



U.S. COMMODITY FUTURES TRADING COMMISSION

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ALEXANDER TIMOTHY DARRAH,  
Complainant,

v.

STEVE DAVID KNOWLES, and  
PAUL F. PLUNKETT,  
Respondents.

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CFTC Docket No. 05-R042

**ORDER ON REMAND  
GRANTING SUMMARY DISPOSITION**

**Background**

By Opinion and Order dated December 10, 2010, the Commission affirmed in part and reversed in part Judge George Painter's Initial Decision dated June 28, 2006.<sup>1</sup> The Commission affirmed Judge Painter's "comprehensive" and "detailed" liability findings against Alexander Darrah's brokers, Greg Allotta and Rosemary Salveggi, based on an "extensive analysis regarding respondents' fraudulent solicitation and [churning] of Darrah's account;"<sup>2</sup> and affirmed the liability of First American Investment Services, Incorporated ("First American"), a defunct south Florida introducing broker, for the fraud of its agents.<sup>3</sup>

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<sup>1</sup> See Commission Opinion and Order, slip opinion at pp. 5-7. The Commission Opinion and Order is published at *Darrah v. First American Investment Services, Inc., et al.*, Comm. Fut. L. Rep. ¶ 31,923 (CFTC December 10, 2010). Judge Painter's Initial Decision is published at Comm. Fut. L. Rep. ¶ 30,259 (CFTC June 28, 2006).

<sup>2</sup> Judge Painter found that Allotta and Salveggi had committed multiple violations of Section 4c(b) of the Commodity Exchange Act and CFTC regulation 33.10.

<sup>3</sup> Judge Painter found that First American was liable for Allotta's and Salveggi's violations pursuant to Section 2(a)(1)(B) of the Act.

The Commission adopted Judge Painter's factual findings:

We adopt the ALJ's factual findings as they are amply supported by the weight of the evidence. Respondents raise no serious challenge to them and ask merely to have the evidence reweighed in their favor.<sup>4</sup>

In this connection, Judge Painter had found: that Paul F. Plunkett and Steven D. Knowles were the co-owners, senior managers and chief compliance officers for First American; that Plunkett and Knowles were responsible for implementing First American's compliance procedures and practices; that Plunkett and Knowles had constructive knowledge of ongoing fraud at First American; that Plunkett and Knowles produced no reliable evidence justifying the blatantly abusive and fraudulent handling and trading of Darrah's account, which was primarily based on commission-generating, large-lot, short-term, deep-out-of-the-money options and option strangles; that the First American policies and procedures manual was facially defective and incomplete; and that Plunkett and Knowles had not established or implemented any of those procedures and practices that were contained in the First American manual, such as establishing dollar limits on trading to cap a customer's exposure, obtaining management approval for investments exceeding 10% of a customer's net worth, and submitting deep-out-of-the-money option trades for compliance review.<sup>5</sup>

The Commission deferred to Judge Painter's credibility assessments, including his determination that Alexander Darrah, and his fact and expert witnesses, had offered testimony that was "far more plausible and compelling" than the unsupported, and evasive and insincere, testimony of Paul Plunkett, Greg Allotta and Rosemary Salveggi,<sup>6</sup> and his determination to draw adverse inferences from Steve Knowles' assertion of the Fifth Amendment at the hearing. The

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<sup>4</sup> Commission Opinion and Order, slip opinion at p. 10.

<sup>5</sup> See *Id.*, at p. 7.

<sup>6</sup> Initial Decision, at pp. 3-4. Notably, Judge Painter determined that Plunkett had "implausibly disavowed any role in or knowledge of compliance and supervision at First American." *Id.*, at p. 33. See also *Id.*, at pp. 11-20, fn. 16 at p. 20, and pp. 25-26.

Commission also affirmed Judge Painter’s finding that the failure of First American, and its designated records custodians Plunkett and Knowles, to produce various business records had been in “bad faith” and in “conscious disregard” of a statutory restraining order, rejected respondents’ argument that Judge Painter had erred in relying on their checkered registration and disciplinary histories, and modified Judge Painter’s damage award downward from \$1,512,354 to \$1,292,685.<sup>7</sup>

Although the Commission adopted Judge Painter’s factual findings that Knowles and Plunkett co-owned First America and were the *de facto* senior managers and compliance directors for First American, the Commission reversed Judge Painter’s determination to impose, under Section 13(b) of the Commodity Exchange Act, controlling person liability on Knowles and Plunkett, solely on the grounds that controlling person liability under Section 13(b) of the Act is not available as a private cause of action in reparations.<sup>8</sup> The Commission remanded this

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<sup>7</sup> The Commission’s determination to disallow damages for Darrah’s deposits after March 12, 2003, totaling \$219,669, was based on its conclusion that after that date, when Darrah first expressed concern about respondents’ trading strategies, Darrah was deemed to have ceased reasonably relying on respondents’ relentlessly aggressive fraud and was deemed to have asserted “control” of the grossly abusive trading activity in his account. Darrah’s last deposit before the Commission’s March 12<sup>th</sup> cut-off date was the \$900,000 mega-deposit on February 28, 2003. *See* Commission Opinion and Order, at page 13. Subsequently, by Order Pursuant to Delegated Authority dated December 28, 2010, the Commission clarified that its award was to run jointly and severally against Salveggi, Allotta and First American.

<sup>8</sup> Darrah had never sought to impose Section 13(b) controlling person liability on Knowles and Plunkett. Rather, Darrah had alleged that Plunkett and Knowles -- as the only two listed principals with controlling ownership interest (*i.e.*, with each holding an over 10% interest) in a small one-office firm and as the listed compliance officers during the firm’s brief life – operated as *de facto* chief executives, office managers, and personnel and compliance directors, and in those roles had failed to implement an authentic supervisory system and had taken no apparent action to prevent, detect, investigate or cure the brazen abuse and fraud by Allotta, Salveggi and First American in connection with the Darrah account, and through these “oversight failures” had knowingly or recklessly permitted and facilitated, if not actively encouraged and directed, the abuse and fraud that resulted in Darrah’s \$1.5 million in losses. Thus, Darrah argued in his complaint and re-iterated in subsequent submissions, Knowles and Plunkett should be held jointly liable under failure to supervise and/or aiding and abetting theories. *See, e.g.*, Darrah’s complaint, at ¶ 58; Darrah’s motion for partial summary disposition (dated November 3, 2005), at ¶¶ 33-36, and fn. 10, at p. 10 (asserting that Plunkett and Knowles should be held liable for “permitting conditions under which churning or other wrongful fiduciary [breaches] can take place”); and Darrah’s post-hearing brief, at ¶¶ 5-8, 9-13 and 194-196. In his initial decision, Judge Painter did not address Plunkett’s and Knowles’ liability for failure to supervise under CFTC rule 166.3, or as aiders and abettors under Section 13(a) of the Act.

The structure of Darrah’s complaint, read in conjunction with Darrah’s subsequent submissions, makes it clear that ¶¶ 4-5 of the complaint exclusively concerned allegations against Knowles, that ¶¶ 6-8 exclusively concerned allegations against Plunkett, and that ¶ 58 in the “chain of liability” section concerned the failure to supervise and

matter with instructions to conduct further proceedings concerning Darrah's CFTC rule 166.3 failure to supervise claim against Knowles and Plunkett. In this connection, the Commission noted that Judge Painter "detailed First American's supervisory system, Plunkett's and Knowles' respective roles in that system, and the role those failures" may have played in Darrah's losses, but . . . [did] not specifically address this claim or the specific elements of [the claim]."<sup>9</sup>

Soon after remand, on July 1, 2011, Darrah filed a motion for summary judgment.<sup>10</sup> On January 3, 2012, after the case was transferred to my docket, Darrah filed a renewed motion for summary judgment.<sup>11</sup> Knowles filed an opposition to the January 3<sup>rd</sup> motion. Plunkett did not.

In reply to a series of *sua sponte* discovery orders that had directed Knowles and Plunkett to produce affidavits with detailed answers to questions about the ownership, operation and

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aiding and abetting liability of each principal. However, a close reading reveals that ¶ 8 of the complaint, which is identical to ¶ 5 of the complaint, obviously contained a word-processing error which resulted in Knowles, rather than Plunkett, being mistakenly named the subject of an allegation which had clearly been intended to relate to Plunkett. Another word-processing error in ¶ 58 of the complaint erroneously omitted Plunkett's name from the allegation that each listed principal of the firm, *i.e.*, Knowles and Plunkett, had "actively aided, abetted, counseled, commanded, induced and procured" and "acted in combination and concert with Allotta and Salveggi to bring about [the fraud against Darrah]."

Darrah's subsequent submissions, cited above, effectively corrected both errors. Moreover, the submissions of respondents' counsel establish that he had not been confused by these two word-processing errors in the complaint, and as a result had defended Knowles and Plunkett against identical aiding and abetting and failure to supervise charges, albeit with delaying and stonewalling tactics that avoided addressing factual matters or producing any documentary evidence. *See, e.g.*, respondents' joint answer, at second paragraph on page 17; Allotta's replies to interrogatories 6 and 7, Salveggi's replies to interrogatories 6 and 7; First American's replies to interrogatories 1-3 and 7-10; and respondents' joint pre-hearing brief, at ¶¶ 21-26.

Unfortunately, at some point during appellate review, the Commission would read ¶¶ 8 and 58 of the complaint in isolation, and as a result would observe erroneously that Darrah had based his claim against Plunkett on more limited grounds, *i.e.*, solely on his status as director and owner, and as trustee after dissolution. *See* Commission Opinion and Order, slip opinion, at last line on page 3, first two lines on page 4, and first paragraph on page 14.

In any event, the Commission did not specifically address aiding and abetting liability, and limited the remand to resolution of Plunkett's and Knowles' failure to supervise liability. In this connection, the Commission noted: "All other arguments raised by the parties have been considered. Those [arguments] not specifically addressed herein lack merit or are procedurally improper and do not warrant extended discussion or lack sufficient weight to alter the outcome of these appeals." *Id.*, at p. 16.

<sup>9</sup> *Id.*, at p. 14.

<sup>10</sup> Darrah has been represented throughout by J.B. Grossman, Esq. First American, Allotta, Salveggi, Plunkett and Knowles initially were jointly represented by the law firm Homer & Bonner. After the Commission remanded this matter, Plunkett and Knowles chose to appear *pro se*.

