

UNITED STATES OF AMERICA  
Before the  
COMMODITY FUTURES TRADING COMMISSION

FRANK J. UDISKEY	:	
	:	
v.	:	CFTC Docket No. 98-R081
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COMMODITY RESEARCH CORPORATION, GEORGE KLEINMAN, and CHARLES ELLIOT STEINHACKER	:	OPINION AND ORDER
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Complainant Frank Udiskey (“Udiskey”) appeals from an Administrative Law Judge’s (“ALJ”) decision dismissing his reparations claim for \$35,647.69 against respondents Commodity Resource Corporation (“CRC”), George Kleinman (“Kleinman”) and Charles Elliot Steinhacker (“Steinhacker”).<sup>1</sup> The ALJ based his dismissal on Udiskey’s failure to show that he was fraudulently induced to trade. He also concluded that Kleinman and CRC had no duty to distribute the disclosure document required by Commission Rule 4.31.

On appeal, Udiskey challenges the ALJ’s credibility determinations and factual assessments. In addition, he argues that the ALJ erred by interpreting Rule 4.31 in an unduly narrow way. Respondents did not file a responsive brief.

In light of our review of the record, we affirm the ALJ’s decision.

**BACKGROUND**

Many of the facts material to this case are undisputed. In the fall of 1995, Udiskey, an accountant from Connecticut, attended an adult education course taught by respondent

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<sup>1</sup>During 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.

Steinhacker, on the subject of “Understanding the Commodity Futures Markets.” The flyer announcing the course stated that it would teach students “a prudent, business-like approach to trading the markets,” and would show them “how to convert this conservative, low risk methodology into the ideal business.” It described Steinhacker as a futures trader with 20 years’ experience and the editor of *Blue Chip Trades*, a newsletter.

At the seminar, Steinhacker presented a trading strategy that called for exiting losing positions when they lost five percent of their value, and letting winners ride. He advocated using stop-loss orders to implement this strategy.

To guide the class in picking winners, Steinhacker distributed a document entitled, *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. Steinhacker described trades that exploited these extreme market conditions as “blue chip trades.” *Historic Opportunities* declared that Steinhacker had developed a trading method for taking advantage of historic price movements. Seminar participants received two issues of *Blue Chip Trades* and charts depicting profitable trades.

Steinhacker also distributed a National Futures Association (“NFA”) publication, *Understanding Opportunities and Risks in Futures Trading*, which stated that futures trading is inherently risky and “is clearly not appropriate for everyone, [because] just as it is possible to realize substantial *profits* in a short period of time, it is also possible to incur substantial *losses* in a short period of time.”

Udiskey enjoyed the course, discussed it with his fiancée, Jo-Anne Muskus, and showed her his class materials. Muskus became interested, and contacted Steinhacker to discuss his theories.

Steinhacker was a professional photographer who taught the futures course as a sideline. Although he was a registered futures professional, he did not handle customer accounts or money. His financial incentive to teach the course arose through his affiliation with respondent Kleinman, the owner of CRC, an introducing brokerage firm. Steinhacker recommended Kleinman to his students as the broker whom he had chosen to endorse after interviewing numerous candidates. After the class ended, students were solicited to open a managed account at CRC, to be traded by Kleinman. If a student opened an account, Steinhacker received a share of the commissions generated.

Udiskey in due course received a package from CRC containing sales materials and account opening documents. In addition to the Commission-required risk disclosure statement, the CRC package contained several supplemental documents that warned customers about risk.<sup>2</sup> The sales material discussed Kleinman's success in trading competitions and the expertise of CRC traders. After considering the matter for several days, during which he checked Kleinman's background and conferred with Steinhacker, Udiskey opened a managed account with CRC in November 1995, depositing \$10,000.

Kleinman sent Udiskey a letter describing his trading style, stating that he cut losses quickly, tried to "lock in" profits or break-even positions, and used stop-loss orders and options to limit losses. Kleinman claimed that if his method worked properly, a "small number of significantly profitable trades each year" would "more than offset" numerous small losses.

