended the purchase of four, less risky, in-the-money T-bond puts, for a lesser total purchase cost of about $7,500, a much smaller commission cost of $960, and a significantly smaller break-even rate of about 15%. For the other two trades in their account, the Sasses could have similarly saved over $4,000 in commissions and faced significantly smaller break-even rates, if Young had recommended available ITM options.

Young sent the Sasses a new package with informational brochures and account-opening documents. The cover letter to the package reinforced Young's message that the Sasses should act quickly to take advantage of the expected run-up in oil prices:

> Your broker will give you personalized service. Your account executive will keep you apprised of market movements and give you timely information. . . . Timing is the key to good investments. There are really no good or bad markets, just good or bad timing. Because timing is critical, we ask that you give this your immediate attention.

The package included three Worldwide/South Coast brochures that featured charts showing seasonal fluctuations in the price of heating oil, crude oil, and unleaded gasoline, as well as news articles about events that affected supply and demand.

The account-opening documents included three documents that warned that trading commodity options generally involved a high level of risk: a standard futures risk disclosure, a standard options risk disclosure statement, and an additional risk disclosure statement for novice traders. The account-opening documents also included the South Coast "fee notification," which was deceptively worded to create the impression that the commissions and fees would be $240 "per round turn," rather than per contract, per round turn.

Sasse read the risk warnings, but was not particularly concerned, because at that time she was contemplating committing only $5,000, and because Young had strongly implied that he could substantially negate the risk with his confident assertions -- seemingly confirmed by the "missed opportunity" -- that he could reliably make good money for his customers by predicting, identifying and exploiting price fluctuations in commodity markets. Sasse also trusted Young, because she assumed that, just as she knew that her real estate clients' expected her to look out for their interests in a real estate deal, she expected that he was the expert she could rely on to avoid a bad investment. The Sasses were not so gullible as to believe that risk could be absolutely negated, and decided to limit their initial deposit to $5,000, because this would be their first venture with Young, on whom they would be relying. In this connection, the recording of the account-opening compliance review supports Sasse's contention that she was confused about Young's trading strategies, and had learned little from Young beyond the necessity to place a trade before the anticipated price change in the commodity.

Young waited a day or two, and then, on or about November 29, 2005, called Sasse, who said that they were ready to open an account. Young skimmed over the customer contract, and the risk and fee disclosures, not discussing the documents in any detail, but reassuring her that she was signing up for a great investment and telling her where to sign. As a result, he left Sasse with the strong impression that South Coast would charge just $240 in commissions per trade, and that the risks described in the written warnings were generic and not really germane to the trades that he would be recommending.

When Sonia told Young that they were starting with $5,000, Young asked to speak to Stephen. After Stephen and Young spoke for a few minutes, Stephen excitedly told Sonia that this was a "once in a lifetime opportunity" where they could easily make big money if they acted quickly, and insisted that they increase their commitment to $30,000. Sonia argued that it was not wise to trust such a large sum to someone they barely knew, even though he appeared to be knowledgeable and successful. However, Sonia relented because Stephen adamantly insisted that Young was going to make them big money. By December 13, 2005, respondents had received the Sasses' $30,000 check and signed account-opening documents. [*See* Sasse testimony at pages 14-31; Stephen Sasse affidavit; Young testimony at page s 66-74, of hearing transcript; and ¶ 6 of Young's supplement to the answer.]

9. Next, Mitch Stein conducted a scripted account-opening compliance review. He started by stating: "The purpose of this review is to make sure you completely understand the investment that you're about to make." However, Stein did not explain the out-of-the-money option trading strategies favored by Young and other South Coast brokers, and did not explain that Young would definitely be recommending multi-contract trades, costing thousands of dollars in commissions, with 40% break-even rates. Stein never asked Sasse to explain in her own words her investment objectives, her expectations, or her understanding of the mechanics, costs, risks and potential rewards specifically associated with the trading strategies discussed by Young. He also never asked her to describe what Young had told her about these matters. Rather, Stein breezed through a series of leading questions that merely touched on matters like risk and commissions, and that were crafted for short, yes or no, answers.