<sup>11</sup> Judge Painter had retired while the appeal was pending. On remand, the Commission directed that this case be assigned to Judge Bruce Levine. Neither Knowles nor Plunkett replied to Darrah's July 1, 2011 motion for summary disposition, and Judge Levine deferred ruling on Darrah's motion. About six months later, on December 13, 2011, after Judge Levine retired this case was assigned to my docket. *See* Order dated March 1, 2012.

supervisory system of First American, Knowles filed two affidavits and Plunkett filed one affidavit. Consistent with their stonewalling litigation tactics before Judge Painter in 2005 and 2006, on remand in 2012 neither Knowles nor Plunkett offered any reliable documentary evidence to substantiate the weak and evasive, and ten-years-after-the-fact, assertions in their affidavits that they had really not owned and operated First American. Thus, Plunkett and Knowles have failed to justify disturbing Judge Painter's affirmed findings and conclusions, particularly his findings that Plunkett and Knowles: had been the co-owners, senior managers and chief compliance officers for First American; had been jointly responsible for implementing First American's compliance procedures and practices; had, at a minimum, constructive knowledge of the ongoing, pervasive fraud at First American; and had failed to establish or implement any of the procedures and practices that were contained in the First American Policies and Procedures Manual.<sup>12</sup>

In addition, Plunkett failed to produce a second requested affidavit. Accordingly, as discussed in more detail in the findings below, rule 12.35(b) adverse inference sanctions have been drawn against Plunkett for his failure to produce the requested information.<sup>13</sup>

Finally, official notice has been taken of the following:

One, the National Futures Association registration and disciplinary history for Plunkett and Knowles, and for the firms that they operated and owned – that is, firms for which they had listed themselves in registration applications to the NFA as a principal with an over-10% ownership interest.

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<sup>12</sup> In this connection, Judge Painter concluded:

Respondents' failure to produce relevant trade documents, to testify meaningfully or at all, to abide by court orders specifically requiring them to maintain and produce records, and to document any relevant supervisory practices at First American ultimately support the finding that supervisory review and compliance procedures were lacking at First American generally and in the case of Darrah's trading. In addition, the testimony of Salveggi strongly supports the view that First American's APs lacked any knowledge of basic compliance and supervisory requirements at the firm. . . . The previous Commission and NFA actions involving Knowles, Allotta and other APs at First American should have suggested the need for stronger rather than the evidently lax compliance structures that existed at the firm.

Initial decision, at p. 33-34.

<sup>13</sup> See Order Imposing Sanctions dated April 25, 2012.

Two, the NFA registration and disciplinary history for Frank Anthony DeSantis a/k/a Frank DeSantis III (NFA membership number 273487) and Frank DeSantis Jr. (#297100). On remand, Knowles has belatedly asserted that a “Frank DeSantis” had purportedly been the true owner and controlling person of First American: in other words, that Knowles and Plunkett had hid DeSantis’ participation in First American by lying and dissembling to the NFA and the CFTC. Since Knowles and Plunkett have failed to produce a scintilla of reliable evidence showing that anyone but themselves had been the owners, managers, supervisors and compliance officers at First American, it has not been necessary to determine which Frank DeSantis is the subject of Knowles’ bald assertion.

Three, several CFTC and NFA orders, decisions, complaints and advisories relating to the relevant supervisory obligations of introducing brokers during the relevant time: circa 2002 and 2003.<sup>14</sup>

The NFA records establish that when Knowles and Plunkett had registered with the NFA as associated persons with First American, they had identified themselves as the sole owners with an over 10% ownership interest and the sole principals of First American. These records also establish: one, that Plunkett had been listed as the chief compliance and registration officer for First American from the firm’s start-up in September 2002, to April 22, 2003, soon after most of Darrah’s losses had accumulated and two months before Darrah’s account would be closed; and two, that Knowles had been listed as the chief compliance and registration officer from April 22, 2003, to the firm’s shut-down in August 2003.

Significantly, the NFA records further establish that First American was the third in a series of several inter-related and short-lived options-peddling introducing brokers, for which Knowles and/or Plunkett would list themselves as owners and principals and compliance chiefs, as well as several forex-peddling boiler-room operations, most of which by 2008 -- in the midst of the lengthy, mid-2006 to late 2010, appeal phase of this case -- would be put out of business by the Commission or the NFA for fraudulent conduct.

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<sup>14</sup> See Notice dated June 8, 2012.

One, perhaps the only, benefit of the four-and-a-half year appellate interlude is that it has afforded an opportunity to look back over the long trail of extensive fraud and financial carnage caused by the firms owned and operated by Knowles and Plunkett, and to establish how they facilitated and perpetuated their fraudulent enterprises with various regulatory dodges. For example, Knowles' and Plunkett's firms routinely: ignored record-keeping requirements and refused to cooperate with NFA auditors or investigators; failed to set up a *bona fide* supervisory system; made false statements to the NFA to conceal the involvement of fraudsters who had been disciplined and barred by the NFA or CFTC; and subverted and skirted NFA enhanced supervision requirements that were designed to curtail fraudulent conduct by closing up shop after a year or two of converting customer funds to excessive commissions, activating a new firm, perpetuating the same fraudulent sales tactics, and orchestrating the *en masse* transfer of junior brokers, like Rosemary Salveggi, and the selective distribution and insertion of small cadres of experienced "tainted" brokers, like Greg Allotta, to the newly activated firm.<sup>15</sup> Thus, it can be determined conclusively that First American was rotten from the get go and from the top down, and that Allotta's and Salveggi's egregious fleecing of Darrah back in 2003 represented,

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<sup>15</sup> The consent orders issued by federal judges or NFA business conduct committees against Knowles' and Plunkett's firms invariably included similar stipulated facts: that the principals of these firms had violated their duties to diligently supervise their firms and employees; that the firms had employed "tainted" brokers who had exclusively or predominately worked for firms that had been barred or otherwise sanctioned by the CFTC or the NFA for fraudulent practices and who personally had been sanctioned by the NFA or CFTC for abusive sales practices; that over 95% of the firms' customers had lost most or all of their funds, largely due to excessive commissions, with aggregate customer losses for each firm totaling in the millions of dollars; and that the firms' brokers systematically: had used high-pressure tactics urging prospective and current customers to invest immediately based on an imminent price move and false guarantees of large profits with little or no risks, had strongly suggested that the firm's customers were highly successful when in reality the overwhelming majority of the firms' customer had lost most or all of their funds, and had provided deceptive investment advice based claims that they could profit from knowledge of well-known public information, typically a current Mideast conflict or a seasonal supply and demand trend like summer travel or cold weather, when such information had already been factored into the price of options by the market. See *In re Group One Financial Services, Inc. and Jay Michael Levy*, NFA Case No. 02-BCC-021 (May 15, 2003); *In re First Liberty Investment Services, Inc., et al.*, NFA Case No. 02-BCC-016 (July 7, 2003); *CFTC v. First American Investment Services, et al.*, Comm. Fut. L. Rep. ¶ 30,242 (S.D. Fla. May 22, 2006); and *CFTC v. United Investors Group, Inc., et al.*, Comm. Fut. L. Rep. ¶ 30,290 (S.D. Fla. June 6, 2006).

not an isolated aberration, but the epitome of what Knowles and Plunkett had worked to make happen at First American.

As explained below, Anthony Darrah’s motion for summary judgment has been granted; and Paul Plunkett and Steven Knowles have been found to have committed multiple violations of CFTC rule 166.3, from September 2002 to July 2003, which, separately and together, proximately caused \$1,512,354 in damages; and Plunkett and Knowles have been ordered to pay an award for the full amount of Darrah’s out-of-pocket losses, \$1,512,354, with prejudgment and post-judgment interest at 5.24%, compounded annually, starting on February 28, 2003, the date that Rosemary Salveggi confirmed was the “biggest payday” at First American.<sup>16</sup>

### **Uncontested Facts<sup>17</sup>**

#### *Steven Knowles*

1. Steven David Knowles was a registered associated person, and a listed principal with over 10% ownership interest, with First American from mid-September 2002 to mid-August 2003. On September 5 and 9, 2002, on the Forms 8-R submitted to the NFA, Knowles listed himself as the President and one of two principals with over 10% ownership interest in First American. Knowles similarly listed himself as the firm’s President on all subsequent registration forms submitted to the NFA. On April 22, 2003, not long after most of Anthony Darrah’s losses had accumulated and two months before the Darrah account would be closed, Knowles submitted to the NFA a Form 3-R, stating that he had replaced Paul Plunkett as chief compliance

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<sup>16</sup> See Salveggi’s testimony, page 248 of hearing transcript.

<sup>17</sup> The uncontested facts are based on: one, the findings and conclusions in the Initial Decision adopted and affirmed by the Commission; two, the registration and disciplinary histories of Knowles, Plunkett and Frank Anthony DeSantis, and their firms; three, Florida Department of State records for First American (attached to the complaint); four, the CFTC and NFA orders, decisions, complaints and advisories relating to the relevant supervisory obligations of introducing brokers in 2002 and 2003; and five, Knowles’ and Plunkett’s post-remand affidavits.

officer, books and records custodian, and contact for arbitration, accounting, membership and registration matters.

2. Knowles first registered as an associated person, and first was listed as principal, in late 1999. Before First American, Knowles was listed as a principal and co-owner with over 10% interest in two other small and short-lived introducing brokers that, as discussed in more detail below, were the predecessors to First American Investment Services, Incorporated: Group One Financial Services, Incorporated (December 1999 to June 2001) and First Liberty Investment Services, Incorporated (June 2001 to October 2002).

3. On June 7, 2004, the CFTC filed a complaint in the United States District Court for the Southern District of Florida seeking an injunction and other equitable relief against First American and certain individuals including Knowles and Allotta. The complaint alleged, among other things, that First American and Knowles were responsible for fraudulent sales solicitations by First American agents that omitted discussions of the actual risks of trading options, misrepresentations exaggerating the likelihood of profits based upon events in the Middle East (including a probable war in Iraq), along with misrepresentations and omissions concerning the risk of loss, and failure to disclose First American's actual bleak performance record between December 2002 and August 2003.

On May 22, 2005, the Honorable Daniel T.K. Hurley issued a Final Consent Order of Permanent Injunction and Other Equitable Relief.<sup>18</sup> Knowles, Allotta and First American stipulated to numerous specific violations of the Commodity Exchange Act based upon First American's fraudulent solicitations and mismanagement of customer accounts. The stipulated violations included: fraudulent solicitation based upon presentation of a false customer success rate and substantial firm expertise; false promises of great profits; mischaracterizations of the

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<sup>18</sup> *CFTC v. First American, supra.*

operation and effect of seasonality and forthcoming events on heating and crude oil futures and options; the omission of required risk disclosures; and failure to balance false promises of great profit with disclosure of First American's unfavorable customer trading history.

In connection with his role at First American, Knowles consented to the following stipulated facts:

Knowles was president and principal of First American. . . . Knowles was responsible for the hiring, firing, supervision and discipline of First American APs. In addition, Knowles was responsible for obtaining, reviewing, responding to, and resolving complaints. Knowles made at least \$300,000 in salary and commissions.

