U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581

DANIEL J. CORBETT,

Complainant,

v.

MARSHA ELEANOR FRIEDMAN, DEBRAH GAIL a/k/a GAIL EISENBERG, UNIVERSAL FINANCIAL HOLDING CORP. and WORLDWIDE COMMODITY CORPORATION,

Respondents.

CFTC Docket No. 05-R022

INITIAL DECISION

In this proceeding, all of the parties made decisions that hurt their respective cases. The respondents chose not to attend the hearing and, thus, lost the right to introduce evidence. Complainant Daniel J. Corbett limited his case against respondents Universal Financial Holding Corp. and Worldwide Commodity Corporation to failure to supervise claims even though he could have charged each of them with strict, vicarious liability. In the one-sided hearing, Corbett proved that respondents Marsha Eleanor Friedman and Debrah Gail defrauded him and that they are liable to him for damages. However, he did not prove that his account was churned, that Universal and Worldwide failed to exercise diligent supervision or that Friedman and Gail proximately caused all of his claimed injuries by committing the proven fraud.

Background

In September of 2004, Corbett saw a television advertisement for services that Worldwide, a registered introducing broker,[1] was offering to retail options traders.[2] He subsequently called the firm and opened an options trading account[3] that Worldwide introduced to registered futures commission merchant Universal.[4] Between September 14th and December 9, 2004, Corbett made 21 trades.[5] Gail[6] solicited Corbett's first trade and, thereafter, Friedman[7] took the lead in guiding his account.[8] The first three trades generated profits but most of the others resulted in losses.[9] In January of 2004, Worldwide

---

[1] CX-9-85.

[2] CX-27-1.

[3] Corbett initially deposited $5,000. CX-9-8. Over the next two months, he made seven more transfers that totaled $114,541. CX-9-12, CX-9-23, CX-9-26, CX-9-36, CX-9-43, CX-9-51. Shortly before he moved his positions to another futures commission merchant and closed the Universal account, Corbett made two withdrawals of $4,600 and $593.65. CX-9-61, CX-9-74.

[4] CX-8-7; CX-9-8; CX-27-1.

[5] One third of these were spreads and the remaining trades were simple long positions. CX-9-8, CX-9-10, CX-9-16, CX-9-18, CX-9-20, CX-9-24, CX-9-27, CX-9-30, CX-9-34, CX-9-38, CX-9-41, CX-9-45, CX-9-49, CX-9-53, CX-9-56, CX-9-59, CX-9-65, CX-9-71.

[6] Gail was a registered associated person of Worldwide from October 11, 2002 until February 1, 2005. CX-9-96 - CX-9-97.

[7] Friedman was a registered AP of Worldwide from September 17, 2004 until February 1, 2005. CX-9-87 - CX-9-90.

[8] CX-8-7 - CX-8-14.

[9] CX-9-8, CX-9-10, CX-9-13, CX-9-16, CX-9-18, CX-9-20, CX-9-22, CX-9-24, CX-9-27, CX-9-30, CX-9-34, CX-9-36, CX-9-38, CX-9-39, CX-9-41, CX-9-45,

(continued..)

informed Corbett that he would have to transfer or liquidate his positions because the firm was going to cease doing business.[10] Corbett responded by transferring the last three open positions to an account that he opened with another FCM.[11] At the time of the transfer, he had deposited $119,541 into the Universal account and withdrawn $5,193.65, and positions he transferred had a liquidating value of $3,155.[12]

As his business with Worldwide was coming to an end, Corbett began complaining to the firm, claiming that he had been mistreated by Gail and Friedman.[13] Unsatisfied with the responses he received, Corbett filed a complaint with the Office of Proceedings[14] that he later amended.[15] In the amended pleading, Corbett charged respondents Friedman and Gail with fraud,

---

(..continued)

CX-9-47, CX-9-49, CX-9-51, CX-9-53, CX-9-56, CX-9-59, CX-9-65, CX-9-67, CX-9-71, CX-9-72, CX-9-77, CX-9-80.

[10] CX-4-1; CX-8-4.

[11] CX-9-77, CX-9-80.

[12] CX-9-81 - CX-9-82. See supra note 3.

[13] CX-1-1 - CX-1-3; CX-2-1.

[14] Commodity Futures Trading Commission Reparations Complaint Form, dated December 23, 2004.

[15] Claims and Compensation Information, dated February 9, 2005 ("Amended Complaint"). The Amended Complaint superseded the initial pleading. Letter from Daniel J. Corbett to CFTC, dated February 9, 2005 ("The attached document titled 'Claims and Compensation Information' which is dated February 9, 2005 supersedes and replaces the initial document that was sent to the CFTC.").

alleged that Friedman churned his account and claimed that Worldwide and Universal failed to exercise diligent supervision.[16] The Office of Proceedings forwarded the amended complaint to the respondents on March 10, 2005[17] and they answered by denying any wrongdoing.[18] On May 10, 2005, the case was transmitted to us.[19]

After discovery, we scheduled a hearing to commence on March 7, 2006.[20] As that date approached, the parties asked us to stay the proceeding on grounds that they had reached a settlement in principle.[21] We granted the request[22] but three months passed without any indication that an agreement had been finalized. Consequently, we ordered the parties to show cause why

---

[16] Amended Complaint at 1.

[17] Letter from the Office of Proceedings to Marsha Eleanor Friedman et al., dated March 10, 2005, at 1.

[18] To be more precise, respondents Worldwide, Friedman and Gail answered the complaint, Universal failed to timely answer and fell into default, the Office of Proceedings forwarded the case to us, Universal filed a motion to set aside its default, we granted the motion and Universal filed an answer. Order, dated June 24, 2007, at 1-2; Amended Answer, dated July 1, 2005, at 1-3; Motion to Set Aside Non-Final Default Order, dated May 31, 2005; Amended Answer, dated April 29, 2005, at 1-3; Untitled pleading, received April 13, 2005, at 1-2.

[19] Notice and Order, dated May 10, 2005, at 1.

[20] Order, dated January 25, 2006, at 1. Initially, we had scheduled it to commence on February 14, 2006. Order and Notice of Hearing, dated November 8, 2005, at 1-2.

