

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

JO-ANNE MUSKUS

v.

COMMODITY RESOURCE CORPORATION,
GEORGE KLEINMAN, and CHARLES
ELLIOT STEINHACKER

CFTC Docket No. 98-R80

OPINION AND ORDER

Respondents Commodity Resource Corporation ("CRC"), George Kleinman ("Kleinman"), and Charles Elliot Steinhacker ("Steinhacker")¹ appeal a Judgment Officer's decision that complainant Jo-Anne Muskus ("Muskus") was fraudulently induced to open a managed trading account. The Judgment Officer found that Steinhacker misled Muskus to believe that Kleinman would trade her account according to a theory of Steinhacker's devising. He also held that Steinhacker presented his theory in a manner that constituted a prohibited guarantee of profits. In addition, the Judgment Officer held that Kleinman did not diligently supervise Steinhacker's solicitation activities. He awarded Muskus \$14,392 in damages, plus interest and costs.

On appeal, respondents argue that the Judgment Officer erred in crediting Muskus's version of events rather than theirs, and otherwise made factual assessments unsupported by the record. Muskus defends the Judgment Officer's decision insofar as it runs in her favor. She argues in the alternative that she is entitled to damages on the ground that Kleinman failed to

¹During the time at issue, CRC was registered as an introducing broker ("IB"). Kleinman was CRC's sole owner and was registered as an associated person ("AP") of the firm. Steinhacker was registered as an AP of CRC during the latter part of the period relevant to this case. Before that, he was registered with a firm with no connection to this case.

provide the disclosure statement mandated by Commission Rule 4.31. Muskus litigated this issue unsuccessfully before the Judgment Officer.

We conclude that the Judgment Officer erred in assessing the parties' and witnesses' credibility. A proper assessment of the record reveals insufficient reliable evidence to support Muskus's fraudulent inducement claim against Steinhacker, and we dismiss it for a failure of proof. We also dismiss Muskus's claim that Kleinman failed to supervise Steinhacker: since no misconduct by Steinhacker detrimental to Muskus has been proved, any failure to supervise could not have proximately caused her damages. Finally, we affirm the Judgment Officer's dismissal of Muskus's claim under Rule 4.31.

BACKGROUND

In February 1998, Muskus filed a reparations complaint alleging that Steinhacker led her to believe he had developed a low risk, high-profit trading strategy, and that if she opened a managed account at CRC, its owner, Kleinman, would trade her account according to Steinhacker's strategy. Muskus's complaint stated that she learned of Steinhacker through her fiancé, Frank J. Udiskey ("Udiskey"), who attended Steinhacker's adult education course, "Understanding the Commodity Futures Markets."² Muskus alleged that Udiskey talked to her about the lectures and showed her the course materials he received. Her interest was piqued, and she called Steinhacker. According to her complaint, they had "several extended telephone conversations" before she opened her account, and in those conversations, Steinhacker confirmed what Udiskey had told her about the course. Complaint at ¶ 13.

²Steinhacker, albeit a registered associated person, was a professional photographer who taught the futures course as a sideline.

As set forth in her complaint, Muskus opened an account with Kleinman in late November 1995 with an initial deposit of \$10,000, which began trading in December. Overall trading was profitable for the first few months, despite losses on some positions, and Muskus made three additional deposits through February totaling \$29,360. Her total account value at the end of February, reflecting realized and unrealized profits and losses, was \$49,438.96, and at the end of March, had risen slightly to \$49,849.16. Muskus made a final deposit of \$5,570 in early April. Her account began declining that month, and losses continued through May. She closed her account in June 1996, and received back \$32,579.50.³

Based on the foregoing, Muskus claimed that Steinhacker misrepresented to her that Kleinman would use his “low risk” method; and also misrepresented the extent to which trading risk could be controlled by his or any method. She alleged that Kleinman engaged in unauthorized trading by failing to follow Steinhacker’s method. She also charged that Kleinman failed to supervise Steinhacker adequately, and failed to provide a disclosure document under Rule 4.31. Finally, she charged that respondents traded her account excessively to generate commissions.