The Court found that Knowles: was the office manager who made the day-to-day decisions necessary to run First American, oversaw floor operations and the verbal solicitations of First American's customers, was the custodian of First American's records, participated in all policy decisions at First American, directly or indirectly controlled First American and its associated persons, and did not prevent or correct First American's AP's fraudulent solicitations of customers.<sup>19</sup> The Court concluded that Knowles was liable as a controlling person for the solicitation fraud of several First American associated persons:

As president, principal and a compliance officer of First American from September 11, 2002 to August 25, 2003, Knowles played a central role in the operation of the company. Knowles was responsible for the hiring and firing of First American APs, as well as any disciplinary action taken against them. [Knowles'] office at First American was located near the room used by First American APs to telephone customers. Knowles routinely observed the APs' solicitation activities. In addition, Knowles claimed responsibility for obtaining, reviewing, responding to, and resolving First American customer complaints. In this regard, Knowles spoke to some First American customers regarding complaints about First American APs.<sup>20</sup>

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<sup>19</sup> Id. at 58,080.

<sup>20</sup> Id. at 58,077. The consent order directed Knowles to pay \$1,600,000 in restitution and a \$400,000 civil monetary penalty, and permanently barred Knowles from seeking re-registration.

Along the same lines, in discovery in the instant reparations case, before Knowles would assert his Fifth Amendment privileges at the hearing, First American produced a similar description of Knowles' role at First American:

Steve Knowles' duties included: 1) management of First American's overall operations to ensure that First American remained in compliance with all CFTC, NFA and other regulatory requirements; 2) supervision of the activities of First American AP's; 3) handling of customer complaints; 4) oversight of First American's trading procedures; 5) processing payroll; 6) oversight of personnel matters, including the hiring and firing of First American employees.<sup>21</sup>

4. From the beginning of this proceeding, Knowles has offered neither plausible explanation nor reliable documentary evidence regarding his or Plunkett's, or anyone else's, responsibilities and conduct at First American, or regarding the ownership, control, management, record-keeping system or supervisory system at First American. More recently, after the remand, Knowles has belatedly purported that he had fronted for "Frank DeSantis" who, Knowles now asserts, was the "true owner" who had controlled First American and who had been responsible for supervisory matters.

For what is worth, Knowles' belated assertion that he had fronted for a Frank DeSantis at a time when Frank DeSantis III had been barred by the NFA from owning and operating a registered firm, and Frank DeSantis Jr. had been directed by the NFA to divest himself of his ownership interest in Group One, does support a conclusion that Knowles has long been willing to lie and dissemble to the NFA and the CFTC whenever it has provided a short-term benefit. For example, in 2002 and 2003, it would have served Knowles' interests to conceal the fact that one or the other Frank DeSantis was associated in some capacity with First American, such as consulting Knowles and Plunkett on how to run a boiler room operation and how to skirt NFA and CFTC rules, if in fact either DeSantis had played such a role. Now, it serves Knowles'

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<sup>21</sup> First American's response to Darrah's interrogatory number 9, dated July 1, 2005.

short-term interest to “reveal” ten years after the fact that DeSantis was the “true” controlling owner and chief executive and that Knowles and Plunkett were naïve figureheads.

However, Knowles’ bald assertion has little or no probative value toward establishing that Frank DeSantis, Deuce or Trey, owned and controlled First American. First, the assertion is unsubstantiated by any reliable evidence. Second, the assertion is overwhelmingly contradicted by Knowles’ and Plunkett’s representations to the NFA in 2002 and 2003, by the stipulated facts in the *First American* consent order in 2006, by First American’s discovery reply in the instant case in 2005, and by the absence of any reliable corroborating testimony from Plunkett, Allotta or Salveggi in 2006.<sup>22</sup> As a result, Knowles’ belated attempt to shift responsibility from himself and Plunkett to a third person for controlling First American operations and for supervising Allotta and Salveggi must be treated as a no more than a patently self-serving and baseless ploy to dodge a finding of liability on remand, and thus not entitled to a scintilla of evidentiary weight.

#### *Paul Plunkett*

5. On November 9, 2001, the articles of incorporation for First American, initially named Global Money Management, were submitted with the Florida Department of State, and identified Paul Plunkett as the firm’s president and director. On April 21, 2002, Plunkett submitted the amended articles of incorporation changing the firm’s name to First American Investment Services, Incorporated.

6. Paul Plunkett was a registered associated person and a listed principal with over 10% ownership interest with First American from April 22, 2002 to August 11, 2003. On October 22,

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<sup>22</sup> In addition, pursuant to rule 12.35(b), as a result of Plunkett’s failure to answer requests 6, 7, 8, and 9 in the order dated March 30, 2012, the information not produced by Plunkett has been taken as established adversely to Plunkett, which supports the conclusion that it was Plunkett who, with Knowles and no one else, co-owned, co-controlled and co-managed First American and co-supervised the First American sales force including Allotta and Salveggi.

2002, on the form 3-R submitted to the NFA, Plunkett was listed as the Chairman and one of two principals with over 10% ownership interest in First American. Plunkett was also listed as chief compliance officer, books and records custodian, and contact for arbitration, accounting, and membership and registration matters. Plunkett was listed as First American's chief compliance officer until April 22, 2003, by which time Darrah had made all of his deposits and First American had converted the bulk of his deposits to commissions.<sup>23</sup> As previously noted, Judge Painter determined that Plunkett had "implausibly disavowed any role in or knowledge of compliance and supervision at First American."<sup>24</sup>

7. Despite the fact that he had less experience than Knowles in running a boiler room operation, Plunkett was effectively Knowles' co-equal. Knowles and Plunkett, and no one else, held an over 10% ownership interest and held positions of authority at First American. Plunkett was the Chairman of First American. Plunkett was the designated compliance officer and the designated arbitration, accounting, membership and registration contact for First American during the first three months of the short life of the Darrah account.<sup>25</sup>

Plunkett shared with Knowles the responsibility for overall operations at First American; the responsibility for making day-to-day decisions necessary to run First American; and the responsibility for overseeing floor operations at First American. Plunkett also shared the final authority in hiring and firing decisions at First American, including the decision to hire Allotta

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<sup>23</sup> The timing of Plunkett's delisting, when viewed in light of respondents' various regulatory dodges, suggests that the delisting was a screening maneuver in anticipation of the imminent CFTC injunctive complaint against First American and Knowles and the imminent start-up of Plunkett's next firm, United Investors Group.

<sup>24</sup> Initial Decision, slip opinion at p. 33.

<sup>25</sup> This finding is based in part on adverse inferences taken for Plunkett's failure to respond to requests 1, 2 and 5 of Order dated March 30, 2012.

and Salveggi, and the authority to investigate, reprimand or discipline agents and employees of First American.<sup>26</sup>

Plunkett further shared the responsibility for establishing the standard \$250 per contract commission charge, and for establishing the compensation and incentive scheme at First American: *i.e.*, basing the compensation of brokers on a percentage of commissions collected, rather than the performance of their customer's accounts, and splitting commission shares between junior less experienced brokers who opened an account, like Salveggi, and the senior more experienced brokers who effectively took over accounts, like Allotta.<sup>27</sup>

Each First American senior broker, including Allotta, reported to Plunkett and Knowles. Plunkett, along with Knowles, encouraged and approved the practice of senior brokers like Allotta to generate trade recommendations, which he and other First American brokers, including Salveggi, passed on to their customers, and which predominately or exclusively involved the purchase of large lots of commission-generating, high-risk, substantially-out-of-the-money or deep-out-of-the-money options or option strangles.<sup>28</sup>

8. As First American was being shut down, Plunkett would hire numerous alums of Group One, First Liberty and First American, including Allotta and other tainted brokers, when he activated a new south Florida introducing broker, United Investors Group, Incorporated. Plunkett was a listed principal of UIG from September 3, 2003 to February 22, 2005. By consent order dated June 6, 2006, Plunkett would be found liable as controlling person for the fraud of UIG and its agents, and subjected to various sanctions including a \$3,569,400 restitution payment, a \$630,600 civil monetary penalty, and a permanent injunction against seeking

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<sup>26</sup> This finding is based in part on adverse inferences taken for Plunkett's failure to respond to requests 10, 11 and 12.

<sup>27</sup> This finding is based in part on adverse inferences taken for Plunkett's failure to respond to requests 14 and 15.

<sup>28</sup> This finding is based in part on adverse inferences taken for Plunkett's failure to respond to requests 13 and 16.

registration.<sup>29</sup>

Since Plunkett controlled UIG without Knowles, it is reasonable to presume that at First American Knowles had groomed Plunkett to run a boiler-room without Knowles' direct involvement, and had familiarized Plunkett with all aspects of running an introducing broker, including compliance and supervision requirements, and all aspects of running a boiler room operation, such as: setting up a commission-based compensation scheme that encouraged and rewarded the churning of customer accounts; perpetuating fraudulent sales and churning tactics perfected at previous boiler rooms; stymying audits and investigations and avoiding compliance requirements by maintaining ersatz record-keeping and supervisory systems; and subverting NFA enhanced supervision requirements by frequently shifting operations and personnel *en masse* from one short-lived firm to another. This conclusion is underscored by Judge Painter's determination that Plunkett had "implausibly disavowed any role in or knowledge of compliance and supervision at First American."<sup>30</sup>

#### *Frank DeSantis*

9. Frank Anthony DeSantis a/k/a Frank DeSantis, III, born in 1967 (NFA membership number 273487), and Frank DeSantis Jr., born in 1941 (#297100), are discussed here in light of Knowles belated assertion that a "Frank DeSantis" was the "true owner" of First American. Frank DeSantis III was registered with the NFA from August 1996 to September 2002. Frank DeSantis, Jr. was never registered in any capacity, but was listed as a principal of Group One from August 1999 to June 2001.

Before starting up Group One, Frank DeSantis III had worked exclusively for firms that had been barred by the CFTC or NFA for fraud: Anthony John Columbo, Inc. (August 1996 to

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<sup>29</sup> *CFTC v. United Investors Group, supra.*

<sup>30</sup> Initial Decision, at p. 33.

February 1997), Commonwealth Financial Group, Inc. (February to May 1997), and American Financial Trading Corp. (May 1997 to July 1999). His termination dates with these firms roughly corresponded to the dates that disciplinary sanctions against the firms became effective. Frank DeSantis III was a registered associated person and listed principal with Group One, Knowles' first firm, from July 1999 to September 2002.