[21] Motion to Stay Proceedings, filed March 6, 2006, at 1.

[22] Order Staying Proceeding, dated March 6, 2006.

the stay should not be lifted.[23] Their responses indicated that the settlement process had broken down and no one argued against reactivating the proceeding.[24] In light of these responses, we terminated the stay[25] and, on January 17, 2007, convened a one-day hearing.[26] At the hearing, we received Corbett's testimony into evidence (as well as most of his proposed exhibits)[27] and established a schedule for posthearing memoranda. Having received Corbett's posthearing memorandum,[28] we now turn to his claims.

---

[23] Show Cause Order, dated June 20, 2006, at 2.

[24] Letter from Vivian R. Drohan to the Office of Proceedings, dated June 27, 2006, at 1-2; Letter from Daniel J. Corbett to the Office of Proceedings, dated June 23, 2006, at 1-2.

[25] Notice of Hearing, dated November 6, 2006; Order, dated October 13, 2006; Order and Notice, dated June 30, 2006, at 1-2.

[26] One day prior, the respondents notified us that they would not appear at the hearing. Letter from Vivian R. Drohan to the Court, dated January 16, 2007. See Transcript, dated January 17, 2007 ("Transcript") at 4-5.

[27] Transcript at 5, 7-10. We excluded testimonial declarations of persons who Corbett listed but did not present as witnesses. Transcript at 5, 29. He marked them as CX-26 and part of CX-25.

[28] Post-Oral Hearing Brief, dated February 1, 2007 ("Posthearing Memorandum"). Corbett's posthearing memorandum included the argument that Friedman and Gail violated National Futures Association compliance rules. Id. at 2. In reparations, we can only award damages for violations of the Commodity Exchange Act, Commission regulations and Commission orders. 7 U.S.C. §18(a)(1). Thus, Corbett cannot recover on the basis of National Futures Association compliance rule violations (unless such wrongdoing also violates the Act, Commission regulations or Commission orders). See Phacelli v. ContiCommodity Servs., Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,250 at 32,672-75 (CFTC Sept. 5, 1986).

The Posthearing Memorandum also included a request to hold nonparties Steve Labell, Larry Kahn and South Coast Commodities liable. (continued..)

Corbett's Case Against Universal And Worldwide Is Limited To Claims That The Firms Violated Rule 166.3

In his prehearing memorandum, Corbett argued that "Universal Financial Holding Corporation is liable for Worldwide Commodity Corporation's violations of the Commodity Exchange Act, 7 U.S.C. [§]1 et seq[.] (2002)."[29] He repeated this charge after the hearing and explained that a guarantee agreement between Universal and Worldwide formed the basis of the vicarious liability.[30] While these theories can succeed in reparations, Corbett's timing raises the issue of fair notice.

"Fundamental fairness . . . requires that commodity professionals be given adequate notice of the legal violations at issue in a reparations proceeding."[31] In addition, the Commission has prohibited us from reinterpreting or embellishing a complaint by adding claims that could have

---

(..continued)

Posthearing Memorandum at 4. On two occasions, we denied Corbett's requests to join the Labell, Kahn and South Coast as respondents (and, then, we denied a motion for reconsideration). Order, dated January 20, 2006, at 1-5; Order, dated December 20, 2005, at 5-6; Order, dated November 29, 2005, at 1-2. Having never joined the three, we cannot hold them liable.

[29] Revised - Prehearing Memorandum, dated January 19, 2006 ("Amended Prehearing Memorandum"), at 2.

[30] Posthearing Memorandum at 2.

[31] Johnson v. Fleck, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,957 at 37,499 (CFTC Nov. 20, 1990).

been raised but were not.[32] On the other hand, a complainant need not specify legal theories in order to provide adequate notice and satisfy the Part 12 Rules.[33] Rather, "[t]he focus of the Commission's standards for a reparation complaint is the articulation of the factual basis for a complainant's dispute with his commodity professional."[34]

In his amended complaint,[35] Corbett alleged, "Worldwide . . . and Universal . . . are negligent for failing to effectively supervise these [b]rokers allowing my account to be traded as described and for allowing my account to be over extended. They tried to cover up their negligence by getting me to increase my initially stated net worth."[36] He did not allege that Worldwide and Universal were parties to a guarantee agreement nor did he state that such a contract formed the basis of his claim against Universal. In addition, he has not asked to amend his complaint to add such a claim against the firm. Moreover, because the existence of a guarantee agreement is relevant to the issue of whether Universal had a Rule 166.3 duty to supervise,[37] Universal's failure to object to evidence of a guarantee agreement does not constitute an

---

[32] In re Heitschmidt, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,263 at 42,204 (CFTC Nov. 9, 1994).

[33] Johnson, [1990-1992 Transfer Binder] ¶24,957 at 37,499.

[34] Id.

[35] See supra note 15.

[36] Amended Complaint at 1.

[37] See infra text accompanying note 43.

implicit consent to try a new issue.[38] Accordingly, Corbett's case against Universal must be limited to his failure to supervise claim.

Corbett's case against Worldwide is just as narrow even though, before and after the hearing, he argued that "Worldwide is liable for . . . fraudulent activities by its brokers as they occurred within the scope of the Brokers[']' employment with Worldwide."[39] As quoted above, he specified one theory of liability with respect to Worldwide, the failure to supervise. While Corbett could have alleged agency-based vicarious liability when he filed his amended pleading, he did not. Had Corbett not summarized his theories in the Amended Complaint, perhaps we might have filled in the blanks[40] and read it as intending to advance respondeat superior liability. However, because Corbett clearly stated his claim for liability on Worldwide's part, we cannot "interpret" the Amended Complaint to include the claims that we would have advanced had we been his counsel. In addition, because the existence of an employment relationship is relevant to the issue of whether Worldwide had a duty to supervise Gail and Friedman, the failure to object to evidence of employment relationships does not qualify as implied consent to an expansion of the case.