Steinhacker and Kleinman filed separate answers denying the allegations. Steinhacker asserted that before Muskus opened her account, he had only one conversation with her, in which she asked him to send her an application to open an account at CRC. Nothing was said in that conversation about his trading methods, he asserted. (Udiskey took the course in the fall of 1995 and Muskus took it in January 1996, shortly after her account began trading.) Steinhacker stated

³Muskus’s original complaint stated her out-of-pocket damages as \$14,392 or \$14,393 (representing the sum of her deposits to her account less the amount she received when it closed). She subsequently amended her complaint to correct arithmetic errors made in adding her deposits, which resulted in the amount of damages claimed being reduced to \$12,380. The initial decision based its damage award on the original complaint without regard to the amendment. On reviewing Muskus’s account statements—which are undisputed although somewhat illegible—we have identified apparent typographical errors in transcribing her deposit amounts from the statements to the pleadings. We calculate her out-of-pocket losses as \$12,350.50 (representing total deposits of \$44,930 less the \$32,579.50 remittance she received when her account closed).

that his class presentations disclosed all material information about the nature and risk of futures trading.

Kleinman contended that before he placed any trades for Muskus's account, he reviewed with her the risks involved in futures trading, and clearly described the program *he* would follow in trading her managed account. Kleinman stated that Muskus followed her account closely, and never mentioned that she expected it to follow a particular strategy recommended by Steinhacker.

A telephonic hearing was held in October 1998, at which Muskus described herself as a very conservative person who limited her investments to mutual funds and money-market accounts, and who could not afford to lose any money. She said she knew "absolutely nothing" about commodities before Udiskey took Steinhacker's course. Tr. at 9.

She said Udiskey told her that, by using Steinhacker's low risk methodology, no more than half of one's account balance would be invested in futures at any one time. Tr. at 9 *et seq.* The remainder would be deposited in an interest bearing account. Tr. at 97. Positions would be protected by stop-loss orders, so that declining trades could be exited quickly, while if trades were making money, "they let the profits ride." Tr. at 9. Thus, "never more than five percent of half of your account balance is risked and . . . if anything started to go down . . . they got out of them right away." *Id.* Muskus said Udiskey told her that a trader using this strategy could expect profits ranging from zero to 300 percent. She said she "leafed" through Udiskey's course materials and became intrigued by graphs showing highly profitable trades. Tr. at 9-10, 11-12.

The course materials included an advertising flyer stating that students would be exposed to a "conservative, low risk methodology" for futures trading; a document, *How Historic Opportunities Lead to Huge Profits* ("*Historic Opportunities*"), which focused on trading

opportunities presented when a particular market reached an historic high or low; two copies of the *Blue Chip Trades* newsletter that Steinhacker edited; graphs depicting trades with gains ranging from 673 to 2,823 percent; and a National Futures Association (“NFA”) publication, *Understanding Opportunities and Risks in Futures Trading*.

Muskus, echoing her complaint, testified that after Udiskey told her about the course, she had two “fairly lengthy” telephone conversations with Steinhacker, during which they reviewed his methodology point-by-point, with Steinhacker confirming everything Udiskey had told her about the course. Tr. at 14; *see also* Tr. at 19-23. Muskus testified that while she was attracted by the profit potential of futures trading, to her the most important aspect of Steinhacker’s method was its ability to limit downside risk. “[W]hat sticks out in my mind is that never more than five percent of half of your account balance is risked on one trade, and even so, you wouldn’t even lose that five percent of the half because they would put the stops in right away if they saw that the position was going down,” she said. Tr. at 22. Muskus testified that Steinhacker said he recommended CRC because Kleinman “embraced” his low risk methodology. Tr. at 16.