Sasse's hesitant and vague replies made it clear that she had a long way to go before gaining a rudimentary familiarity, let alone complete understanding, of options trading:

> *Stein:* Which markets are you interested in trading.
>
> *Sasse:* We want to trade in [long hesitation] --
>
> *Stein:* Energies?
>
> *Sasse:* Yes, it's energy. Energy. Yes.

About two minutes into the ten-minute conversation, Stein brought up commissions, and the notion of multi-contract trades, for the first and only time during his review:

> *Stein:* You can't lose more than what you put in. . . . That's all we're talking about now is the limited risk strategies. . . . Now, do you also understand that you're going to be charged a round-turn commission of $240 for each option that is opened for your account and that these charges will be debited from your account?
>
> *Sasse:* Uh huh.

Stein: Now, just for an example, if you were to open ten positions for your account, the charge is going to be $240 times ten, which totals $2,400.

Sasse: Buy ten positions for our account. What do you mean?

Stein: Well, you can buy any number of options that you want for your account, whether you buy 1, 5, 10, 30, 50, however many. But for each option that you purchase, you are going to be charged a commission of $240.

Sasse: Uh huh.

Stein: So if you were to purchase 10 options, it's going to be $2,400. If you were to purchase 5 options, it's going to be $1,200. If it's going to be 30 options, now you're looking at a number that's too big to do in my head.

Sasse: So, that would be --

Stein: $7,200. But, I just want you to understand it's $240 for each option. How many you decide to buy is totally between you and your broker.

Coincidentally, over the next three straight days, Young would quickly convince Sasse to approve the purchase of a total of 30 option contracts, plus the sale of eight option contracts for the short legs of a spread trade, which would generate $9,120 in commissions and fees: greater than the number that Stein claimed was "too big to do in my head." In any event, since Young had not clearly explained how South Coast charged commissions, and since neither Young nor Stein had told her that Young would be advising her to approve multi-contract OTM trades -- 12, 10 and 16 contracts, respectively, for the three trades -- she was hindered from processing and retaining Stein's cursory explanation of commissions in a meaningful way.

Stein never alluded to the fact that almost all South Coast customers lost money, and Stein repeatedly undercut any mention of risk with assurances that trading options was a "limited risk strategy," that Young would help her limit any losses, or that total loss was a worst case scenario:

Stein: Now you understand that your investment will consist of the purchase of put and call exchange-traded options?

Sasse: Uh-huh. [hesitating]

Stein: Are you sure?

Sasse: He --

Stein: [interrupting] See. What the important word on that is "purchasing." Because, again, when you are purchasing the option, you're limiting your risk.

Sasse: That's what we're going to do. We're going to purchase options. That's it.

Stein: Right.

. . . .

Stein: Do you realize if the market does not move in the direction by the expiration date, that your options will expire worthless, and that you will lose your entire premium?

Sasse: Explain that again.

Stein: Sure. When you purchase an option, you are buying a specific amount of time, whether it's two months, three months, four months, again that's between you and your broker.

Sasse: Uh huh.

Stein: Now, if you purchase options and the market never moves in your favor and you hold onto them all the way to their expiration, in all probability, they are going to expire worthless. That's the worst-case scenario.

Sasse: Uh huh.

Stein: Okay? You can see if something is not working out, and you can always sell your position to cut your loss. . . .

Sasse: I am counting on the fact that our broker will be informing us.

Stein: Absolutely.

Sasse's statements at the conclusion of Stein's review revealed that she had lingering concerns about risk, but that Young had convinced her that if she acted quickly he would get her into trades that were highly likely to be profitable:

Stein: Do you feel that you can risk this money?

Sasse: You know, I'm not comfortable with it, but I think that right now is a good time to invest in energy. And if we do want to make, you know, good growth on that amount, this is the time to do it.