---

[38] Cf. Acequia, Inc. v. Clinton (In re Acequia, Inc.), 34 F.3d 800, 814 (9th Cir. 1994) (explaining that, when introduced evidence alleged to have shown implied consent was also relevant to the other issues at trial, its introduction cannot form the basis of implied consent to try a new issue).

[39] Posthearing Memorandum at 3. Accord Amended Prehearing Memorandum at 2.

[40] The Amended Complaint includes no allegation that Worldwide employed Gail or Friedman. See, e.g., Amended Complaint at 1-2.

Corbett Did Not Establish That Universal Violated Rule 166.3

Rule 166.3 imposes a duty of diligence upon all registrants who have supervisory responsibilities.[41] To establish that a respondent violated that regulation, a complainant must first prove[42] the existence of a relationship with the persons (the actions of whom form some part of the causal chain) that triggered a Rule 166.3-based duty to supervise.[43] He must also prove that the

---

[41] It states,

> Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

17 C.F.R. §166.3.

[42] Complainants must generally meet the preponderance of the evidence standard of proof. See Gilbert v. Refco, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,081 at 38,060 (CFTC June 27, 1991).

[43] See Sanchez v. Crown, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,183 at 57,726 (CFTC Jan. 18. 2006); Lobb v. J.T. McKerr & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,568 at 36,443-45 (CFTC Dec. 14, 1989).

Determining whether Rule 166.3 obligated Universal to supervise Worldwide is complicated by the firms' relationship. The Rule 166.3 duty depends on the existence of a principal-agent relationship between the two firms. See supra note 41. Evidence that a firm dealt exclusively with its alleged principal and evidence that the alleged principal exercised control over the firm have ordinarily been taken to support an inference that there was an agency relationship. Webster v. Refco, Inc., [1998-1999 Transfer Binder] (continued..)

respondent's supervision was negligent.[44] To recover damages, the complainant would also have to prove that the respondent's negligence was a cause in fact and proximate cause of cognizable injuries.[45] For the moment, we

---

(..continued)

Comm. Fut. L. Rep. (CCH) ¶27,578 at 47,697-98 (ALJ Feb. 1, 1999), aff'd sub nom., Sommerfeld v. Aiello, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,271 (CFTC Sept. 29, 2000). However, in cases such as this, regulations compelled Universal to act as though there was an agency despite the fact that guaranteed IBs are not per se agents of their guarantors. Violette v. First Options of Chicago, Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,951 at 44,624 (CFTC Feb. 20, 1997). The source of this compelled principal-like activity is Commission regulations and National Futures Association compliance rules.

Rule 170.15(a), 17 C.F.R. §170.15(a), requires persons that must register as FCMs to be members of a registered futures association and there is only one such self-regulatory organization, the NFA. The NFA requires FCMs to supervise the IBs they guarantee. Interpretive Notice for Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs (NFA 1992, rev'd 2000) ("Rule 2-9 . . . imposes a direct duty to guarantor FCMs to supervise the activities of their guaranteed IBs."). In addition, 17 C.F.R. §1.57(a)(1) requires a guaranteed IB to introduce accounts to the guarantor FCM exclusively. Thus, two classic factors in an agency requirement lose their probity because they can simply reflect rule compliance rather than the existence of a deeper relationship between a guaranteed IB and a guarantor FCM.

[44] Because it does not modify the term "diligently," Rule 166.3 seems to require "ordinary" diligence. See supra note 41. This impression receives some support from precedent indicating that the regulation does not require perfection. See Sanchez, [2005-2007 Transfer Binder] ¶30,183 at 57,726; In re Murlas Commodities, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,485 at 43,158-59, 43,161 (CFTC Sept. 1, 1995). Ordinary diligence is reasonable care and a failure to exercise ordinary diligence is negligence. Sun Printing & Publ'g Ass'n v. Moore, 183 U.S. 642, 654 (1902); Smith v. United States, 207 F. Supp. 2d 209, 214 (S.D.N.Y. 2002); Black's Law Dictionary 412 (5th ed. 1979).

[45] In Sanchez, the Commission held,

(continued..)

will assume that Universal had a duty to supervise and proceed directly to the issue of negligence.

In general, there are three ways to prove negligent supervision. A complainant can (1) introduce direct evidence that, in its design or application,[46] a respondent's supervisory system fell short of reasonable care, (2) introduce evidence of phenomena that, more likely than not, would never have occurred in the presence of ordinary diligence and/or (3) introduce evidence that phenomena would not have occurred with the frequency proven by the complainant unless the respondent was negligent in its supervision.[47] To prove that inculpating phenomena occurred too often, a complainant must not only prove some number of occurrences, he must also introduce adequate evidence concerning the scope of the respondent's business to support the

---

(..continued)

> In assessing an alleged violation of Rule 166.3, the Commission focuses on: (1) the nature of a respondent's system of supervision; (2) the supervisor's role in that system of supervision; and (3) evidence that the supervisor did not perform his assigned role in a diligent manner. In addition, a complainant must establish that the supervisor's breach of duty played a substantial role in the wrongdoing that proximately caused the damages.

[2005-2007 Transfer Binder] ¶30,183 at 57,726.

[46] In re First Fin. Trading, Inc., [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,089 at 53,688 n.96 (CFTC July 8, 2002).

[47] See Murlas, [1994-1996 Transfer Binder] ¶26,485 at 43,158-61.

inference that the occurrences of agent malfeasance were not relatively isolated.[48]

In this case, Corbett introduced no direct evidence of Universal's supervisory efforts (or their absence). Thus, his case depends on circumstantial proof. Corbett introduced a substantial number of declarations that, if they could be considered for the truth of the matters asserted, would shed light on Worldwide's behavior and, thereby, support inferences concerning the effectiveness of Universal's supervision and its diligence.[49] Most of these declarations were made by non-parties who Corbett did not present as witnesses.[50] He also introduced the deposition testimony of Gail and Friedman.[51]

Although we admitted this material into evidence, we must still consider the uses to which it may be put. In Dawson v. Carr Investments, Inc., the

---

[48] The Commission has held that proof that an AP committed fraud "does not necessarily mean that the employee was improperly supervised." Sanchez, [2005-2007 Transfer Binder] ¶30,183 at 57,726 (quoting Protection of Commodity Customers, 42 Fed. Reg. 44,742, 44,747 (Sept. 6, 1977)). Furthermore, in Murlas, the Commission declined to find negligence on the part of a firm, even though the respondent's employees had churned 20 customer accounts, because the 20 accounts represented a small portion of the respondent's business. [1994-1996 Transfer Binder] ¶26,485 at 43,158-59, 43,161.