Muskus testified that when she later took Steinhacker’s class herself (after opening her account with CRC), she was most interested in the graphs, and paid scant attention to the NFA booklet. Nor did Steinhacker review the NFA material in detail, she said, spending most of the time on the graphs, trading mechanics, and anecdotes, information she said constituted the “meat” of the course. *See generally* Tr. at 79-81, 83-84, 87-88, 103.

Udiskey, who testified on behalf of Muskus, said she decided to open an account on the basis of her “lengthy” conversations with Steinhacker, which he said lasted at least 15 or 20 minutes. Tr. at 117. He said that he and Muskus discussed Steinhacker’s strategy, believed it

would work as presented, and expected that Kleinman would follow it. Tr. at 118-119.

Udiskey, like Muskus, had traded unsuccessfully at CRC and had filed a separate reparations action to recover his losses.⁴ The parties agreed to limit his testimony in Muskus's hearing to his conversations with her, and stipulated to the testimony about Steinhacker's course that he gave in his own case. Tr. at 112-13.

Steinhacker's testimony conflicted with that of Muskus and Udiskey. Steinhacker said that before Muskus began trading, he had one conversation with her, which lasted five minutes, during which she told him only that she wanted to open an account. Tr. at 151-52, 157, 162-63. Steinhacker acknowledged recommending Kleinman to his students, but said he never told them that Kleinman either would or would not use the trading approach taught in the class. Tr. at 182. Anyone who decided to open an account with Kleinman could discuss trading strategy with him, and at that point, "[i]t had nothing further to do with me," Steinhacker said. Tr. at 183.

According to Steinhacker, he discussed risk thoroughly in class, telling students that leverage makes commodity speculation more risky than stock market investments, Tr. at 158. He said he cautioned them that one could attempt to limit losses by using stop-loss orders, but that such orders may not be filled at the stop-loss price. Students were advised that execution risk "comes with the territory and they have to take that risk," he said. Tr. at 160, 164. Steinhacker said he also told the class that risk disclosure statements "*ought* to scare the hell out of you," Tr. at 150 (emphasis added), and denied forecasting profits of up to 300 percent. Tr. at 153, 156.

During cross-examination, Steinhacker conceded that his methodology was not "low risk" in any absolute sense, and said he used that description in the advertising flyer to attract

⁴See *Udiskey v. Commodity Resource Corporation*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,599 (ALJ Apr. 2, 1999), *aff'd*, CFTC Docket No. 98-R81, slip op. (Dec. 16, 2002) ("*Udiskey*").

students. Tr. at 178. He said he made it clear to his classes that futures trading is an inherently high-risk activity, and that his method sought to minimize risk through “a strict, disciplined money management approach to trading.” Tr. at 177. *See generally* Tr. at 177-79.

Kent Knock, who took Steinhacker’s class at the same time Muskus did, testified for respondents. Knock remembered that Muskus told the class she had started trading and made a lot of money. Knock said he found her “unbelievably enthusiastic” and thought she may have been a “shill” to “pump up business.” Tr. at 130. Knock recalled Steinhacker “grinding” through the NFA booklet, Tr. at 131, discussing a risk disclosure statement, reviewing NFA rules and regulations, explaining how markets worked, and showing students how to read account statements. Tr. at 140-41. Knock did not remember any statements about “a zero to 300 percent risk or profit,” Tr. at 132, and did not recall, until prompted, any discussion of a “low-risk methodology.” Tr. at 132, 137-38. Knock confirmed that Steinhacker recommended Kleinman. Tr. at 136.

Kleinman testified that whenever his firm accepted a new account, he discussed trading risk with the customer. Tr. at 197-200. Kleinman said he spoke to Muskus before and after he received her account forms and initial deposit, and specifically remembered talking with her about the account application, risk, and risk capital. Tr. at 198-99, 259. He said his discretionary clients seldom telephoned, but Muskus and Udiskey called in “quite a bit,” initially about twice a week. Tr. at 201.