By 1999, Frank DeSantis III had become toxic in the eyes of the NFA. On June 30, 1999, the NFA issued a disciplinary complaint against American Financial Trading Corporation and several associated persons, including Frank DeSantis III, alleging fraudulent conduct and supervisory failure. By decision dated August 17, 2000, the NFA fined DeSantis \$40,000, and barred DeSantis from NFA membership or from acting as a principal of an NFA member for two years (until September 1, 2002). The NFA further ordered that if DeSantis became an NFA Member after the two-year period had passed, he could not directly or indirectly exercise supervisory authority over any person required to be registered as an associated person, and he must obtain a sponsor certification from his employer certifying that it would supervise DeSantis' activities for compliance with the terms of the decision. Furthermore, DeSantis' sponsor would be required: to tape record his conversations with customers and prospective customers; to retain the tapes for five years, with the tapes being readily accessible during the first two years; to make the tapes available to NFA upon request; and to maintain a daily log of DeSantis' solicitations. Finally, the NFA ordered that DeSantis must be strictly supervised by a branch manager or designated principal of the sponsor who was physically present in the office on a daily basis.<sup>31</sup>

Soon afterwards, on October 26, 2000, the NFA issued a disciplinary complaint against Frank DeSantis III and Group One, alleging fraudulent conduct by Group One and supervisory

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<sup>31</sup> *In re American Financial Trading Corp., et al.*, NFA Case No. 99-BCC-014 (August 17, 2000).

failures by DeSantis. On May 22, 2001, the NFA issued a decision in which it disciplined Group One with a \$35,000 fine and enhanced supervisory requirements including tape-recording conversations between brokers and customers. The NFA ordered Frank DeSantis Jr. to divest himself of his ownership interest in the firm. The NFA also ordered that Frank DeSantis III not obtain employment or a position with any NFA Member “in any capacity whatsoever, whether registered or unregistered, including, but not limited to, the following capacities: principal, associated person, managing director, supervisor, owner, non-supervisory owner, employee, consultant, independent contractor, agent, or unpaid volunteer,” effective September 1, 2002, and terminating March 1, 2004. The NFA further ordered that DeSantis be barred from NFA membership and associate membership, from acting as a principal of an NFA Member, or from serving in any of the positions described above, also effective September 1, 2002 and terminating March 1, 2004.<sup>32</sup>

In a second disciplinary complaint against Group One, dated September 11, 2002, the NFA charged:

NFA has received numerous anonymous tips that Knowles is using Knowles Enterprises to pay cash to Frank DeSantis III and John Taddeo who are alleged to be the “true owners” of First Liberty. Taddeo is the former president of Group One and both he and DeSantis has been the subject of NFA disciplinary actions alleging sales practice fraud. DeSantis is currently barred from the industry as a result of a 1999 disciplinary case. Knowles refused to produce books and records of Knowles Enterprises to the NFA.<sup>33</sup>

Notably, similar charges that DeSantis was a “true owner” of First American would not be included in the CFTC’s injunctive complaint against First American and Knowles.

By 2004, Plunkett and Knowles had joined Frank DeSantis III, along with DeSantis’ mother-in-law Doreen Rose Plunkett Valko, and DeSantis’ wife Erin Valko DeSantis, to operate

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<sup>32</sup> *In re Group One Financial Services and Frank A. DeSantis*, NFA Case No. 00-BCC-010 (May 22, 2001).

<sup>33</sup> *In re Group One and Levy*, *supra*.

a cluster of forex boiler rooms. The CFTC alleged that Frank DeSantis III had provided “consulting services” for these firms, which the CFTC would put out of business via a series of permanent injunctions.<sup>34</sup>

*First American’s predecessor firms: Group One and First Liberty.*

10. Steve Knowles and Paul Plunkett activated First American in September 2002, when they mass-transferred operations, brokers and customer accounts from First Liberty. Before that, as noted above, Knowles had owned and operated two small, short-lived predecessor firms: Group One and First Liberty.

Nine associated persons with Group One, including Knowles, would form a key part of the core of First American, and six of these nine would be named defendants in the CFTC’s injunctive complaint against First American.

The desultory to non-existent record-keeping and compliance systems, the calibrated mix of “tainted” brokers in the sales force, the commission-based compensation scheme that rewarded churning, the excessive commission structure (*e.g.*, \$250 commission per option contract), the commission-generating trading strategies (*e.g.*, utilizing substantially out-of-the-money or deep-out-of-the-money options), and the fraudulent sales tactics used at Group One and First Liberty, and later at First American, were identical or substantially similar.

11. Well before Plunkett and Knowles would activate First American, Group One had been named in the first of two NFA disciplinary complaints alleging fraudulent conduct and

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<sup>34</sup> The forex boiler rooms included World Market Advisors, Inc., United Equity Group, Inc., Liberty One Advisors, Inc., Universal Options, Inc., Qualified Leverage Providers, Inc., and Safeguard FX, LLC. *See CFTC v. World Bank Foreign Currency Trades, Inc., et al*, Comm. Fut. L. Rep. ¶ 29,666 (S.D. Fla. January 20, 2004); *CFTC v. World Market Advisors, Inc., et al*, Comm. Fut. L. Rep. ¶ 30,664 (S.D. Fla. June 27, 2006); and *CFTC v. Doreen Rose Valko, Frank A. DeSantis a.k.a. Josh Anthony, et al*, No. 06-60001, 2006 U.S. Dist. LEXIS 67486, (S.D. Fla. August 16, 2006).

supervisory failures, and Group One had consented to various disciplinary sanctions.<sup>35</sup> On September 11, 2002, just as Plunkett and Knowles were activating First American, Group One was named in the second disciplinary complaint alleging similar fraudulent conduct. On May 15, 2003, a month before the Darrah account would be closed, the NFA issued its decision, finding more fraudulent conduct and supervisory failures, and barring Group One for ten years.<sup>36</sup>

12. First Liberty became registered in August 1999. From August 1999 to June 2001, the firm did little if any business. On June 22, 2001, a week before Group One was required to begin tape-recording its sales solicitations under the terms of the NFA decision, the nine Group One associated persons mentioned above, along with the bulk of Group One's sales force, were mass-transferred to First Liberty. In turn, the core of nine Group One/First Liberty associated persons would be mass-transferred to newly activated First American on September 5, 2002, in apparent anticipation of the NFA disciplinary complaint against First Liberty which would be issued on September 26, 2002.

13. In 2001, 309 out of 312 customer accounts that had been opened at First Liberty lost money, with customer losses totaling 3.4 million dollars. The largest customer loss at First Liberty was for about \$300,000, which would be dwarfed by Darrah's \$1.5 million loss at First American.

14. In June 2002, Knowles hired Greg Peter Allotta from Barkley Financial Corporation to work at First Liberty. By this time, Allotta, who since 1993 had exclusively worked extended tenures at a series of firms disciplined by the NFA or CFTC for fraudulent sales tactics, had himself been named in an NFA business conduct committee complaint for fraudulent sales

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<sup>35</sup> *In re Group One and DeSantis, supra.*

<sup>36</sup> *In re Group One and Levy, supra.*

tactics at Barkley Financial Corp.<sup>37</sup>

15. At First Liberty, Knowles supervised Allotta and Salveggi, who worked together and perfected their skills as an “opener and loader” team, which they would transfer to First American to the extreme detriment of Darrah. It has long been a well-established practice for boiler-room operations like First Liberty and First American to pair up a relatively inexperienced broker like Salveggi with a more experienced broker like Allotta. The junior broker acts as an “opener” by cold-calling a prospect, gaining his trust, convincing him to open an account with a relatively modest sum – in Darrah’s case, \$5,000 -- and recommending an initial small, trade, and then introducing the new customer to the senior broker who is portrayed as a successful expert trader. The senior broker then takes the lead as the “loader.” That is, after the first trade and initial deposit, the loader, applying his or her expertise gained at previous boiler room operations, promises extravagant profits at little risk, and lulls and pressures the customer to commit more and more funds to be converted into commissions.<sup>38</sup>

16. When Knowles and Plunkett activated First American, on or about September 5, 2002, in addition to the nine Group One/First Liberty associated persons mentioned above, an additional nineteen First Liberty associated persons, including Allotta and Salveggi, would be mass-transferred to First American.

17. As previously noted, around the time that Knowles and Plunkett activated First American as the *de facto* successor to Group One and First Liberty, and well before Salveggi and Allotta first spoke to Darrah: one, the NFA had issued its business conduct committee complaint

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<sup>37</sup> The NFA complaint against Allotta and Barkley was issued January 18, 2002, eight months before Knowles and Plunkett would hire Allotta to work at First American. On March 27, 2003, two months after the Darrah account had been opened, one month after Darrah had made the \$900,000 deposit, and three months before the Darrah account would be closed, the NFA issued its Decision, which found serious violations by Allotta and required him to tape record his conversations with customers. *In re Allotta, et al.*, NFA case number 02-BCC-001 (March 27, 2003).

<sup>38</sup> See, e.g., *Zehner v. Great American Commodities, et al.*, Comm. Fut. L. Rep. ¶ 24,553 (CFTC Nov. 15, 1989).

against Allotta; two, the NFA had issued its second complaint against Group One; and three, the NFA had issued its complaint against First Liberty and Knowles. All three complaints had alleged similar fraudulent sales practices and supervisory failures.

On May 15, 2003, one month before Darrah would close his account, the NFA issued its decision in the second Group One disciplinary case, finding fraud and permanently barring Group One. On July 7, 2003, shortly after Darrah had closed his account, the NFA issued its decision in the First Liberty disciplinary case finding that Knowles had failed to adequately supervise the fraudulent conduct of First Liberty associated persons. The NFA imposed a ten-year membership bar on First Liberty, fined Knowles \$20,000, and restricted Knowles' ability to run a boiler-room by requiring that any firm for which he was a listed principal submit for 18 months to an enhanced surveillance compliance program.<sup>39</sup>

#### *First American*

18. First American Investment Services, Incorporated, activated in September 5, 2002, was the third firm for which Knowles, and the first firm for which Plunkett, were registered associated persons and listed principals. First American, located in south Florida, was another short-lived introducing broker, registered for twenty months from February 4, 2002 through September 25, 2003, but active for just eleven months from September 2002 to July 2003. First American's primary business, like Group One's and First Liberty's, was to solicit customers to purchase exchange-traded options on commodity futures. More to the point, the evidence amply substantiates Darrah's assertion that First American in reality was not the reputable and

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<sup>39</sup> The enhanced supervisory requirements imposed on Knowles by the NFA included tape-recording conversations between brokers and current and prospective customers, and allowing NFA compliance personnel to pose as prospective investors in order to receive sales solicitations for the purpose of evaluating their compliance with NFA's sales practice rules, and allowing the NFA to tape record any and all sales solicitations made [to] NFA staff posing as prospective customers.

successful option trading powerhouse portrayed by Salveggi and Allotta, but rather a “sundry and mundane telemarketing office in the nature of a boiler room.”<sup>40</sup>

19. First American was a small firm. Over its twenty-month lifespan, First American employed a grand total of 51 associated persons. This number included several “tainted” brokers who were parked for a few weeks, mostly before November 2002 and after May 2003, before being transferred to other firms. During the first nine months of calendar year 2003, which encompassed the short life of the Darrah account (late January to mid-June 2003), First American employed a total of 32 associated persons, including Knowles, Plunkett, Allotta and Salveggi. Thus, during the relevant time, Plunkett and Knowles supervised a small sales force of no more than 30 brokers.

20. Of the 51 total associated persons with First American over its twenty-month lifespan, a substantial portion had previously worked at its predecessor firms: Group One and First Liberty. As noted above, a mass transfer of operations and sales forces took place between Group One and First Liberty in the summer of 2001 to avoid the enhanced supervision requirements about to take effect at Group One; and a second mass transfer took place between First Liberty and First American in fall of 2002 in anticipation of the imminent NFA disciplinary complaint against First Liberty. When First American shut down in August 2003 – just after the NFA in its decision in the First Liberty disciplinary case had imposed enhanced supervision requirements on any firm owned or controlled by Knowles -- another mass transfer took place between First American and Plunkett’s new firm, United Investors Group.