[49] CX-11; CX-12-1 - CX-12-16; CX-13-1 - CX-13-43; CX-14; CX-15; CX-17-1 - CX-17-2; CX-19; CX-31; CX-33; CX-34; CX-35; CX-36; CX-37; CX-42; CX-48; CX-45.

[50] See supra 49.

[51] CX-39-1; CX-43; CX-44.

administrative law judge considered an affidavit that a non-party had filed in a closely-related case.[52] The Commission characterized "any reliance" on the affidavit as "clearly erroneous" and, in support of that proposition, cited Boring v. Apache Trading Corp.,[53] a case in which it held that we generally cannot allow a party to substitute written declarations for oral testimony.[54] Given these rulings, we cannot credit the declarations of persons who are not parties[55] and did not appear as witnesses as evidence that the matters asserted therein are true.[56] Friedman and Gail's declarations, on the other hand, may be used against the respective declarants[57] but not against other

---

[52] [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,983 at 53,318, n.51 (CFTC Apr. 10, 2002).

[53] [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,380 at 39,281-82 (CFTC Aug. 27, 1992).

[54] Dawson, [2002-2003 Transfer Binder] ¶28,983 at 53,318 n.51. On the other hand, 17 C.F.R. §12.312(d)(1) allows us to order the parties to submit their witnesses' direct testimony in written form. However, we must do this in a way that protects the other parties' right of cross-examination.

[55] Proof of a party's out-of-court statements may be considered against him as evidentiary admissions. In re Nikkhah, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,884 (CFTC May 12, 2000). In addition, as discussed below, out of court declarations of a party's agent may be used against the party if it concerned a matter within the scope of the agency and was made during the existence of the principal-agent relationship. See infra note 58 and text accompanying notes 62-63.

[56] If relevant, we may consider them for other purposes that do not depend on their reliability such as evidence that the declarations were made.

[57] See supra note 55.

respondents.[58] Thus, the only testimonial evidence of primary wrongdoing on the part of Worldwide that we can properly consider, with respect to the case against Universal, is Corbett's testimony.[59]

---

[58] Federal Rule of Evidence 801(d)(2)(D) excludes from the hearsay definition "a statement by the party's agent or servant concerning a matter within the scope of the agency or employment, made during the existence of the relationship." We have signaled a willingness to adopt this rule when the circumstances did not indicate that the agent had incentives to falsify information to the principal's detriment. See In re Global Minerals & Metals Corp., [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,555 at 55,387 n.29 (CFTC Aug. 4, 2003). As noted above, Corbett introduced the deposition transcripts that seem to memorialize the statements of Friedman (CX-39-1), Gail (CX-43, CX-44) and Bruce Crown (CX-45), a former Worldwide employee. Friedman's deposition took place on March 1, 2005, after Worldwide had ceased operating and her association with the firm ended. CX-39-1, CX-39-10; CX-9-90. Similarly, the Commission deposed Gail on March 1, 2005 and December 12, 2005 but there is no evidence that Gail's employment with Worldwide postdated February 2005. CX-43-1, CX-43-32; CX-44-1; CX-9-97. There is no evidence that, when Bruce Crown was deposed on August 15, 2005, he was a Worldwide employee. See CX-45-30. In addition, Corbett did not allege or inadvertently prove that Friedman, Gail and Crown were Universal's agents at the time they spoke. Thus, their deposition testimony cannot be used against Worldwide or Universal. For the same reason, Labelle's and Kahn's depositions may not be used against the FCM. See infra text accompanying notes 62-63.

[59] There is another type of material that could have affected the outcome of our inquiry. Although Corbett did not expressly ask us to apply offensive collateral estoppel, he directed our attention to orders that came from litigation in which some of the respondents were charged with wrongdoing. They are (1) CFTC v. Worldwide Commodity Corp., NO. 2:04-cv-3641 (E.D. Pa. Sept. 19, 2006) (slip op.), a consent order that was issued in a federal court case that the Commission had brought against defendants that included Worldwide and Universal, and (2) Dukes v. Friedman, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,302 (CFTC Aug. 10, 2006), an initial decision (that became a Commission final decision pursuant to 17 C.F.R. §12.314(d) when it was not appealed) in a reparation case brought against Friedman, Worldwide and others who are not party to this proceeding. CX-13-30 - CX-13-43; CX-25-156 - CX-25-172. We will temporarily assume that Corbett intended to assert offensive, non-mutual collateral estoppel. In other words that he asks us to preclude the respondents from contesting findings that were made in previous cases to which Corbett was not a party.

(continued..)

(..continued)

We can apply collateral estoppel when: (1) "the forum resolving the issue in the first case was a 'judicial-like' decision-maker that was acting within its jurisdiction," (2) "the issue was actually litigated," (3) "the issue was actually and necessarily resolved," and (4) "the issue that was resolved in the first case is in substance the same as the issue in the second case." In re Clark, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,032 at 44,929 (CFTC Apr. 22, 1997). "The party asserting preclusion bears the burden of showing with clarity and certainty what was determined by the prior judgment." Id. at 44,929 n.28 (quoting Clark v. Bear Stearns & Co., Inc., 966 F.2d 1318, 1321 (9th Cir. 1992)).

Because they are effectively settlements rather than the results of litigated fact finding, consent orders are generally not granted issue preclusive effect unless it appears that the parties intended to so bind themselves. Arizona v. California, 530 U.S. 392, 414-15 (2000). Universal was not party to the agreement that culminated in the consent order to which Corbett referred. CX-13-31 ("To effect settlement of the matters alleged in the Complaint in this action without a trial on the merits or further judicial proceedings, Worldwide, South Coast, Labell, Kahn, Allen, Ferrini, and Schwartz (collectively, 'Defendants') . . . ."). In addition, those parties that consented to the order agreed,

> With respect to any bankruptcy proceeding relating to any Defendant, or any proceeding to enforce this Order, Defendants agree that the allegations of the Complaint, Amended Complaint and all of the Findings of Fact and Conclusions of Law as contained in Part III of this Consent Order shall be taken as true . . . and be given preclusive effect . . . .