Kleinman testified further that, after doing well in the beginning, Tr. at 205, Muskus’s account suffered a setback in April 1996, when a coffee trade was filled 400 points under the stop price. Tr. at 206. The account also held a large position in soybeans. Muskus followed the soybean market avidly, he said, researching weather forecasts and advisory services, and in May

1996, decided against his advice to be “real aggressive and be in soybeans only.” Tr. at 210. The soybean market collapsed in mid-June and Muskus closed her account, he said. Tr. at 211. Kleinman also stated that during the eight months she traded with him, Muskus never mentioned Steinhacker’s name or his trading strategy, Tr. at 250, a point on which his testimony and Muskus’s agreed.

Asked to explain his relation to Steinhacker, Kleinman said that Steinhacker contacted him in 1995, and told him that he taught an adult education course on the commodity markets that might inspire one or two of his students in each class to open an account. Steinhacker became registered as an AP of CRC and received a portion of the commissions generated by his referrals. Tr. at 252-53. Because Steinhacker referred only five customers over several months, Kleinman terminated the relationship. Tr. at 253. Kleinman said he fulfilled his duty to supervise Steinhacker by reviewing an outline of his course, and concluded on that basis that the course was “totally balanced,” especially because the entire first session was devoted to the NFA booklet. Tr. at 242-43, 249. He said Steinhacker never mentioned that he advocated a particular trading program.

* * *

In March 1999, the Judgment Officer issued a decision finding Steinhacker liable to Muskus on one theory, and Kleinman and CRC liable on another. *Muskus v. Commodity Resource Corp.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,562 (March 5, 1999) (“I.D.”).

He held that Steinhacker, through his course materials and class presentation to Udiskey, which Udiskey relayed to Muskus, made misrepresentations that fraudulently induced Muskus to trade. According to the Judgment Officer, the course materials and classroom presentation

operated as a prohibited guarantee of profits. He found that Muskus relied on the class advertising flyer promising a “low risk” approach to trading, *id.* at 47,565, and also was influenced by charts showing unusually successful trades. *Id.* at 47,568. He found that Steinhacker represented that his method successfully could control losses, while yielding annual profits as high as 300 percent.⁵

The Judgment Officer also held that Steinhacker misled Muskus to believe that Kleinman would follow his method. He found that when Muskus called Steinhacker, she informed him that she wanted to open an account to be traded in accordance with the low risk trading system that he taught in class. Steinhacker thereupon had a duty to inform her in unequivocal terms that Kleinman would use his own trading methodology, the Judgment Officer held. *Id.* Although Muskus and Udiskey both testified that at least two extended conversations took place between Muskus and Steinhacker before she opened her account, the Judgment Officer found that they spoke only once, for about five minutes, but that in that brief conversation, Muskus made clear her reliance on Steinhacker’s method.

The Judgment Officer found Kleinman liable, as CRC’s agent, for failing to supervise Steinhacker diligently, noting that Kleinman did not review Steinhacker’s written materials, attend any of his seminars, or request a tape recording of his presentation.

The Judgment Officer acknowledged that Muskus was apprised of risk before she began trading. The NFA booklet Udiskey showed her presented a balanced view of trading risks and rewards, and Muskus received risk disclosure documents when she opened her account. He

⁵The Judgment Officer found that Steinhacker had described a strategy of “using five-percent stop-loss orders and ‘letting the profits run’ which, if successful, would result in a few trades with large profits that would exceed the small losses in the losing trades.” *Id.* at 47,566. The judge also found that, in the last session of the class, Steinhacker responded to a question about potential profits by indicating that the range was from zero to three hundred percent. *Id.*

concluded, however, that this disclosure was outweighed by Steinhacker's deceptive information.

Based on this analysis, the Judgment Officer ordered respondents to pay Muskus \$14,392, plus interest and costs. Muskus's claim under Rule 4.31 was dismissed. Muskus presented no evidence regarding her churning claim, and the Judgment Officer did not address it, apparently deeming it abandoned.