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<sup>2</sup>The customer agreement included a customer acknowledgement that "investment in futures contracts is speculative, involves a high degree of risk and is suitable only for persons who can assume risk of loss in excess of their margin deposits." The package also included a customer acknowledgement that an advisor has a conflict of interest between generating brokerage commissions and making trading decisions in the customer's interest.

Monthly account statements show that Kleinman traded a range of futures and options for Udiskey's account, including metals, grains, coffee, Swiss francs, and crude oil. He traded fairly frequently but limited each position to either one or two contracts.

Initially, the account made money.<sup>3</sup> Encouraged by his early profits, Udiskey deposited an additional \$20,000 to his account in January and another \$10,000 in February. The account's liquidation value at the end of February was roughly \$47,600. Udiskey made a final deposit of \$8,000 in early April.

The account began a major decline that month.<sup>4</sup> Its liquidation value fell to \$41,311 by the end of April. It stood at \$37,876 at the end of May, and at \$31,035 at the end of June, before rising slightly to end July at \$36,744. Thereafter it fell, month after month through December, ending the year at \$15,367. Udiskey closed his account in January 1997, after further losses.

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On February 9, 1998, Udiskey filed a complaint alleging that his account was traded in a manner incompatible with the conservative strategy described by Steinhacker. Although Udiskey did not use the term "fraudulent inducement," his complaint alleged in essence that Steinhacker deceived him into opening an account managed by Kleinman, and that he was lulled into continued trading after he suffered losses. He also alleged that his account was traded excessively to generate commissions; that Kleinman and CRC failed to provide the commodity trading advisor ("CTA") risk disclosure statement described in Commission Rule 4.31; and that Kleinman failed to supervise Steinhacker diligently.

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<sup>3</sup>The December account statement is not in the record. Udiskey's January statement shows an opening balance of \$12,450—a \$2,450 profit on his initial \$10,000 investment.

<sup>4</sup> Udiskey's monthly account statements disclose sizable losses on individual trades, however, as early as February 1996, when the account was making money overall. On February 26, 1996, he lost over \$3,000 on a single coffee contract, and on March 28, 1996, he lost almost \$3,000 on a Swiss Franc position.

Steinhacker and Kleinman filed separate answers denying the allegations. Steinhacker asserted that his class presentation disclosed all material information about the nature and risk of futures trading. Kleinman contended that he independently reviewed the risks of trading with Udiskey before Udiskey's account began trading, and clearly described the program he would follow in trading Udiskey's managed account. Kleinman claimed that Udiskey followed the trading results in his account very closely and never mentioned that he expected his account to follow a particular trading strategy recommended by Steinhacker.

After a period of discovery, the ALJ held a hearing in New York. Udiskey testified that he enrolled in Steinhacker's course because it purported to offer a conservative, low-risk trading methodology, which appealed to him as a conservative person and investor. Tr. at 10-13, 56-57. He testified that Steinhacker told the class that, because losing trades were offset after declining five percent, losses could be controlled so that futures trading would be no more risky than the stock market. He stated also that Steinhacker told the class that the expected rate of return from futures trading was zero to 300 percent. Tr. at 22. Udiskey said he would not have taken the course or opened an account if trading risk had been presented properly to him. Tr. at 25.

Udiskey said that during class, Steinhacker presented the cautionary NFA material "with his head down reading it," Tr. at 109, in marked contrast to his "very entertaining" anecdote about making a killing in the silver market. Tr. at 15-16. Udiskey testified that any discussion of risk presented in class materials or classroom lectures made no impression on him, either because he was distracted by material he found more interesting, or because he was inattentive. Tr. at 107, 109-11. He said that Steinhacker told the class that the risk disclosure statement would "scare the hell out of you," Tr. at 26, and accordingly he gave it short shrift when he opened his account. Tr. at 68.