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<sup>40</sup> Darrah’s complaint, at ¶ 29. In this connection, commissions were the predominant source of income for First American. Given the consistently dismal performance of its customers’ accounts, First American obviously had to base its brokers’ compensation, not on performance of accounts, but on a share of commissions generated, which created strong incentive for the sort of churning fraud visited on Darrah.

21. During the life of Darrah's account, First American employed two or three experienced "tainted" brokers who had previously worked for firms, or multiple firms, that had been barred or otherwise disciplined by the CFTC or the NFA for fraudulent sales or trading practices, and who themselves had been personally named in NFA disciplinary complaints for fraudulent sales or trading practices, including Allotta, the "loader" for the Darrah account. This employee mix kept First American just under the "tainted" broker threshold that would have triggered NFA enhanced supervision requirements, including increased capital requirements, stricter record keeping, and submission to more frequent and intrusive audits, and tape recording of conversations between brokers and customers and prospective customer.<sup>41</sup> When Knowles would begin winding down First American, soon after Darrah's account was closed, Allotta and the bulk of First American's junior brokers and rookie brokers trained by Plunkett, would be among those mass-transferred to UIG.<sup>42</sup>

22. First American's trading record, like Group One's and First Liberty's trading records, was dismal, with its customers typically realizing huge losses and paying excessive commissions. Between January 2002 and August 2003, First American opened approximately 700 new options trading accounts. Over 97% of these accounts lost money. As recapped below, Darrah's experience was all too typical, albeit on a most grand scale.

#### *First American's non-existent supervisory system*

23. The First American policies and procedures manual was facially defective and incomplete: nothing more than window-dressing. Plunkett and Knowles offered no evidence

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<sup>41</sup> See Interpretive Notice to Compliance Rule 2-9: Enhanced Supervisory Requirements, Notice I-01-06, (April 6, 2001)

<sup>42</sup> In connection with Knowles' and Plunkett's frequent firm-to-firm shifting of personnel and operations, the District Court adopted in full the magistrate's recommended findings and conclusions, including that it was "troubling . . . that Defendants have developed a pattern of misleading customers regarding the profit and loss potential of purchasing options, developing an extraordinarily high loss rate, and then closing up shop." *CFTC v. United Investors Group, supra*.

that they had established or implemented any of the procedures and practices that were contained in the First American manual, such as establishing dollar limits on trading to cap customer exposure, obtaining management approval for investments exceeding 10% of a customer's net worth, and submitting deep-out-of-the-money option trades for compliance review. Moreover, Knowles, Plunkett, Allotta and Salveggi exhibited no meaningful familiarity with the manual's contents. Allotta's and Salveggi's solicitation and handling of the Darrah account, and Knowles' and Plunkett's oversight of their solicitation and handling of the Darrah account, indicated that if the four respondents had bothered to familiarize themselves with the contents of the compliance manual, they completely and cynically ignored them.

24. When Plunkett and Knowles activated First American in September 2002, they disregarded the NFA's adverse decision against Group One issued on May 22, 2001, disciplinary complaint against First Liberty issued on September 26, 2002, and second disciplinary complaint against Group One issued on November 1, 2002, all of which found or alleged similar fraudulent conduct and supervisory failures. As a result, from the start, Plunkett and Knowles perpetuated the same trifling to non-existent record-keeping and compliance systems, the same mix of "tainted" brokers in the sales force, the same commission-based compensation scheme, the same excessive commission structure (*i.e.*, \$250 commission per option contract), the same abusive commission-generating trading strategies (*i.e.*, utilizing substantially out-of-the-money or deep-out-of-the-money options), and the same fraudulent sales tactics.

25. Before they closed First American, Plunkett and Knowles disregarded the NFA's adverse decision in the second Group One disciplinary case issued on May 15, 2003 (before the Darrah account was closed), and disregarded the NFA's adverse decision in the First Liberty disciplinary case issued on July 7, 2003 (soon after the Darrah account was closed). As a result,

Plunkett and Knowles took no steps to stand-down operations and to investigate the solicitation and handling of First American customer accounts to determine if they had been subjected to the same sort of fraud and abuse found by the NFA at First American's two predecessor firms.

26. In September 2002, when Plunkett and Knowles activated First American and hired Allotta to work at First American, they did not utilize any screening procedures to identify "tainted" brokers. As a result they did not implement any strict supervision system for Allotta, in complete disregard of the fact that Allotta had exclusively worked for a series of boiler room operations, and had been personally named just eight months earlier in an NFA disciplinary complaint alleging fraudulent conduct when he worked at Barkley Financial Corp.

27. Plunkett and Knowles similarly disregarded the fact that on March 3, 2003, just three days after Darrah had made the massive \$900,000 deposit in his First American account, the NFA issued its decision finding fraudulent conduct by Allotta which required enhanced supervision of Allotta's activities, beginning April 11, 2003, when the Darrah account would still be open. As a result, neither Plunkett nor Knowles took any prompt steps to more strictly supervise Allotta, or to investigate immediately Allotta's solicitation and handling of First American customer accounts over the previous five months to determine if his First American customers had been subjected to the same sort of fraud and abuse found by the NFA to have been committed by Allotta at Barkley Financial.

28. Neither Knowles nor Plunkett bothered to scrutinize Allotta's and Salveggi's solicitation and handling of the Darrah account, despite several red flags: one, the fact that Darrah was a novice; two, the fact that Darrah was reliant on oral status reports from Allotta and Salveggi, because the written account statements and on-line account status reports generated by the clearing broker, Universal Financial Holding Corporation, were difficult for novice traders to

decipher; three, the fact that Allotta was a “tainted broker” who had previously worked for a series of boiler room operations and himself had recently been disciplined by the NFA for fraudulent conduct; four, the fact that Salveggi had been trained at First Liberty which had recently been named in an NFA disciplinary complaint alleging fraudulent sales tactics; five, the high frequency of deposits, and the extraordinary and ever increasing sums of money being deposited in the Darrah account; six, the fact that Darrah’s aggregate deposits by February 28<sup>th</sup> far exceeded 10% of his net worth; seven, the relentlessly abusive trading activity in the Darrah account; eight, the massive commissions being quickly generated and engendering the “biggest payday” at First American; and nine, the rapidly mounting trading losses which, combined with the massive commissions, extinguished virtually all of Darrah’s \$1.5 million “investment” in under just four months.

*Recap of the unchecked fleecing of Darrah*

29. Anthony Darrah, notwithstanding a net worth -- before the fleecing by respondents -- between five and ten million dollars, was an unsophisticated and inexperienced futures and options investor who could not effectively evaluate complex futures and options strategies or independently formulate a coherent trading strategy. In other words, he lacked the experience or know-how to detect readily that respondents were steering him into highly dubious option trades designed to quickly generate massive commissions and destined to totally deplete his account.

30. Salveggi and Allotta subjected Darrah to the same sales tactics that had predominated at First American’s predecessors Group One and First Liberty: that is, the same tactics that the NFA, in its disciplinary complaints and decisions against Group One and First Liberty, had given Knowles and Plunkett clear notice were abusive, deceptive and fraudulent. Despite this notice, Salveggi and Allotta were permitted, if not encouraged, to induce and lull

Darrah to open and to repeatedly fund the account with “continual” deceptions, false assurances, omissions and unsubstantiated claims regarding such material matters as: First American’s, Salveggi’s and Allotta’s purported expertise and integrity; the windfall profits purportedly enjoyed by First American clients; the cost, risk and mechanics of respondents trading strategies; the operation and effect of seasonality and forthcoming events on petroleum futures and options; and the status of Darrah’s account.

31. Despite the fact that they would routinely steer Darrah into deep-out-of-the-money options, Salveggi, Allotta and First American did not give Darrah the specific disclosure for deep-out-of-the money options required by CFTC rule 33.7(b)(6).

32. First American’s abusive trading practices were obscured and facilitated by the fact that the clearing firm, Universal Financial Holding Corporation, generated account statements that were difficult to understand and reconcile and that were assured to confuse novice traders like Darrah, and further facilitated by the fact that Universal sent the account statements to a Hong Kong address where Darrah, an international airline pilot, only intermittently visited.<sup>43</sup>

33. Trading in Darrah’s account could be divided into three phases, with 92% of the trading volume occurring during the first two phases. The first, tenderizing, phase was from January 27 to February 23, 2003, when Salveggi and Allotta lulled Darrah deeper and deeper into an abusive fiduciary relationship and convinced him to make ten deposits totaling \$153,000, and charged Darrah \$88,250 in commissions. The second, high-intensity churning, phase was from February 24 to March 31, 2003, when Darrah made seven more deposits totaling \$1,302,669, and was charged 89% of the total commissions. The third phase was from April 1,

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<sup>43</sup> Starting in 1995, Universal and its owner, and its predecessor corporation, Universal Commodity Corp., were named in numerous reparations complaints and disciplined multiple times by the CFTC and NFA. In 2004, Universal and its owner were barred in connection with their failure to supervise Universal’s guaranteed introducing brokers, including Group One and First Liberty. *In re Universal Financial Holding Corporation, et al.*, NFA Case Number 03-BCC-035 (November 2, 2004).

to the final trade on May 28, 2003, with three more deposits totaling \$57,000, and the account “allowed to run a dissipated course” with relatively smaller scale churning.

34. Set out below is a summary of Darrah’s twenty deposits:

<i>First Phase</i>	<i>Second Phase</i>	<i>Third Phase</i>
Jan. 27 \$ 5,000	Feb. 24 \$ 220,000	Apr. 7 \$20,000
Jan. 28 5,000	Feb. 27 20,000	Apr. 8 20,000
Jan. 29 5,000	Feb. 28 900,000	<u>Apr. 10 17,000</u>
Jan. 30 5,000	Mar. 19 100,000	\$57,000
Feb. 5 25,000	Mar. 25 12,669	
Feb. 7 20,000	Mar. 26 20,000	
Feb. 10 45,000	<u>Mar. 27 30,000</u>	
Feb. 12 20,000	\$1,302,669	
Feb. 14 13,000		
<u>Feb. 21 10,000</u>		
\$153,000		

35. Set out below is a summary of the commissions charged to Darrah’s account:

<i>First Phase</i>	<i>Second Phase</i>	<i>Third Phase</i>
Jan. 27 \$ 8,750	Feb. 24 \$ 75,000	Apr. 4 \$ 7,000
Jan. 31 5,000	Feb. 25 10,000	Apr. 7 6,750
Feb. 3 2,750	Feb. 26 18,250	Apr. 9 7,000
Feb. 5 16,250	Feb. 28 250,000	Apr. 10 3,250
Feb. 7 6,000	Mar. 3 87,500	Apr. 14 1,750
Feb. 10 17,750	Mar. 5 35,000	Apr. 25 1,750
Feb. 11 5,500	Mar. 6 27,500	Apr. 28 1,250
Feb. 12 7,500	Mar. 7 26,250	May 1 750
Feb. 13 2,250	Mar. 10 29,000	May 6 250
Feb. 14 3,500	Mar. 12 81,250	May 14 750
Feb. 18 3,000	Mar. 13 1,000	May 16 750
Feb. 20 1,000	Mar. 14 34,500	May 21 1,000
<u>Feb. 21 9,000</u>	Mar. 17 50,000	May 23 750
\$ 88,250	Mar. 18 62,500	<u>May 28 160</u>
	Mar. 19 43,750	\$33,162
	Mar. 21 62,500	
	Mar. 24 13,750	
	Mar. 25 5,000	
	Mar. 26 14,250	
	Mar. 27 3,750	
	Mar. 28 10,500	
	<u>Mar. 31 18,750</u>	
	\$960,000	

As can be seen, commissions were charged on the majority of business days between Jan. 27, and May 28, 2003, and on almost every business day from late January to early April.