DISCUSSION

Our review of the record reveals instances of clear error by the Judgment Officer in assessing the parties' and witnesses' credibility. These errors led him to conclude, wrongly, that Muskus was a credible witness who carried her burden of proof as complainant. We find Muskus's credibility suspect, and accordingly, reverse the liability findings and dismiss her complaint as unproved.

While observing that none of the key witnesses gave particularly compelling testimony, the Judgment Officer indicated that the testimony of Muskus and Udiskey was "generally more plausible and convincing" than the testimony of Steinhacker. I.D. at 47,562. Because the Judgment Officer had the benefit of demeanor-based evidence in evaluating credibility, we normally would defer to the determinations underlying his decision. *See Ricci v. Commonwealth Financial Group, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,917 at 44,444 (CFTC Dec. 20, 1996) (the Commission's policy is to defer to a presiding officer's credibility determinations in the absence of clear error). For the following reasons, deference is inappropriate here.

The Judgment Officer compared Muskus's credibility only to Steinhacker's, without addressing her testimony in light of Kleinman's and Knock's. He apparently omitted weighing

Muskus's testimony against Kleinman's because, he stated, Kleinman "forthrightly admitted that he could not specifically recall his conversation with Muskus during the account opening," I.D. at 47,562. That finding was error; our review of the record shows that Kleinman testified he specifically recalled his initial conversation with Muskus. Tr. at 198-99. Moreover, he gave a version of that conversation that stood in direct conflict with hers, and was no less plausible.

By failing to address Kleinman's testimony, the Judgment Officer erroneously treated Muskus's recollection of her account opening conversation with Kleinman as unrebutted, when in fact the contents of that conversation were a contested issue. To wit, Muskus testified that their "very quick" conversation involved only his trading experience, number of clients, and trading method. Tr. at 27. Kleinman testified that the conversation covered those points, and also included a discussion of her risk capital, the Commission-required risk disclosure statement, how stop-loss orders work (and sometimes do not work) and how to read account statements. Tr. at 198-200. This is normal due diligence for a broker opening a new account and there is no reason to disbelieve Kleinman's testimony that he addressed those subjects with Muskus. Because Muskus bears the burden of proof, she may prevail only if the record supports a conclusion that she is *more* credible and reliable than respondents. In addition, we note also that a point of evidence on which Muskus and Kleinman agree—that they never discussed Steinhacker's trading strategy—tends to cast doubt on Muskus's claim that she counted on Kleinman to follow it.

As a separate matter, the Judgment Officer offered no explanation for not evaluating Muskus's testimony in the context of Knock's, although they gave conflicting testimony on the contents of Steinhacker's class, which both attended in January 1996. Muskus said the issue of risk was glossed over, while Knock said it was covered in "grinding" detail. The Judgment

Officer simply noted that Knock described Muskus as a highly enthusiastic seminar participant, a point on which Muskus concurred.

The Judgment Officer may have given short shrift to Knock's testimony about the contents of Steinhacker's seminar, thinking that it did not relate immediately to the factual disputes central to Muskus's claim. The differences between Knock's testimony and Muskus's bear directly, however, on her overall credibility. Of the two, we find Knock's testimony more reliable. His testimony was dispassionate and coherent, and some of what he said supported Muskus's contentions. Moreover, of all the witnesses, he was the sole disinterested one, there being no evidence that he had a particular interest in the outcome of the parties' dispute.

Knock admittedly was an experienced trader and heard Steinhacker's presentation with the benefit of that background. Irrespective of that advantage, his testimony shows clearly that the seminar included both a substantial discussion of general trading risk and the specific risk that stop-loss orders could fail. Muskus's claim that the "meat" of the course did not involve trading risk simply cannot be squared with Knock's account. This tendency to hear and remember selectively casts doubt on her general reliability as a witness.