CX-13-32 - CX-13-33. Thus, the consent order's text does not reflect an intent to create a decision that had preclusive effect in a case such as the one before us and we cannot give it preclusive effect.

There could be reasons not to grant the Dukes initial decision preclusive effect as well. In Dukes, the respondents were found to be in default and the resulting order was a default judgment in the sense that it predominantly rested on the allegations set forth in the complaint (which the presiding administrative law judge took to be true). CX-25-157 - CX-25-165. Federal default judgments generally cannot be the grounds for applications of collateral estoppel because, in default proceedings, matters are not actually litigated and fact finding is one-sided. In re Catt, 368 F.3d 789, 792 (7th Cir. 2004).

(continued..)

Assuming it to be credible, Corbett's testimony establishes that he was defrauded. However, he has not proven that the type of wrongs of which he complains, if perpetrated by an introducing broker, cannot occur unless an FCM is negligent in its supervision. In addition, Corbett did not establish that there was such a level of malfeasance committed by those over whom Universal was required to exercise supervision[60] that we can draw an inference of negligence.[61] Thus, Corbett has not proven, by a preponderance of the evidence, that Universal violated Rule 166.3.

Corbett Failed to Establish That Worldwide Violated Rule 166.3

Although, standing alone, Corbett's testimony provides too little information to support a finding that Worldwide was negligent in its supervision, his Rule 166.3 case against the IB enjoys a bit more support. He introduced the deposition testimony of Labell and Kahn, at a time when they

---

(..continued)

However, when a party participated in the earlier proceeding but opted out of the trial, the earlier proceeding merits collateral estoppel effect. Id. at 792-93. The Dukes respondents were found to be in default because, they "elected not to be available for cross examination by Complainant." CX-25-157. Consequently, we could give a decision such as Dukes preclusive effect but that would not effect the outcome against Universal because the FCM was not a respondent in the earlier proceeding. CX-25-156.

[60] See supra note 48.

[61] For example, Corbett did not introduce probative evidence tending to show that, during the relevant time, Universal serviced a small number of accounts, serviced only accounts that Worldwide introduced or had supervisory duties limited to Worldwide and its own employees. Consequently, Corbett did not prove that the wrongs that Worldwide's employees committed occurred in connection with a substantial portion of Universal's business.

were still Worldwide officers.[62] Given Labell's and Kahn's status and the absence of a reason to suspect that, at the depositions, they were inclined to perjure themselves at the firm's expense, we will treat their statements as evidentiary admissions made by Worldwide.[63] On the whole, Labell's and Kahn's descriptions of Worldwide's supervisory system support the inference that it was less than ideal.[64] However, the depositions lacked specific admissions or a depth of questioning necessary for us to find that the direct evidence amounts to a prima facie showing of negligence. On the other hand, Corbett might benefit from the fact that Worldwide was party to the Dukes proceeding and, thus, collateral estoppel may apply.[65]

The Dukes decision included the findings that, in January 2005, Worldwide AP Stuart F. Schwartz solicited Obioha F. Dukes to open an options trading account, and, from January until March 2005, Schwartz and Friedman churned Dukes' account and fraudulently induced him to trade by making affirmative misrepresentations.[66] When these findings are combined with Corbett's testimony, we can find that, during a six-month period, three Worldwide APs (Friedman, Gail and Schwartz) engaged in fraud that was

---

[62] CX-42.

[63] See supra note 58.

[64] CX-42.

[65] As discussed above, the Worldwide consent order lacks preclusive effect in this proceeding.

[66] CX-25-160 - CX-25-171.

perpetrated upon two Worldwide customers (Corbett and Dukes). We must, therefore consider whether the frauds qualify as the type and/or volume of wrongdoing that adequately support an inference of negligent supervision by Worldwide.[67] As noted above, the primary wrongdoing that Corbett's testimony and the Dukes initial decision reveal has not been proven to depend on the existence of negligent supervision.[68] Although Corbett introduced credible evidence that during the time in question Worldwide had 14 employees,[69] the lack of reliable evidence concerning the volume of its business precludes us from finding that the wrongs done to Corbett and Dukes were sufficiently pervasive to support a finding of negligent supervision. Consequently, the complainant failed to prove, by a preponderance of the evidence, that Worldwide violated Rule 166.3. This conclusion brings us to the claims against the individual respondents.

To Establish Churning, Corbett Must Prove, Among Other Things, That Friedman Excessively Traded His Account

The Amended Complaint includes allegations that, from November 9,

---

[67] See supra text accompanying notes 46-47.

[68] Cf. Murlas, [1994-1996 Transfer Binder] ¶26,485 at 43,158-61.

[69] This evidence takes the form of payroll check copies in CX-42 and NFA BASIC reports in CX-9. CX-9-85 - CX -9-97; CX-42.

2004[70] through December 8, 2004,[71] Friedman churned his account. Churning, i.e., trading excessively "for the purpose of generating commissions, without regard for the investment or trading objectives of the customer," constitutes a fraud.[72] Thus, when it occurs in connection with exchange-traded options, a Rule 33.10 violation results.[73] In order to establish that

---

[70] Actually, Corbett did not precisely fix the date upon which churning started. Instead, he alleged that "after losses were piling up . . . the [b]roker began trading her own agenda (at my risk and expense) to try to recover the losses that occurred," and, in connection with a November 9th trade, claimed that "Marsha's desperate -- she was now trying to play 'catch up' by getting me to trade my account even more." Amended Complaint at 1, 11.

[71] Corbett alleged that, with respect to the next day,

> 12/9/04: First time I made my own sell and buy: I had Marsha sell my February gold [p]uts to buy April gold [c]alls at a cheaper call price than my current April gold call holdings in order to average down on the price with a belief that gold is going to go back up again.