Stein: Okay. Then, you would like to go ahead and do this?

Sasse: Uh huh.

Stein: Okay the tape is finished.

Stein then transferred Sasse back to Young, for the first trade recommendation. [Sasse testimony at pages 31-38 of hearing transcript.]

Trading the Account

10. Set out below is a summary of the trading in the Sasse account:

In	*Out*	*Trade*	*Net Premium*	*Commissions & fees*	*Commission-to-Premium Ratio*
12-13	2-24	12 Mar. T-bond puts	($6,563)	($2,880)	44%
12-14	1-06	10 Apr. Gold calls	$3,300	($2,400)	44%
12-15	1-06	8 Feb. Heating Oil calls	($4,368)	($3,840)	45%

The $9,120 in commissions and fees, all charged during the first three days of trading, consumed 30 percent of the Sasses' investment. The fact that the commission-to-premium-paid ratio – *i.e.*, the breakeven rate – for each trade exceeded 40 percent underscores that these commissions presented a substantial, and nearly insurmountable, barrier to profits.

11. For each trade, Young told Sasse that he had a great trade, and gave her a brief rationale for the trade. For the first trade, he told her that he expected interest rates to rise over the next couple of months. For the second trade, he told her that he expected a rise in the price

of gold. For the third trade, he told her that he expected the price of heating oil to rise, like petroleum products had shot up in 2005, due to shortages caused by hurricane damage to Gulf platforms and refineries and due to the reliably predictable increase in use as the weather in the northeast cooled. For each trade, Young told Sasse that the "commission is $240," but did not tell Sasse the total cost of the trade, and did not break the total cost down into total premiums and total commissions and fees paid. Young also did not tell her the break-even price, and did not tell her that the option had to appreciate over 40% merely to break even.

After briefly describing each trade, Young handed Sasse to Stein, who conducted a brief recorded trade authorization. Stein confused Sasse with his use of the term "position." During the account-opening review he had used the term to mean individual contracts when he discussed the commission charges for various hypothetical trades. In contrast, during the trade authorizations, he used the term "position" for the whole multi-contract trade: "I have an order to buy twelve March Treasury Bonds, 109 puts, at 40 points or better to open the position." Stein did not disclose the break-even price, or the break-even rate, which exceeded 40 per cent. Stein also did not clearly break down the costs into total commissions, total premiums and total costs. Rather, he stated that the "round-turn commission was $240 for each." [Sic.] Next he stated the amount of the total commissions, but he created the false impression that that amount was the total cost of the trade – *i.e.*, premiums plus commissions – by describing that amount as "the total," and not actually estimating the total premium cost or the total cost of the trade. As a result, Sasse believed that she would be charged a total of $720 in commissions for the three trades. [Sasse testimony at pages 17-18, 29-32, 40-48, and Young testimony at pages 74-7, of hearing transcript.]

13. Upon receipt of the mailed confirmation statements, which reported that she had been charged $9,120 in commissions, Sasse called Young to complain that he had not clearly disclosed the size of the commissions. Young replied that South Coast had recordings of the calls which would show that Stein had told her about the commissions, and asserted that the commissions were justified because "I am a professional, and that is what I charge." As a result, Sasse lost all trust in Young, and called the CFTC Division of Enforcement, which informed her that if she felt defrauded, she should consider cutting her losses and closing her account. On January 6, 2006, Sasse called Young and told him to close out the heating oil and gold trades and return the balance, but to hold the T-bond trade, because it had sunk to below $1,000, and he had initially advised her that it was a long-term trade. The T-Bond puts would expire worthless.

On January 11, 2006, respondents returned the account balance of $13,248. Thus, the Sasse's out-of-pocket losses totaled $16,752.