As to opening his account at CRC, Udiskey testified that he reviewed the CRC material, and completed and signed the account opening documents on November 18, but did not mail them back immediately because he “g[ot] cold feet.” Tr. at 30. Steinhacker called him and persuaded him to give futures trading a try, Udiskey said, observing that his instructor “is a very convincing person.” Tr. at 33. Udiskey testified that after he returned his account application and initial deposit, Kleinman called to “welcome me aboard,” Tr. at 34, but that in the course of the conversation, Kleinman never discussed risk or advised him to limit his investment to risk capital, *i.e.*, money he could afford to lose. Tr. at 64-66.

Udiskey claimed not to understand his account statements fully, but grasped the bottom line and knew whether he was winning or losing. Tr. at 114. Udiskey said he decided not to close his account in May or June, after two or three months of substantial net losses, because Kleinman explained the losses as aberrations and told him there would be significant profit opportunities in the future. *See generally* Tr. at 38-45. Udiskey testified that he eventually lost confidence in Kleinman and closed his account. Tr. at 45.

Udiskey called his fiancée, Muskus, as a witness to corroborate his testimony. She, like Udiskey, testified that Steinhacker told her that losing positions were offset when they lost five percent of their value, and that she should expect profits of zero to 300 percent. *See generally* Tr. at 128-30.<sup>5</sup>

Steinhacker and Kleinman appeared in opposition to Udiskey. Steinhacker denied minimizing trading risk. He testified that he told students that leverage is a double-edged sword, making futures trading more, not less, risky than the stock market. Tr. at 167. He denied

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<sup>5</sup>Muskus opened a separate account with CRC and suffered losses, which she sought to recover through a separate reparations action. *See Muskus v. Commodity Resource Corp.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,562 (Mar. 5, 1999) (ALJ decision awarding Muskus \$14,392 in damages) (app. filed Mar. 22, 1999).

guaranteeing that losses could be capped at five percent. He said he had advised that a person could decide to risk five percent of an investment and place a stop-loss order at that point, but cautioned that stops are not always executed at the loss-limit point. Tr. at 176. He also denied making the profit predictions attributed to him. He said he told his students that risk disclosure statements *should* “scare the hell out of [them],” but did not say not to read them. Tr. at 167-68.

Steinhacker said there were two ways to approach the futures market: (1) with a gambler’s mentality, characterized by greed and a desire for action; or (2) in a prudent, disciplined business-like fashion. Tr. at 173. Steinhacker testified that he used the latter approach, and thus characterized his method as conservative and “low-risk.” He stated that his approach was not low-risk in any absolute sense, merely lower-risk than other trading strategies. Tr. at 175. During cross-examination, he admitted describing his method as “low-risk because it “helps to get people in the class.” Tr. at 183-84.

Kleinman’s testimony also directly contradicted Udiskey’s, especially on the content of their first conversation. He stated that he and Udiskey discussed the risk disclosure statements and other account opening documents Udiskey had been sent, and that their conversation covered the fact that futures trading carries a large degree of risk. The conversation lasted 30 to 45 minutes and was typical of the talk he had with all new clients, he said. Kleinman said his normal account opening procedure involved contacting clients, advising them of potential margin calls, and letting them know that stop-loss orders are not infallible. *See generally* Tr. at 219-20, 224-27. Kleinman asserted that he told Udiskey that the market declines periodically and he could not guarantee that it would ever come back. Tr. at 232.