Amended Complaint at 14 (emphasis omitted). This was the last trade before Corbett transferred his account to another FCM. CX-9-71 - CX-9-80.

[72] Hinch v. Commonwealth Fin. Group, Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,056 at 45,020-21 (CFTC May 13, 1997) (quotation marks omitted).

[73] Id. at 45,020. The regulation states,

> It shall be unlawful for any person directly or indirectly:
>
> > (a) To cheat or defraud or attempt to cheat or defraud any other person;
> >
> > . . . .
> >
> > (c) To deceive or attempt to deceive any other person by any means whatsoever;

(continued..)

churning occurred, a complainant must prove that a respondent: (1) controlled the level and frequency of trading in the account, (2) chose an overall volume of trading that was excessive in light of the complainant's trading objectives, and (3) acted with either intent to defraud or in reckless disregard of the customer's interests.[74] Because it can end there, our analysis starts with consideration of the second element.

Although Corbett bears the burden of proving that excessive trading occurred, once he makes a prima facie showing, we can shift the burden of production by considering whether the respondents have put forth a credible explanation for their trading methodology.[75] In all but the clearest cases, the excessive trading inquiry boils down to little more than a gut-level decision because there are no recognized formulae or bright lines to guide us.[76]

(..continued)

> in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction.

17 C.F.R. §33.10.

[74] Ferriola v. Kearse-McNeill, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,172 at 50,154 (CFTC June 30, 2000).

[75] Hinch, [1996-1998 Transfer Binder] ¶27,056 at 45,022.

[76] See id. at 45,021. For example, the Commission has cautioned, "a large volume of trading, generation of a high level of commissions, or the entry of a large number of unprofitable trades do not, of and by themselves, establish that an account was traded excessively." DeAngelis v. Shearson/American Express, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,753 at 31,138 (CFTC Sept. 30, 1985). Similarly, it "ha[s] held that the existence of numerous day trades, standing alone, does not amount to a prima facie (continued..)

However, we cannot give too much weight to subjective impressions.[77] Accordingly, in futures cases, the Commission has identified five non-exclusive factors that indicate excessiveness: "(1) high monthly commission to equity ratios, (2) a high percentage of day trades, (3) the broker's departure from a previously agreed upon strategy, (4) trading in the account while it is undermargined, and (5) in and out trading."[78] The differences between futures and options trading compelled it to opine that commission-to-equity ratios lack meaning in options cases.[79] In its place, the Commission has compared the total amount of commissions paid over the life of the account to the total amount of deposits.[80] In addition, the agency has considered whether, in

---

(..continued)

showing of churning." Johnson v. Don Charles & Co., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,986 at 37,624 n.5 (CFTC Jan. 16, 1991). However, in options cases, the Commission has shown a tendency to give proof that a respondent, that charged commissions on a per-contract basis, caused a complainant to trade deep out of the money dispositive weight. See Hinch, [1996-1998 Transfer Binder]) ¶27,056 at 45,021.

[77] Johnson, [1990-1992 Transfer Binder] ¶24,986 at 37,624 ("Nevertheless, the judge erred by focusing on subjective labels such as 'hyperkinetic' and 'helter-skelter' in lieu of the analytical tools the Commission has previously endorsed.").

[78] Ferriola, [1999-2000 Transfer Binder] ¶28,172 at 50,155 n.21.

[79] Hinch, [1996-1998 Transfer Binder] ¶27,056 at 45,021-22.

[80] Ferriola, [1999-2000 Transfer Binder] ¶28,172 at 50,156. Unlike the commission-to-equity ratio analysis in futures cases, the commissions over the life of an account analysis lacks meaningful guidance concerning accounts of differing life-spans and how that relates to the commission percentages that support inferences of excessive trading and the strength of such inferences.

determining what trades to make, there is evidence that the respondents rejected trades that had risk/reward profiles that were equal to or better than those of the trades that actually occurred and whether this choice reduced the likelihood of profit by raising the commissions that were to be paid.[81] When possible, evidence of the complainant's trading objectives forms the prism through which we view the presence and absence of these factors.[82]

In this case, we lack reliable evidence that, at the point Corbett alleges churning began, his trading objectives were anything other than to seek profits by trading options.[83] In addition, Corbett did not present expert testimony or organized price data that could demonstrate the degree to which his trades were made out of the money.[84] Moreover, because he did not claim that his

---

[81] Id. at 50,155-56. The need to make such an inquiry stems from mechanics of options trading, mainly the ability to choose among a range of strike prices, and the resulting capacity of a broker to increase its revenue from a customer account by trading larger positions farther out of the money (instead of trading more often). See id.

[82] Id. at 50,154.

[83] Corbett testified that he began trading "in hopes of making some money to offset lost job wages" and that, initially, he intended to risk no more than $5,000. CX-8-2. However, by November 9th, he deposited more than $60,000 into the account. CX-9-8, CX-9-12, CX-9-23, CX-9-26, CX-9-36. Thus, if Corbett initially intended to risk only $5,000, his objectives changed soon thereafter. However, as discussed below, fraud is a likely explanation for why Corbett upped the stakes. In addition, "the absence of a specific trading objective does not justify the use of a trading strategy that emphasizes the account executive's interest over those of the customer." Ferriola, [1999-2000 Transfer Binder] ¶28,172 at 50,154.

[84] The Commission found these handicaps to be notable in Johnson, [1990-1992 Transfer Binder] ¶24,986 at 37,624. The only reliable price data in the record is found in the account statements that Corbett introduced. However, (continued..)

account was churned from the point it was opened, a measure of commissions paid during Corbett's entire relationship with Worldwide sheds little light on what occurred from November 9th through December 8th. Be that as it may, we note that Corbett paid $26,927.01 in net commissions and fees to Worldwide and Universal in connection with the positions that he initiated during this period.[85] This amount equals 44 percent of the deposits that Corbett made from the time he opened his account until November 8, 2004 and 23 percent of the net deposits in the account up to December 8th.[86] The complainant did not establish that the respondents departed from an agreed-upon trading strategy.[87] In addition, there was only one in-and-out trade in

---

(..continued)

they shed insufficient light on prices that Gail and Friedman could have but did not recommend to Corbett.