CONCLUSIONS

Young's fraudulent solicitation and trading advice

The preponderance of the evidence establishes that Ferdinand Young, in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rules 33.10,[14] intentionally defrauded Sonia and Stephen Sasse during the solicitation, the account-opening, and the trading of their account by distorting the relative risks and rewards of following his trading advice, by deceiving them about the size of the commissions, and by urging them to approve large positions in high-risk out-of-the-money options and option spreads, in order to increase respondents' commission

[14] 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."

income. Young misled Sasse into believing that South Coast charged a $240 commission per transaction, when in reality South Coast charged thousands of dollars per transaction, because South Coast charged commissions, not on a per-trade basis, but on a per-contract basis, and Young and other South Coast brokers routinely recommended large positions in out-of-the-money options. Young also never disclosed to Sasse that the commissions would immediately consume a third of the Sasses' total investment, and that the commissions would be sufficiently onerous: to create break-even rates over forty percent; to consume the lion's share of any trading profits; and to magnify trading losses. Young concealed and perpetuated these deceptions during his trade recommendations, by not accurately disclosing the huge commission costs or the high break-even rates, and by urging Sasse to approve three quick trades during the first three days, before she could receive the written confirmation statements that accurately reported that the Sasses had paid, not $720 in commissions as she had expected, but over $9,000 in commissions. Young falsely represented that he had consistently made money for his customers, when in reality most of his customers had consistently lost most of their money, principally because Young steered them into trades that generated excessive commissions. It is "rudimentary" that these sorts of misrepresentations and omissions about profit potential and risks are material. *In re JCC,* Comm. Fut. L. Rep. (CCH) ¶ 28,059 at 41,576 n.23 (CFTC 1994), *affirmed* 63 F.3d 1557 (11th Cir. 1995). The materiality of Young's various deceptions about the commissions is underscored by the fact that as soon as Sasse received Comtrust's written confirmation statements -- which reported accurately, for the first time, the size of the commissions – Sasse acted quickly, first complaining to Young, and then closing the account when he cavalierly refused to acknowledge his deceptions.

Larry Kahn provided Young with the necessary motivation to convince Sonia Sasse to approve trading strategies that emphasized respondents' interests over the Sasses' interests, by basing Young's compensation on a cut of the commissions, instead of on account performance. Thus, Young recommended trades in out-of-the-money ("OTM") options and option spreads, even though comparable in-the-money ("ITM") positions had been available. These OTM trades exponentially increased respondents' commission income, because respondents charged Sasse 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 lower than the premium for a comparable ITM option.

Young's "affordability," "reduced risk," and "leverage" explanations for his focus on OTM options failed to show that his recommendations were consistent with the Sasses' basic objective to make trades with a reduced risk and a reasonable likelihood of profits. Young's "affordability" rationale was based on the fact that the premiums for OTM options are smaller than the premium for ITM options. However, as noted in the findings above, for each of the three trades, for the same or slightly smaller outlay, the Sasses could have saved substantial commission costs, and faced significantly lower break-even rates, if Young had recommended a smaller number of comparable ITM options that were available.

Young's "reduced risk" rationale was similarly unconvincing. The premium represents the value, or market price, of an option, at a given time. The market sets the premium based on various factors: the relation of the option's strike price to the prevailing market price of the underlying commodity or instrument, the option's expiration date, prevailing interest rates, and the volatility of the underlying futures contract. As Young and Stein repeatedly emphasized, the premium also represents the total risk, *i.e.*, the most that the Sasses could lose, plus those heavy commissions that Young and Kahn instinctively refused to acknowledge. Thus, all things being equal, two portfolios consisting only of long option positions with the same total premium value present equal risk, regardless of the number of contracts in each portfolio. *See Ferriola v. Kearse-McNeill*, Comm. Fut. L. Rep. (CCH) ¶ 28,172, n. 22 and n. 24, at 50,155 (CFTC 2000). Of course, things were not remotely equal, because Young chose to buy greater numbers of cheaper OTM options, which generated exponentially greater commissions, which in turn created comparably greater break-even rates. Thus, for the OTM options in the Sasse account, the profit potential was diminished and the risk of loss correspondingly increased.