36. Plunkett was the designated First American compliance officer during the first two phases and the first part of the third phase. Knowles was the designated First American compliance officer during the second part of the third phase.

37. Respondents utilized inherently dubious trading strategies -- principally large lot (*i.e.*, hundreds of contracts), short-term, deep-out-of-the-money option strangles -- that, coupled with the \$250 per contract commission charge, were guaranteed to quickly generate massive commissions and, almost as quickly, to completely deplete the account.

38. The trades that respondents selected for Darrah's account lacked a reasonable basis, and were highly unlikely to break-even, let alone make a profit, due to a combination of factors: the fact that they were deep-out-of-the-money or substantially out-of-the-money options; the fact that they were burdened with excessive commission loads (average 43.5% commission-to-premium ratio); and the fact that, based on a model "delta neutral" trade portfolio compared to Darrah's portfolio for June '03 crude oil, First American did 83% more trading than necessary.

39. First American's trade execution, based on the selection of illiquid, deep-out-of-the-money options, was consistently very poor, with Darrah frequently receiving the lowest price of the day, and typically receiving below, or well below, the average price of the day.

40. First American frequently removed profitable trades and placed "inexplicable" losing "as is" trades in Darrah's account without any justification. For example, on February 27, 2003, First American converted \$36,280, when it removed a trade with a credit of \$18,350, and replaced it with a trade with a debit of \$17,930. Again, on March 27, 2003, First American

converted \$30,560 from Darrah's account by inexplicably removing a trade with a positive \$14,360 value, and adding a trade with a negative \$16,200 value.

41. Out of approximately \$1.5 million invested by Darrah, over \$1.08 million was consumed in commissions in just four months.<sup>44</sup> Eighty-nine percent of these commissions were generated in just 26 days of trading from late February to late March 2003. All but \$315 of Darrah's investment was lost to the combination of massive commissions and trading losses.

42. On February 28, 2003, about a month after Darrah had opened the account, Allotta convinced Darrah to empty his retirement account and deposit \$900,000, which Allotta would relentlessly convert into \$684,500 in commissions in just nineteen days, including \$250,000 on February 28<sup>th</sup> alone which had engendered the "biggest payday" at First American. The February 28<sup>th</sup> \$250,000 commission payday was not the only big payday offered up by the Darrah account. The next five biggest paydays -- March 3<sup>rd</sup> (\$87,500); March 12<sup>th</sup> (\$81,250); February 24<sup>th</sup> (\$75,000); March 18<sup>th</sup> (\$62,500); and March 21<sup>st</sup> (\$62,500) -- totaled an additional \$368,750 in commissions. On the following fifteen additional dates in 2003, Darrah's account provided commission paydays of over \$10,000: February 5, 10, 25 and 26, and March 5, 6, 7, 10, 14, 17, 19, 24, 26, 28 and 31.

43. Darrah's \$1.5 million account was by far the largest account at First American, and his \$1.5 million loss was by far the largest loss for any First American customer and dwarfed the \$300,000 loss which had been the largest loss for any customer at Knowles' previous firm, First Liberty. Similarly, the \$1.08 million charged in commissions to Darrah's account was by far the

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<sup>44</sup> An independent calculation has confirmed that the commissions charged to Darrah had totaled a little more than \$1.08 million. All of Darrah's submissions and exhibits -- with the isolated exception of one flawed exhibit that omitted commissions charged in April and May 2003, and thus stated wrongly that the commissions totaled \$1,050,859 -- asserted that the commissions had totaled \$1,081,412. Respondents did not challenge Darrah's assertion that the commissions had totaled \$1,081,412. The Initial Decision contained conflicting references to the amount of commissions. The first reference noted correctly that the commissions had totaled \$1,081,412, and the second noted incorrectly that that the commissions had totaled \$1,050,859. The Commission's opinion -- covering the spread -- noted that the commissions had totaled "over \$1.05 million."

greatest amount charged to an account at First American, and represented about eighteen percent of all commissions charged to all First American customers.<sup>45</sup> Thus, anyone in Plunkett's and Knowles' central positions of joint control and authority at a small one-office firm, organized to dodge strict compliance requirements and to generate commissions for profits, could reasonably be expected to be interested, pleased and fully aware of the facially abusive activity in the Darrah account generating a massive and unprecedented commission income stream for First American.

## **Conclusions**

### *Summary disposition*

Commission rule 12.310 provides that summary disposition shall be granted if there exists no genuine issue as to any material fact; there is no necessity for further facts to be developed; and the moving party is entitled to a decision as a matter of law. The Commission's summary disposition rule is patterned on the summary judgment provisions of Fed. R. Civ. P. 56, and the Commission is guided by federal case law in applying its rule. At the summary disposition stage, the judge's function is not to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial. All reasonable doubts about the facts should be resolved in favor of the non-moving party. If reasonable minds could differ on any inferences arising from undisputed facts, summary judgment should be denied. When more than one inference reasonably can be drawn, it is not for the trier of fact to determine the proper one. *Aboulghar v. Mulcahey*, Comm. Fut. L. Rep. ¶31,932 at 66,121 (CFTC Sept. 2,

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<sup>45</sup> In this connection, Knowles conceded, in his own fashion:

I do not know [\$1.512 million] to be the greatest amount lost [by] any single [First American] customer, but I cannot think of a larger account. . . . Mr. Darrah's \$1.512 million represents roughly twenty-five percent of all the money lost by First American clients. If there were two such accounts that would mean that two accounts lost half of all the money lost by First American. . . . [\$1.08 million in commissions charged to] Mr. Darrah's account would represent almost eighteen percent of all the commission charged by First American. If there were another similar customer that would mean that two customers accounted for roughly forty percent of all commissions generated, and that is unlikely.

Knowles' affidavit dated April 9, 2012, ¶¶ 35-37, on pp. 8-9.

2010). Here, after carefully reviewing the parties' submissions, and considering Plunkett's and Knowles' failure to produce any reliable corroborating evidence,<sup>46</sup> I have determined that additional discovery and written testimony, or a second round of oral testimony, is highly unlikely to develop or clarify further the factual circumstances material to Darrah's failure to supervise claim against Plunkett and Knowles, or otherwise to justify disturbing Judge Painter's affirmed findings. From this, the record amply supports the conclusion that there is no genuine issue as to any fact material to the claim, and that Darrah is entitled to summary disposition in his favor as a matter of law.

#### *Multiple violations of CFTC rule 166.3*

Commission rule 166.3 requires each Commission registrant, except an associated person who has no supervisory duties, to diligently supervise the handling by his partners, officers, employees, and agents of all commodity interests carried and other activities relating to the business as a commission registrant. A violation of rule 166.3 is actionable in a reparations proceeding. *Bunch v. FCCB*, Comm. Fut. L. Rep. ¶ 25,352 at 39,168 (CFTC August 5, 1992). To determine whether a violation has occurred, the following factors must be considered: one, the nature of the system of supervision; two, the respondent's role in that system; and three, whether the respondent performed that role in a diligent manner. In addition, it must be shown that a breach of the duty to supervise played a substantial role in the wrongdoing that proximately caused the complainant's damages. *Id.* at 39,168-69. Furthermore, failure to

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<sup>46</sup> See Initial Decision, fn. 16 at p. 20, and pp. 20, 25 and 33. The failure, going back to 2005, by Plunkett and Knowles to produce in this proceeding any reliable relevant documentary evidence about the ownership, management and supervision of First American flows in most part from their decision in 2002 not to institute a legitimate record-keeping system at First American. Their decision to implement a deficient record-keeping system, consistent with their various other actions designed to subvert compliance and supervision requirements, served to obstruct and delay anticipated audits and investigations by the NFA and the CFTC, and anticipated complaints by the NFA, the CFTC, and customers like Darrah. Thus, Knowles and Plunkett, the co-owners, managers, compliance chiefs and custodians of records for First American, must bear the adverse evidentiary consequences of their bad faith conduct stretching back to 2002.

supervise is an independent and primary violation for which no underlying violation is necessary. *In re Collins*, Comm. Fut. L. Rep. ¶ 27,194 at 45,744 (CFTC December 10, 1997).

Plunkett and Knowles were the co-owners, senior managers and chief compliance officers for First American. Plunkett and Knowles were identified in First American's registration applications as the sole principals and the sole owners with an over 10% ownership interest in First American.<sup>47</sup> Plunkett was identified as the Chairman, and Knowles was identified as the President, of First American. Plunkett was the designated chief compliance officer and the designated arbitration, accounting, membership and registration contact for First American from its start-up and during the first three months of the short life of the Darrah account. Knowles was the designated chief compliance officer and the designated arbitration, accounting, membership and registration contact for First American during the last two months of the short life of the Darrah account, up to the closing of the firm.

Although Knowles may have been the first among two co-equals, Plunkett and Knowles were jointly responsible: for overall operations at First American, for making day-to-day decisions necessary to run First American, for overseeing floor operations at First American, for all hiring and firing decisions at First American, including the decisions to hire Allotta and Salveggi, for investigating, reprimanding and disciplining agents and employees of First American, for implementing First American's compliance procedures and practices, and for

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<sup>47</sup> The CFTC has delegated to the NFA front-line responsibility for regulating every firm and individual who conducts futures business with public customers, including the responsibility to process registration applications from such firms and individuals. With certain exceptions, all persons and organizations that intend to do business as futures professionals must register under the Act. The primary purposes of registration are: to screen applicants' fitness to engage in business as futures professionals, and to identify those individuals and organizations whose activities are subject to federal regulation. In addition, all individuals and firms that wish to conduct futures-related business with the public must apply for NFA membership or associate status. The NFA requires an introducing broker to provide, among other things, a Form 8R and fingerprint card for each principal of the firm. *See* <http://www.nfa.futures.org/nfa-registration/ib/index.HTML>. Whether an individual's status requires that the firm identify him or her as a principal of the firm is determined by three independent factors: one, the ability to exercise controlling influence over the firm's activities subject to regulation by the Commission; two, the formal title or position of authority (*i.e.*, director, president, CEO, COO, CFO or chief compliance officer); and three, a 10% or more financial or ownership interest. *See* <http://www.nfa.futures.org/nfa-registration/principal/index.HTML>.

directly supervising Salveggi and Allotta. Plunkett and Knowles jointly established the standard \$250 per contract commission charge, and jointly established the compensation and incentive scheme at First American: that is, basing the compensation of brokers on a percentage of commissions collected, rather than the performance of their customer's accounts, and splitting commission shares between openers like Salveggi and loaders like Allotta. Plunkett and Knowles each had, at a minimum, constructive knowledge of the pervasive fraud and abuse that Allotta and Salveggi routinely heaped on most or all their First American customers. Moreover, Plunkett and Knowles each had actual knowledge of the patently abusive commission-generating activity in the Darrah account.