Apart from Muskus's reliability *vis a vis* that of other witnesses, we challenge the plausibility of her characterization of herself as "conservative" and "risk-averse." The Judgment Officer credited this description and found it to be bolstered by Muskus's reaction to losses in her account. He noted that she promptly asked Kleinman to change his trading style in May, after her account value at the end of April had fallen to \$39,629,⁶ several thousand dollars below her total investment. She quickly closed her account the next time she experienced a large loss, the Judgment Officer observed. I.D. at 47,563.

⁶Muskus realized a \$6,923 loss on a coffee trade in late April. Her account value also was affected by unrealized losses on option positions used to hedge futures.

This analysis ignores Muskus's claims that under Steinhacker's low risk trading method, on which she claimed to rely, she expected to lose no more than "five percent of half of your account balance" at a time; in her case, about \$1,125, based on her approximately \$45,000 investment. Muskus, however, incurred losses much larger than this amount early on: more than \$3,000 each on two coffee contracts in February, approximately \$2,000 on a wheat position in March, and almost \$3,000 on a corn trade in April. She continued trading, apparently because her account value overall showed a profit through March.

This conduct suggests that her desire to minimize risk and her commitment to Steinhacker's method were secondary to her interest in immediate profits. We note in this regard that in December, three weeks after her first trade, she doubled her initial \$10,000 investment to \$20,000. After earning a profit that month—her account value at the end of December was \$21,925—she invested another \$16,430 to her account in January. She eventually more than quadrupled her initial \$10,000 stake. These factors undermine the Judgment Officer's view that her conduct confirmed her self-characterization.

Indeed, Muskus's conduct in its entirety suggests that while she was attracted to futures trading by her fiancé's description of Steinhacker's class, she was less than completely reliant on Steinhacker's method. As noted above, before opening her account Muskus never discussed with Kleinman a desire to adhere to Steinhacker's trading strategy, nor did she raise the issue after absorbing losses that exceeded the per-trade loss limits that Steinhacker presented as the centerpiece of his system. Muskus exhibited a degree of blindness and deafness to risk disclosure. She paid little attention to the NFA booklet Udiskey showed her, and the oral and written risk disclosure Kleinman presented made no impression. Similarly, Steinhacker's classroom discussion of risk, which she heard in person shortly after her account began trading,

apparently went unnoticed. The risk disclosure was not outweighed, as the Judgment Officer found, but rather was tuned out.

CONCLUSION

In light of the conflicts between Muskus's testimony and that of Kleinman and Knock, and the internal conflicts between Muskus's testimony and her actions, we find that the evidence supporting her claims is insufficiently reliable to support findings under the weight of the evidence standard. *See McDaniel v. Amerivest Brokerage Services*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,264 at 50,589 (CFTC Sept. 26, 2000) (presiding officer erred by failing to assess reliability of evidence offered by party with the burden of proof in light of the record as a whole). Accordingly, we vacate the Judgment Officer's decision and dismiss Muskus's complaint for failure of proof.⁷

IT IS SO ORDERED.⁸

By the Commission (Chairman NEWSOME and Commissioners HOLUM, LUKKEN and BROWN-HRUSKA).

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

Dated: December 30, 2002

⁷We affirm the Judgment Officer's dismissal of Muskus's claim based on Commission Rule 4.31 for the reasons stated in his opinion and in *Udiskey v. Commodity Resource Corp.*, CFTC Docket No. 98-R81, slip op. at 12. All claims and arguments of the parties have been considered, and those not addressed specifically are rejected as lacking merit and not warranting extended discussion.

⁸Under Sections 6(c) and 14(e) of the Commodity Exchange Act (7 U.S.C. §§ 9 and 18(e)) (1994), a party may appeal a reparation order of the Commission to the United States Court of Appeals for only the circuit in which a hearing was held; if no hearing is held, the appeal may be filed in any circuit in which the appellee is located. The statute also states that such an appeal must be filed within 15 days after notice of the order, and that any appeal is not effective unless, within 30 days of the date of the Commission order, the appealing party files with the clerk of the court a bond equal to double the amount of the reparation award.