Young's "leverage" rationale ignores the fact that, all things being equal, the value of a low-priced OTM option is almost always less responsive to price changes in the underlying commodity or asset than a higher priced ITM option. An option's profit potential is measured by its delta – *i.e.*, the sensitivity of the option's premium to changes in the value of the underlying instrument or commodity. The delta of an OTM option is lower than the delta of an otherwise identical ITM option. That is why an ITM option is more valuable than an OTM option, and why a portfolio containing the smaller number of ITM options will have a greater profit potential than an equivalent portfolio with a greater number of OTM options. *Id.*, n. 24, at 50,155. 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, Young's assurances of reduced risk and high profit potential when he convinced Sasse to trade OTM 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 potentially profitable, and that the only real guarantee was that the Sasses' account would be depleted, while respondents' stream of commission revenue would be unnecessarily increased, as proven over the years by the experience of Young's and South Coast's other customers.

Young's confident assurances of profits similarly failed to reflect the detrimental effect of respondents' burdensome commissions on profit potential. Here, the commissions and fees charged to the Sasse account immediately consumed a third of their total investment; consumed two-thirds of the gross profit on the only profitable trade; magnified trading losses; and invariably consumed large portions of equity. For each trade, the substantial commissions resulted in commission-to-premium-paid ratios, or break-even rates, exceeding 40%, which represented formidable barriers to profit potential. Thus, Young's confident, barely restrained, 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, Comm. Fut. L. Rep. (CCH) ¶ 24,957, at 37,502 (CFTC 1990) (Chairman Gramm concurrence).

The intentional nature of Young's fraud is underscored by his subtle pressure on the Sasses to act quickly and to increase the size of their investment; his knowledge that the Sasses were novices who were relying on him to provide honest, fair and reasonable trading advice; his blatantly false and deceptive claims about his trading expertise; and his concerted efforts to conceal the true costs of the commissions.

Reliance and proximate causation

The Sasses' decision to open the account was consistent with Sonia Sasse's credible testimony that the Sasses relied on Young's virtual guarantee that they would make quick and large profits with minimal accompanying risk. The following factors support the conclusion that the Sasses reasonably relied on Young's misrepresentations and omissions to their detriment: the fact that they had no previous experience in the futures and options markets, the fact that their investment experience was limited, and the fact that Sasse told Stein that she was totally reliant on Young to provide dependable advice. *See Ricci v. Commonwealth Financial Group, Inc.*, 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 Young, where the overall effect of Young's intentionally deceptive statements substantially outweighed and vitiated the written risk warnings. *Ferriola,* at 50,153; and *Levine v. Refco,* Comm. Fut. L. Rep. (CCH) ¶24,488, at 36,115-36,116 (CFTC 1989). Similarly, Mitch Stein's scripted compliance review, and the minimalist risk disclosures during the trade authorizations, cannot be used as "advance exoneration" of Young's lies and deceptions, where Stein obscured the commission costs, failed to disclose the high break-even rates and the high risk of loss associated with respondents' recommended trading strategies, and ignored the fact that Young had obviously not provided fair and accurate disclosures about the costs, the risks and the mechanics of the recommended trades.

The proper measure of damages for Young's fraud is the Sasses' out-of-pocket losses: $16,752.

Kahn's Failure to Supervise

CFTC rule 166.3 provides that:

> Each Commission registrant . . . must diligently supervise the handling of its partners, officers, employees, and agents . . . of all commodity interest accounts carried, operated, advised, or introduced by the registrant and all other activities of its partners, officers, employees, and agents . . . relating to its business as a Commission registrant.