[85] CX-9-41 - CX-9-75.

[86] CX-9-8, CX-9-12, CX-9-23, CX-9-26, CX-9-36, CX-9-43, CX-9-62.

[87] To find that there was a departure from an agreed-upon strategy, we must, of course, find there was an initial strategy and determine its nature. Evidence that a broker took an ad hoc approach to trading is insufficient. Ordinarily, when an introducing broker obtains control over a customer's trading, there will not be an explicit agreement over the strategy to be employed. Instead, we are more likely to find a tacit agreement in the form of a broker telling the customer how he intends to trade and the customer ceding control to the broker.

In this case, the only evidence that Gail or Friedman touted a particular strategy to Corbett was his testimony that "Marsha said, 'I'm a fundamentalist. All these people with their graphs and charts -- it's ridiculous, they get so caught up with them and can't see the cart before the horse.'" CX-8-9. Before the alleged churning began, Gail and Friedman had advised Corbett to open spread and simple long positions in options on bonds, heating oil, crude oil,

(continued..)

Corbett's account.[88] While Corbett made spread trades and, therefore, could have been under margined, there is no evidence that he ever traded while under margined. However, the respondents permitted him to make trades before they actually received the money necessary to fund the positions (although it appears that, before these trades occurred, Corbett promised to deposit the funds necessary to finance them).[89]

The presence of inculpatory factors lends support to the proposition that, if Friedman exercised control over Corbett's account, she excessively traded it. However, the degree of support is too low for us to find that Corbett met his burden of proof on the issue of excessive trading. Accordingly, he failed to establish that Friedman engaged in churning. Thus, Corbett's ability to establish that Friedman should be held liable boils down to whether he proved that she committed fraud in the solicitation of trades.

(..continued)

natural gas and gold futures. CX-9-8, CX-9-16, CX-9-18, CX-9-27, CX-9-34, CX-9-38.

[88] On November 17, 2004, Corbett liquidated a long position in February 2005 gold calls and, the next day, purchased April 2005 gold calls. CX-9-51, CX-9-53.

[89] For example, Corbett established a spread position on September 23, 2004 that resulted in a debit cash balance of $13,136.84. CX-9-10. The next day, Universal received his deposit of $13,147. CX-9-12.

Corbett Established That Friedman Committed Fraud

Corbett claims that Friedman and Gail defrauded him[90] by making misleading statements while soliciting trades and discussing his account activity.[91] Such misconduct, when it occurs in connection with trades such as Corbett's, violates Rule 33.10.[92] To establish that the regulation was violated through statements, a complainant must prove that a respondent: (1) made a representation of fact, (2) the representation was false or misleading, (3) the misrepresented fact was material, (4) the misrepresentation was made with scienter,[93] and (5) the fraud occurred in connection with a commodity option transaction.[94] Before we award damages, a complainant must also prove

---

[90] He also alleged that, December 6, 2004, Friedman liquidated a position without authorization and returned the proceeds to Corbett. Amended Complaint at 14 ("12/06/04: Marsha made a mistake and sold something she should not have and then sent me the money.") However, Corbett's monthly account statement for December of 2004 reports no trades from December 5th to December 7th. CX-9-75.

[91] Amended Prehearing Memorandum at 1.

[92] See supra text accompanying note 73.

[93] "[M]isleading statements are made with scienter when, at the time they are made, the 'speaker' knows them to be false or harbors a reckless disregard for their truth or falsity." First Fin., [2002-2003 Transfer Binder] ¶29,089 at 53,684. As discussed in First Financial, the Commission's take on what constitutes recklessness has been difficult to pin down. Id. at 53,684 n.66. However, we need not determine whether a complainant must establish recklessness that is a state of mind or merely a standard of conduct when a respondent is proven to have acted so culpably that we can find him to have acted with both types of scienter.

[94] In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,924-25 & n.67 (CFTC June 5, 1996), aff'd in relevant part [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 (CFTC Dec. 18,

(continued..)

actual and proximate causation, and the existence of a resulting, cognizable injury.[95] In this case, Corbett established that the individual respondents made a series of factual statements that may be fraudulent. However, other than his account records, he introduced very little reliable evidence that sheds light on falsity. Thus, with one immaterial exception,[96] we can only find this element proven with respect to representations that Corbett's trading results disprove or statements that are false in light of noticeable facts. However, turning first to the case against Friedman, this limitation does not preclude us from finding that she committed fraud.

To classify Friedman's solicitations, we must determine their content. For this task, "the touchstone is not so much the words of the solicitations, themselves, but the message that those words . . . convey" (i.e., how a reasonable recipient of the communication would have understood the

---

(..continued)

1997). "Statements made in solicitations to open commodity option accounts meet the in connection with requirement as do representations made in the solicitation of specific orders." In re Thomas, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,461 at 47,213 n.115 (CFTC Nov. 10, 1998)) (citations omitted). Moreover, any representation that is primarily intended to induce trading satisfies the "in connection with" requirement even if the statement is not made during the solicitation or execution of specific trades, or the solicitation of accounts. In re Global Telecom, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,143 at 57,567-68 (CFTC Oct. 4, 2005).

[95] Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,225 at 38,650 (CFTC Jan. 17, 1992).

[96] See infra note 104.

statement in light of its actual content and the surrounding circumstances).[97] When the alleged misleading statements went unrecorded, the complainant's description of them is, often, little more than a starting point from which we try to imagine the "objective" message conveyed.[98] However, when it is "sufficiently specific," testimony may be adequate to prove what was said even if it does not include verbatim accounts of the relevant conversations.[99]

Corbett testified to the following.[100] In connection with her solicitation of a spread trade in calls on oil futures that occurred on September 23, 2004, Friedman told Corbett that he could not lose on the trade and that she would

---

[97] First Fin., [2002-2003 Transfer Binder] ¶29,089 at 53,682 n.39.