It should come as no surprise that Plunkett and Knowles had implemented a deficient to non-existent supervisory system at First American, since they had activated First American in September 2002 in order to skirt compliance requirements and to perpetuate the fraudulent sales and trading practices perfected previously at Group One and First Liberty. Knowles and Plunkett periodically had re-organized their business in order to avoid enhanced supervisory requirements imposed by the NFA on firms that meet certain criteria, in this instance, the percentage of "tainted" principals and associated persons who had worked for firms disciplined by the NFA or CFTC for deceptive sales practices.<sup>48</sup> The first mass transfer of operations and

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<sup>48</sup> The percentage of tainted brokers that triggered the enhanced supervisory requirements during the relevant time ranged from 20% to 40%, depending on the size of the firm. As previously noted, the enhanced supervisory requirements include various prophylactic measures: increased capital requirements, stricter record keeping, submission to more frequent and intrusive audits, and tape recording of conversations between brokers and customers and prospective customers. The NFA first established the enhanced supervisory requirements for firms employing a significant number of tainted brokers based on the determination that it was reasonable to conclude that brokers employed at a firm disciplined for fraudulent sales practices had received inadequate or inappropriate training and supervision which they will carry would carry to their next job, and thus should be subject to "stringent supervision procedures . . . to ensure that improper training its AP's have previously received associated does not taint their sales efforts." NFA Interpretive Notice #9021 -- *Compliance Rule 2-9: Enhanced Supervisory Requirements* (Jan. 19, 1993). "The guiding principal in creating and refining the [enhanced supervisory requirements] has always been to improve the overall level of supervision at those few member firms which are likely to cause sales practice problems." NFA Explanation of Proposed Amendments to Interpretive Notice #9021

sales forces took place between Group One and First Liberty in the summer of 2001, to avoid the enhanced supervision requirements about to take effect at Group One. The second mass transfer took place between First Liberty and First American in fall of 2002 in anticipation of the imminent NFA disciplinary complaint against First Liberty. The third mass transfer took place between First American and Plunkett's new firm, United Investors Group, when First American shut down in August 2003 – just after the NFA, in its decision in the First Liberty disciplinary case, had imposed enhanced supervision requirements on any firm owned or controlled by Knowles. During the life of Darrah's account, First American employed no more than two or three experienced "tainted" brokers, including Allotta, which kept First American just under the "tainted" broker threshold that would have triggered NFA enhanced supervision requirements.

When Plunkett and Knowles activated First American in September 2002, they made no changes in the ways that Knowles had operated, managed and supervised First American's two predecessor firms, Group One and First Liberty, in total disregard of a trio of NFA business conduct committee disciplinary actions that had put them on clear notice that the normal sales and supervisory practices at Group One and First Liberty were fraudulent and deficient: the first adverse decision against Group One issued on May 22, 2001; the disciplinary complaint against First Liberty issued on September 26, 2002; and the second disciplinary complaint against Group One issued on November 1, 2002. As a result, from the start, Plunkett and Knowles failed to correct, and thus perpetuated: the same trifling to non-existent record-keeping and compliance systems, the same carefully calibrated core of "tainted" brokers in the sales force operating without sufficiently strict supervision; the same commission-based compensation scheme and same excessive commission structure (*i.e.*, \$250 commission per option contract) that

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(Sep. 19, 2005). The versions of the NFA's enhanced supervisory requirements interpretative notice that were in effect during the relevant time were dated August 21, 2001, and March 18, 2003.

encouraged and rewarded churning;<sup>49</sup> and the same abusive commission-generating trading strategies (*i.e.*, utilizing substantially out-of-the-money or deep-out-of-the-money options).<sup>50</sup> More specifically, Plunkett and Knowles failed to implement stringent supervisory procedures to ensure that First American brokers, including Allotta and Salveggi: one, gave customers clear, complete and accurate disclosure regarding the detrimental impact of First American’s heavy commission costs on the likelihood of achieving profit;<sup>51</sup> two, gave customers clear, complete, and accurate disclosure regarding the extremely low likelihood of achieving profit following the recommendations favored by First American given its poor performance; three provided the specific disclosure for deep-out-of-the-money options required by CFTC and NFA rules, since First American routinely steered its customers into deep-out-of-the-money options; four, did not make deceptive or false claims or suggestions of large, easy profits based on seasonal demand

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<sup>49</sup> The conclusion that First American’s \$250 per contract commission was patently excessive is underscored by the determination of the NFA that commissions greater than \$100 per contract are well above the industry norm and sufficiently dissociated from recouping costs and making a reasonable profit that a strong correlation existed between firms that charge such commissions and firms that have been subject to disciplinary actions for sales practice abuses, and thus that it is “incumbent” on firms that charge such commissions “to exercise a very high degree of supervision of solicitations by its APs so as to ensure that customers are given accurate information regarding the [adverse] impact of those expenses on the likelihood of achieving profit.” NFA Explanation of Proposed Amendments to Interpretive Notice #9021 (February 2, 2007). The NFA thus extended the enhanced supervisory requirements to firms routinely charging \$100 or greater commissions per contract to “provide a practical opportunity . . . to monitor solicitations and correct problems with those solicitations in an expeditious manner.” *Id.* See NFA Interpretive Notice #9021 *Compliance Rule 2-9: Enhanced Supervisory Requirements* (Nov. 1, 2007).

<sup>50</sup> Long before Plunkett and Knowles started up First American, the CFTC had initiated injunctive and administrative enforcement cases that had put registrants on notice that a firm that maximizes commission income by steering and pressuring customers to purchase large numbers of significantly out-of-the-money or deep-out-of-the-money options, coupled with high commissions, would be engaging in presumptively abusive and fraudulent conduct. *CFTC v. Chilmark Commodities Corp.*, Civil Action No. 88-6058-CIV-SCOTT, (S.D. Fla.) CFTC complaint (January 29, 1988), and Consent to Order of Permanent Injunction (September 15, 1988); and *In re Chilmark Commodities Corp.*, CFTC Docket No. 88-25, complaint (September 20, 1988), and Opinion and Order (September 20, 1988). The Commission also had put registrants on notice that a broker who charges commissions on a per-contract basis and recommends out-of-the-money options, when similar in-the-money options were available, would presumptively be acting contrary to customer’s best interest. *Ferriola v. Kearsse-McNeill*, Comm. Fut. L. Rep. ¶28,172 (CFTC June 30, 2000).

<sup>51</sup> The CFTC and NFA also long ago put the industry on notice that any firm that charges high commissions must constrain from making confident profit projections, and must provide fair and accurate disclosure of the amount of commissions and the adverse impact of commissions on profitability. See *Grey v. LMB Trading*, Comm. Fut. L. Rep. ¶28,019 (Initial Decision February 24, 2000), *affirmed* ¶28,584 (CFTC July 3, 2001); NFA Interpretive Notice #9005 – *Guidelines for the Disclosure by FCMs and IBs of Costs Associated with Futures [and Options] Transactions* (July 24, 2000); and NFA Interpretive Notice #9047 – *Fair Commissions* (March 19, 2000).

and other well-known public information, such as the latest crises in the Mideast;<sup>52</sup> and five, refrained in the first instance from steering customers into dubious, commission-generating trading strategies. Plunkett's and Knowles' failure -- at the start-up of First American in the fall of 2002, and thereafter through July 2003 -- to correct the fraudulent practices transferred to First American from Group One and First Liberty in the face of a series of recent, related NFA disciplinary decisions and complaints against First American's predecessor firms, constituted a deliberate gross failure by Plunkett and Knowles to supervise diligently the activities of First American and its associated persons, in violation of CFTC rule 166.3. This violation set up and green-lighted Salveggi's and Allotta's readily foreseeable fraud against Darrah.

Similarly, when they activated First American in the fall of 2002, Plunkett and Knowles approved the use of a compliance manual that was facially defective, incomplete, and nothing more than window-dressing. Plunkett and Knowles also failed to establish or implement, from fall 2002 to summer 2003, any of the procedures and practices that happened to be contained in the manual, such as establishing dollar limits on trading to cap customer exposure, obtaining management approval for investments exceeding 10% of a customer's net worth, and submitting deep-out-of-the-money option trades for compliance review. Furthermore, Knowles and Plunkett took no steps to train First American associated persons, including Allotta and Salveggi, to become familiar with the manual's contents. These failures by Plunkett and Knowles in connection with the First American compliance manual constituted independent failures of their duty to supervise diligently the activities of the First American and its associated persons, in

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<sup>52</sup> The CFTC and NFA have long made it abundantly clear to the industry that it is fraudulent and deceptive to hype profits based on seasonality and current news events, because they had already been factored into the price of futures and options. See *Kelly v. First Investors Group of the Palm Beaches*, Comm. Fut. L. Rep. ¶26,940 (Initial Decision Dec. 31, 1996), *summarily affirmed* (CFTC Aug. 1, 1997); *Bishop v. First Investors Group of the Palm Beaches*, Comm. Fut. L. Rep. ¶27,004 (CFTC March 26, 1997); *In re Staryk*, Comm. Fut. L. Rep. ¶27,206 (CFTC December 18, 1997); NFA Interpretation #9033 – *Deceptive Advertising* (June 9, 1997); NFA Interpretation #9034 – *Deceptive Advertising* (September 9, 1998); and CFTC *Consumer Advisory Warning on Sales Pitches Based on Seasonal Demand and Other Public Information* (November 3, 1998).

violation of CFTC rule 166.3, which also fostered and facilitated Salveggi's and Allotta's readily foreseeable fraud against Darrah.