The objective of this rule is to protect customers from fraudulent activities. *Modlin v. Cane*, Comm. Fut. L. Rep. (CCH) ¶27,392, at 46,809 (CFTC 1998). Failure to supervise is an independent and primary violation of Commission rules. *In re Paragon Futures Association*, Comm. Fut. L. Rep. (CCH) ¶25,266, at 38,849 (CFTC 1992). An assessment of an alleged violation of rule 166.3 should focus on the nature of a respondent's system of supervision, the supervisor's role in that system, the evidence that the supervisor did not perform his assigned role in a diligent manner, and the extent to which the supervisory breach played a substantial role in the wrongdoing that proximately caused the damages. *Bunch v. First Commodity Corp. of Boston*, Comm. Fut. L. Rep. (CCH) ¶25,352, at 39,168 (CFTC 1992). For Kahn to be held liable as a supervisor, the evidence must establish that he had knowledge of Young's and Stein's wrongdoing and failed to take reasonable steps to correct the problem, and that his failure was a proximate cause of the Sasses' losses. *Id.* at 39,169.

Kahn controlled all aspects of his small firm's operations. In that capacity, Kahn controlled the finances; established a compensation scheme that encouraged churning and other abuses; set the onerous commission rates; instituted the deceptive scripted account-opening compliance review and the deceptive scripted trade authorization procedure conducted by Mitch Stein, whom he directly supervised; hired a sales force made up almost exclusively of tainted brokers who had worked for boiler room operations; and directly supervised Young's sales and trading activities. Kahn reviewed equity runs and monthly summaries, and was aware that most the Worldwide/South Coast customers had lost money and was aware that commissions were by far the largest contributing factor to those losses. Kahn was also aware that his firms' sales and trading practices were suspect by virtue of the injunctive complaint brought by the CFTC in 2004. However, Kahn instituted no changes in operations. As a result, Kahn's brokers continued to push trades that generated onerous commissions, and Stein continued to conduct account-opening reviews and trade authorizations that deceptively downplayed and obscured the high risk and high cost of the trades recommended by Kahn's brokers. The disingenuous manner in which Stein's scripted reviews were crafted – skimming over matters like commissions and risks, without providing clear, fair and accurate disclosure of those matters -- establishes that Kahn intended that the reviews be used as a ruse to deflect complaints from customers who suspected that they had been deceived about commissions and risks.

Kahn was personally aware that the Sasses were novice traders with conservative trading objectives, and that Young had convinced them to commit a large portion of their savings to options trading. Thus, Kahn was uniquely positioned to use his authority to prevent Young from defrauding the Sasses with dubious commission-generating trades. However, Kahn did not instruct Young to steer the Sasses to less risky, and less costly, in-the-money options. Rather, Kahn made sure that Young used "diversification," which events proved to be a cynical euphemism for putting the Sasses into three quick trades, before they could discover that the commissions had already eaten a third of their investment.

Despite the fact that he knew that Young was steering the Sasses toward the same sort of trades that had wiped out other customers' accounts, Kahn did not give Stein instructions to deviate from the scripted account-opening review and scripted trade authorizations, thus assuring that the Sasses did not receive accurate and useful disclosures about the specific risks and specific costs associated with Young's trades. As a result, Kahn was aware of Young's and Stein's deceptions and abuses; Kahn, at worst, encouraged their wrongdoing, and, at best, failed to take reasonable steps to prevent or cure their deceptions and abuses, in violation of his duty to supervise Young and Stein; and Kahn's violation proximately caused Sasses' losses.

ORDER

Sonia and Stephen Sasse have established: that Ferdinand Young fraudulently solicited and traded their account in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10; that Larry Kahn failed to supervise Young and South Coast Commodities in violation of CFTC rule 166.3; that South Coast Commodities is liable for Young's and Kahn's violations pursuant to Section 2(a)(1)(B) of the Act; and that these violations proximately caused $16,752 in damages. Accordingly, Larry Alan Kahn, Ferdinand Joseph Young, and South Coast Commodities are ordered to pay to Sonia Sasse and Stephen Sasse reparations of $16,752, plus pre-judgment interest on that amount at 1.66%, compounded annually from December 13, 2005, to the date of payment, plus $125 in costs for the filing fee. Liability is joint and several.

Dated March 14, 2008.

Philip V. McGuire,
Judgment Officer