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In April 1999, the ALJ issued a decision dismissing Udiskey’s complaint, holding that he had failed to prove fraud or other violations by Steinhacker and Kleinman. *Udiskey v. Commodity Resource Corp.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,599 (April 2, 1999) (“I.D.”). He found it undisputed that Steinhacker unabashedly promoted a “conservative” approach to trading futures and options; and that Steinhacker’s flyer hooked prospective students by describing his trading methods as low-risk. *Id.* at 47,846. He held, however, that these claims and opinions were “too vague, general, soft and subjective” to establish Udiskey’s fraud allegations. *Id.*

He then turned to the principal points on which Udiskey and Steinhacker offered conflicting testimony: the potential for high profits; the allegation that losses on individual trades could be limited to five percent with certainty; and the allegation that futures trading could be no more risky than the stock market. *Id.* at 47,846-47. *Id.* at 47,847 & n.63. To resolve these disputes, the ALJ addressed Udiskey’s credibility—he being the party with the burden of proof—and found it deficient.<sup>6</sup> The ALJ also held that Muskus lacked credibility.

In addition to assessing the parties’ demeanor, the ALJ found Udiskey’s assertions that he “trusted” Steinhacker and relied on his representations to be inconsistent with other, undisputed evidence of record. *Id.* at 47,849. He noted that Udiskey was a “sophisticated” individual employed as an auditor, who thus was knowledgeable about financial matters. *Id.* at 47,849. He emphasized Udiskey’s careful approach to trading, observing that Udiskey took a trading course; consulted with Muskus, who had an M.B.A. degree; had a number of conversations with Steinhacker; read articles on trading; and checked Kleinman’s record. *Id.* at 47,850 n.75. In

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<sup>6</sup>The ALJ explained that he based his evaluation on a “search for consistency, both within and without”—(1) internal consistency; (2) consistency with prior statements; (3) congruity with other, more reliable evidence; and (4) harmony with the proven surrounding circumstances. *Id.* at 47,848 n.68.



addition to the foregoing factors, the ALJ bore in mind Udiskey's testimony that after completing and signing his account-opening documents, he waited several days to return them because of his concern about the risk of loss. *Id.* at 47,851. This admitted hesitation, the ALJ reasoned, fatally undermined Udiskey's claim that he gave short shift to the risk disclosure statements because he trusted Steinhacker and the efficacy of his methods. *Id.*

As a separate basis for doubting that Udiskey reasonably could have believed that futures could be traded with low risk, the ALJ pointed to some of the course materials Steinhacker provided. The material "repeatedly highlight[ed] the risks associated" with futures trading in a manner that was "[p]lainly in tension with any simplistic guarantees that profits could be made by use of Steinhacker's (or any other) trading approach, that stop-loss orders are fail-safe, or that commodities speculation is no more risky than equity investing," the ALJ held. *Id.* at 47,849.<sup>7</sup>

In addition, the ALJ found that information Kleinman imparted to Udiskey further undermined complainant's claim that he opened his CRC account because he believed that the risk of loss was minimal. The ALJ credited Kleinman's testimony that he followed his standard procedure of reviewing the account-opening documents and discussing risks prior to trading for Udiskey. He found specifically that Kleinman reviewed the risk warnings in the disclosure documents and stated that stop-loss orders could not guarantee that an open position would be liquidated at a given price. *Id.* at 47,854.

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<sup>7</sup>In this regard, he noted that the NFA booklet advised that speculation in futures could result in "substantial losses in a short period of time," and involved a type of leverage that could work "against you when prices move in" an unanticipated direction. *Id.* at 47,849 n. 74. The ALJ emphasized that the booklet warned that there was "no guarantee" that techniques used to limit the size of losses "[would] prove effective" and specifically advised "don't trade" if "you cannot afford the risk, or even if you are uncomfortable with the risk." *Id.* The ALJ specifically discredited Udiskey's testimony that he did not carefully review the NFA booklet because he was spellbound by the silver market story. *Id.* at 47,850 n. 75.

Finally, the ALJ noted that as early as April 1996, the results of the trading in Udiskey's account (a 14 percent decline) clearly demonstrated that the risk of loss was substantial and real. He emphasized that neither Udiskey nor his witness, Muskus, challenged Kleinman's testimony that they were keenly attentive to the trading in their accounts. *Id.* at 47,851-52. The ALJ rejected Udiskey's claim that Kleinman lulled him into continuing trading despite the losses, finding Kleinman's continued optimism was not a guarantee of future success and that the mounting losses made it clear that the effectiveness of stop-loss orders had limits. *Id.* at 47,854-55 n.112.