When Plunkett and Knowles activated First American and hired Allotta to work at First American in September 2002, they did not utilize any screening procedures to identify "tainted" brokers like Allotta,<sup>53</sup> and thus they did not implement any strict supervisory procedures for Allotta to assure that he had not brought to First American the improper sales tactics that he had learned and employed at his previous firms, in complete disregard of the fact that Allotta had exclusively worked for a series of boiler room operations, and had been personally named just eight months earlier in an NFA disciplinary complaint alleging fraudulent conduct at Barkley Financial Corp. Next, on March 3, 2003 -- just after Allotta had induced Darrah to make the massive \$900,000 deposit -- when the NFA issued its decision which found fraudulent conduct by Allotta at Barkley Financial and required enhanced supervision of Allotta's activities no later than April 11, 2003, Plunkett and Knowles failed to implement immediately more stringent supervision of Allotta. Plunkett and Knowles also failed to conduct a prompt retrospective investigation of Allotta's solicitation and handling of First American customer accounts, including Darrah's, to determine if Allotta had subjected Darrah and his other First American customers to the same sort of fraud and abuse that the NFA had found Allotta to have committed at Barkley. Plunkett and Knowles similarly disregarded the fact that Salveggi had been trained at First Liberty, which had recently been named in an NFA disciplinary complaint alleging fraudulent sales tactics, and the fact that she had worked closely with Allotta at First Liberty, and

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<sup>53</sup> When Plunkett and Knowles started up First American and hired Salveggi and Allotta, they were on notice that they had a duty to "carefully screen prospective APs, both to ensure their qualifications and to determine the extent of supervision the prospective AP would require if hired." In this connection, the NFA noted: "Certainly, if a recently hired AP has received the bulk of his professional training and experience from, for example, a number of firms which have been closed down as a result of disciplinary proceedings brought by the Commission or by NFA, that individual may well require closer supervision for a period of time than other APs." NFA Interpretive Notice #9010 – *Information Available From NFA Regarding Background of Prospective Employees* (July 1, 2000).

thus had likely received inadequate or inappropriate training and supervision there. These failures by Plunkett and Knowles to subject Allotta and Salveggi to strict supervision constituted independent failures of their duty to supervise diligently the conduct of Allotta and Salveggi, in violation of CFTC rule 166.3. These violations played a crucial and indispensable enabling role in Salveggi's and Allotta's ongoing egregious fraud against Darrah, and precluded timely remedial measures.

Neither Knowles nor Plunkett bothered to scrutinize Allotta's and Salveggi's solicitation and handling of the Darrah account, despite several red flags: one, the fact that Darrah was a novice and thus presumably significantly reliant on Allotta's and Salveggi's trading advice; two, the fact that Darrah was presumably reliant on oral status reports from Allotta and Salveggi, because the written account statements and on-line account status reports generated by the clearing broker, Universal Financial Holding Corporation, were difficult for novice traders to decipher; three, the fact that Allotta was a "tainted broker" who had previously worked for a series of boiler room operations and had been personally disciplined by the NFA for recent fraudulent conduct; and four, the fact that Salveggi had probably received improper training at First Liberty, which had recently been named in an NFA disciplinary complaint alleging fraudulent sales tactics. By disregarding these multiple red flags, Plunkett and Knowles failed to prevent, to investigate, to detect, or to take necessary remedial measures with respect to, Allotta's and Salveggi's deceptive and misleading sales solicitations and trade recommendations to Darrah where, for example, they had failed to disclose the impact of First American's massive commissions on profitability, had hyped profitable returns that bore no relationship to the actual disastrous performance experienced by First American, and had deceptively suggested that well-known events and seasonal trends could be exploited for substantial profits. Thus, each time that

Plunkett and Knowles took no action -- when a deposit was made, when a trade was opened and a commission was charged, and when a trade was closed out for a net loss – constituted an independent, knowing, gross dereliction of their duty to supervise diligently the conduct of Allotta and Salveggi in connection with the Darrah account, in violation of CFTC rule 166.3. Each such violation prevented ending Allotta’s and Salveggi’s fraudulent inducements of Darrah’s multiple deposits, encouraged further fraudulent inducements, and precluded timely remedial measures.

Plunkett and Knowles also failed to implement effective procedures to target accounts which required close scrutiny for inappropriate trading activity, based on frequent deposits, large deposits, significant and accumulating losses, substantial and accumulating commissions, and/or frequent errors or corrections. As a result, Plunkett and Knowles disregarded numerous red flags raised by patently dubious activity in the Darrah account: one, the high frequency of deposits and the extraordinary and ever increasing sums of money being deposited by Darrah; two, the fact that Darrah’s aggregate deposits by February 28<sup>th</sup> had far exceeded 10% of his net worth; three, the short-term, large-lot deep-out-of-the-money option strangles; four, the inexplicable errors resulting in five-figure losses; five, the massive five and six-figure commissions being quickly generated, engendering the “biggest payday” at First American; and six, the rapidly mounting trading losses which, combined with the massive commissions, extinguished virtually all of Darrah’s \$1.5 million “investment” in just under four months. By failing to set up an account-monitoring system and failing to heed these multiple red flags, Plunkett and Knowles assured that they would not review and analyze the facially abusive trading activity in the Darrah account, and thus would not prevent, detect, or take necessary remedial measures with respect to the excessive commissions and consistent trading losses that were rapidly depleting Darrah’s

account. As a result, each time that Plunkett and Knowles took no action -- when a deposit was made, when a trade was opened and a commission was charged, and when a trade was closed out for a net loss -- constituted an independent gross dereliction of their duty to supervise diligently the trading activity in Darrah's account, in violation of CFTC rule 166.3. These violations, independently and collectively, facilitated and perpetuated the patently abusive trading activity in Darrah's account, and precluded any timely remedial measures.

Finally, Knowles and Plunkett failed to take any prompt review of the handling of the Darrah account soon after it had been totally depleted and closed on June 16, 2003, or soon after the NFA had issued its adverse decisions against First American's predecessor firms owned by Knowles, Group One and First Liberty, on May 15, and July 7, 2003, respectively. These failures constituted independent violations of CFTC rule 166.3, which similarly perpetuated the fraud against Darrah and precluded any remedial measures.

### *Damages*

Since failure to supervise is an independent violation, the Commission's conclusion that Darrah's reliance on respondents' fraud and that respondents' control of Darrah's account ceased after March 12, 2003 does not preclude finding that Plunkett's and Knowles' multiple failure to supervise violations proximately caused damages after that date. Several factors support the conclusion that Darrah's total out-of-pocket losses are the proper measure of damages proximately caused by Plunkett's and Knowles' multiple supervisory breaches from September 2002 to July 2003. First, but for Knowles' and Plunkett's supervisory violations when they activated First American, Salveggi and Allotta could not have initiated and compounded their readily foreseeable fraud against Darrah. Second, Knowles' and Plunkett's supervisory violations during the life of the Darrah account -- particularly their gross indifference to the

blatantly abusive activity in Darrah's account, which was terminated only by the total depletion of the account -- facilitated and perpetuated, if not encouraged, First American's ongoing aggressive fraud against Darrah. Third, Knowles' and Plunkett's supervisory violations at or near the end of the Darrah account precluded any timely remedial measures. Additionally, the deliberate, pervasive and egregious nature of Knowles' and Plunkett's supervisory violations warrants an award based on Darrah's total losses. Thus, where Knowles' and Plunkett's supervisory violations, from September 2002 to July 2003, played a crucial and indispensable role in First American's fleecing of Darrah, it is reasonable to conclude that the proper measure of damages proximately caused by Plunkett's and Knowles' multiple supervisory violations should be Darrah's total losses: \$1,512,354.

*Prejudgment and post-judgment interest*

The purpose of prejudgment and post-judgment interest is to fully compensate the fraud victim by returning him to the *status quo ante*: that is, repairing the victim's financial status back to before he was fraudulently deprived of the use of his funds. Consistent with the compensatory purpose of an interest award and the remedial purpose of reparations, the prejudgment and post-judgment interest component of a reparations award should run from the date that the fraud victim suffered his loss. *See Mintz v. Heinhold Commodities*, Comm. Fut. L. Rep., ¶ 22,707 at 30,996 (CFTC Aug. 22, 1985). Typically, such loss is suffered when the fraud victim hands-over his funds, and thus the date of the loss normally and properly will be the date of the first or largest deposit, which will almost always occur at or near the opening of the fraudulently solicited account, and not at the close of the account well after the fraud victim has made his last deposit and after the victim's funds have been dissipated.

In this connection, on February 28, 2003, about a month after Darrah had opened the account, Allotta convinced Darrah to empty his retirement account and deposit \$900,000, which Allotta would relentlessly convert into \$684,500 in commissions in just nineteen days – a quarter million dollars in commissions on February 28<sup>th</sup> alone, the “biggest payday” at First American. Darrah’s \$900,000 deposit on February 28<sup>th</sup>, by far Darrah’s largest deposit, brought the total deposited by Darrah to \$1,293,000, which represented 85% of the total that Darrah would eventually deposit.<sup>54</sup> Correspondingly, the failures of Knowles and Plunkett to take any prompt corrective supervisory action upon notice of receipt of this massive deposit, and upon notice of Allotta’s relentless conversion of this deposit into commissions totaling \$684,500 in just 19 days via facially dubious trades, constituted their most egregious supervisory violations in connection with the Darrah account. Thus, the most equitable start date for the running of interest is February 28, 2003.<sup>55</sup>

Finally, the interest rate for the award on remand will be the same as the interest rate in effect for awards issued on the date of Judge Painter’s Initial Decision.<sup>56</sup> *See Atonio v. Wards Cove Packing Co.*, No. CS-74-145-JLQ, 1991 U.S. Dist. LEXIS 5531 (C.D. Wash. April 12, 1991).

## **ORDER**

Steve David Knowles and Paul F. Plunkett committed multiple violations of CFTC rule 166.3 in connection with the solicitation and handling of Alexander T. Darrah’s account. These

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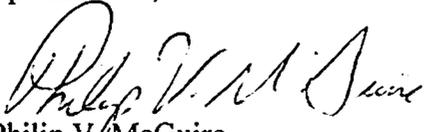
<sup>54</sup> *See* Initial Decision: factual finding 12, at p. 10; factual finding 20, at p. 13; factual finding 21, at p. 13; factual finding 26, at p. 14; and churning analysis at pp. 28 and 30.

<sup>55</sup> As previously noted, between January 27 and April 10, 2003, Darrah made 20 deposits totaling \$1,512,669, but Darrah’s February 28th \$900,000 deposit was by far his largest deposit. Also, many of the deposits were clustered close to that date. Although Darrah’s February 28th deposit was the thirteenth deposit, he made this deposit a mere month after opening the account. Similarly, the second and third largest deposits (\$220,000 on February 24, and \$100,000 on March 19, 2003) closely bracketed the February 28th deposit. Therefore, for administrative convenience, a single starting date, rather than graduated starting dates, has been selected for the running of interest.

<sup>56</sup> *See* Commission Opinion and Order, slip opinion at p. 15.

violations, separately and together, proximately caused \$1,512,354 in damages. Accordingly, Steve David Knowles and Paul F. Plunkett are ordered to pay to Alexander T. Darrah reparations of \$1,512,354, plus prejudgment and post-judgment interest on that amount at 5.24%, compounded annually, from February 28, 2003 to the date of payment, plus \$250 in costs for the filing fee. Liability shall be joint and several.

Dated September 28, 2012.



Philip V. McGuire,  
Judgment Officer