In light of his adverse credibility determination against Udiskey, the ALJ held that Udiskey failed to establish either that Steinhacker made deceptive statements or that he justifiably relied on such statements in opening and maintaining his CRC account.

The ALJ also rejected Udiskey's claim that CRC and Kleinman failed to provide a CTA disclosure document as required by Commission Rule 4.31(a). In connection with this claim, the ALJ noted that, as a registered IB, CRC was exempt from CTA registration, provided that its advice was issued solely in connection with its business as an IB; and as a registered AP, Kleinman was exempt from CTA registration provided that his advice was issued solely in connection with his employment as an AP. *See* Commission Rule 4.14(a).

The ALJ found no evidence that either respondent provided trading advice to persons other than CRC brokerage customers, or with respect to futures or option products as to which CRC did not accept orders; thus, their advisory services occurred solely in connection with their respective IB and AP activities. Finding that they were exempt from CTA registration and were

not in fact so registered, the ALJ concluded that neither was required to provide the disclosure document called for by Commission Rule 4.31(a).<sup>8</sup>

## DISCUSSION

Udiskey argues on appeal that the ALJ erred by finding that he was not credible. Udiskey contends that he was misled by Steinhacker's misrepresentations and omissions in the course flyer, materials, and seminar. He claims that Kleinman facilitated Steinhacker's violations by failing to supervise him, by failing to deliver a CTA disclosure document, and by failing to disclose that he was not using Steinhacker's trading system. Additionally, Udiskey asserts that Kleinman lulled him into keeping his account open. Respondents did not reply.

In recognition of a presiding officer's opportunity to assess demeanor-based factors in determining credibility, we defer to his credibility determinations in the absence of clear error. *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). We generally find that when the testimony of two or more witnesses is in conflict and a presiding officer finds one witness to be more truthful than any of the others, the circumstances are rare when that determination will amount to clear error. *Secrest v. Madda Trading Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,627 at 36,696 (CFTC Sept. 14, 1989).

Our review reveals no such clear error in the ALJ's credibility analysis. Significant flaws exist in Udiskey's version of the events at issue—flaws thoroughly canvassed by the ALJ—that render his testimony immediately suspect, even on a paper record. Absent clear error in the ALJ's process of weighing the evidence, his access to demeanor-based evidence becomes decisive. He disbelieved Udiskey, and in these circumstances, an exception to our usual policy

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<sup>8</sup>The ALJ ruled that Udiskey had withdrawn his churning and other claims. *Id.* at 47,855 n.114.

of deference is not warranted. Thus, we reject Udiskey's allegations of fraudulent inducement and lulling.

Udiskey claims that facts admitted by respondents establish that CRC and Kleinman had a duty to provide the disclosure document mandated by Commission Rule 4.31. The ALJ appropriately found, however, that Udiskey failed to establish a reliable basis for concluding that they were required to be registered as CTAs; nor were they in fact so registered. Accordingly, they had no duty to provide a CTA disclosure document.<sup>9</sup> We have considered all other arguments raised by Udiskey and reject them as lacking merit without extended discussion.

### **CONCLUSION**

For the reasons discussed above, we affirm the dismissal of Udiskey's complaint for a failure of proof.

IT IS SO ORDERED.<sup>10</sup>

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

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

Dated: December 16, 2002

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<sup>9</sup>Udiskey emphasizes language in Rule 4.31 that requires distribution of a detailed disclosure statement by certain persons "guiding customer trading by means of a systematic program that recommends specific transactions." Even if the manner in which respondents traded Udiskey's account fit this definition, the rule makes it clear that only those who are registered or "required to be registered" as a CTA are subject to this disclosure requirement.

<sup>10</sup>Under 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.