[98] In the context of insider trading, Professor Kathleen Coles explained,

> The more remote a tippee is from the primary tipper and tippee, the more likely it becomes that the information received by the remote tippee is less specific and less accurate than the information that was originally possessed or conveyed by the primary tipper. This process has been anecdotally compared to the children's game of "telephone," but the attenuation in accuracy and specificity of information as it passes from one person to another has also been demonstrated in academic studies involving hearsay evidence and the psychology of rumors.

Kathleen Coles, "The Dilemma of the Remote Tippee," 41 Gonz. L. Rev. 181, 215-16 (2005) (footnotes omitted).

[99] Ferriola, [1999-2000 Transfer Binder] ¶28,172 at 50,153 n.18.

[100] Corbett's written, direct testimony incorporated the Amended Complaint by reference. CX-27-8. See CX-8-1.

double his money.[101] Later, when soliciting an October 7th trade to open a spread position, she told Corbett that the trade "will make you big money."[102] A few days later, Friedman touted a crude oil spread trade by telling him that it "will be a big winner."[103] Afterward, she continued to describe proposed trades as being virtually certain to generate large profits.[104]

We credit Corbett's testimony concerning Friedman's representations and, because the likelihood of profit and loss are important factual matters to

---

[101] "Marsha said 'The hurricanes are wiping out our supply. There is just not enough oil. You can't lose - I will double your money. Can you do 10?'" CX-8-8.

[102] CX-8-8.

[103] CX-8-9.

[104] CX-8-9 ("10/26/05: January Natural Gas 11 call spread - Marsha said, ' . . . I will double your money' . . . Common statements that Marsha's (sic) made often are: 'I will double your money' . . . ."); CX-8-10 ("11/3/04: January T-bonds 25 puts - . . . I will double your money . . . ."); CX-8-11 ("11/8/04: February gold 20 calls - '. . . you can't lose' . . . .").

He also testified that Friedman described herself as "financial major making six figures 3 times over." CX-8-2. Although there is no reliable evidence concerning Friedman's salary at the time in question, Corbett proved that Friedman was not a "financial major." Instead, the evidence shows that, on her National Futures Association Form 8-R, Friedman disclosed that she had attended college for two years, she had been a "Liberal Arts" major and she did not earn a degree. CX-32-7. However, Corbett did not establish that, under the proven circumstances, the subject in which Friedman majored was a fact that a reasonable trader would have consider to be important. Cf. Greenhouse v. MCG Capital Corp., 392 F.3d 650, 658 (4th Cir. 2004). Thus, he did not prove that the misrepresentation concerning her college studies was material. Sudol v. Shearson Loeb Rhoades, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,748 at 31,229 (CFTC Sept. 30, 1985).

speculators such as Corbett, these statements were material.[105] In addition, she made these representations in connection with exchange-traded options transactions.[106] Moreover, Corbett's trading results adequately falsify representations of virtually certain profit and no risk of loss.[107] Thus, if Friedman acted with scienter, she violated Rule 33.10.

Although Friedman did not testify, Corbett introduced an evidentiary admission indicating that she knew options trading carried substantial risks of loss.[108] Moreover, representations that options trades are certain to profit

---

[105] R & W Technical Servs. Ltd. v. CFTC, 205 F.3d 165, 170 (5th Cir. 2000); CFTC v. British Am. Commodity Options Corp., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,662 at 22,701 (S.D.N.Y. Aug. 31, 1978); Ferriola, [1999-2000 Transfer Binder] ¶28,172 at 50,153.

[106] See supra note 94.

[107] See supra text accompanying notes 9, 12.

[108] Corbett presented the transcript of a Division of Enforcement deposition in which she testified,

> . . . That these are very highly speculative investments. Extremely highly. You can -- this is in my head -- you can lose every dime and not one penny more if you feel and understand that.
>
> . . . .
>
> . . . it's just something you need to know when you take the Series 3. It's just in my case, while I never took the 3, with all my vast experience, the pros and cons and companies, that I know this.

CX-39-12. Later in the deposition, she stated, "For me to say you can't lose is a blatant lie." CX-39-19.

and/or will not result in losses are patently false.[109] Thus, it is exceptionally unlikely that experienced registrants would make such claims without scienter and, because Friedman has been a registered AP since 1983,[110] we can infer that she either knew that her misrepresentations about profit and loss potential were false or spoke with a conscious disregard for their potential falsity. Accordingly, we find that Friedman acted with scienter and violated Rule 33.10. Before considering causation and damages, we turn to Gail's culpability.

Corbett Established That Gail Committed Fraud

Corbett claims that Gail misled him by misrepresenting facts relating to Friedman (the falsity of which he did not prove)[111] and the likelihood that proposed trades and open positions would generate profits (the speciousness of which his trading record exposed).[112] In support of these allegations the complainant credibly testified that, when Gail solicited him to purchase crude oil calls on October 1, 2004, she stated that the trade "will make lots of

---

[109] The Commission considers the falsity of such claims to be indisputable. See Ferriola, [1999-2000 Transfer Binder] ¶28,172 at 50,153.

[110] CX-9-87 - CX-9-90.

[111] Corbett alleged that Gail touted Friedman's advice by describing her as "the one who made big money for clients" and who had been "doing this since 1979." Amended Complaint at 2. Corbett's failure to introduce evidence that we can credit concerning Friedman's track record is discussed above. In addition, for reasons also noted above, Friedman's out-of-court admissions cannot be considered as evidence (for the truth of the matters asserted therein) against Gail.

[112] See supra text accompanying notes 9, 12.

money."[113] However, as fraudulent as it may be, this representation proximately caused no injury.[114] Instead, the harmful misrepresentations that Corbett attributed to Gail occurred just over one month later and took the form of lulling.[115]

Corbett also testified to the following. On or about November 8, 2004, when he expressed concern with the losses that he was beginning to realize, Gail told him that his open positions had value and he "was going to make lots of money."[116] On November 15th, Corbett reiterated his concerns and Gail reiterated that he had "good trades that were going to make [him] money."[117] These representations were factual and, for reasons discussed above, Corbett proved that they were also false, material and satisfied the "in connection with" requirement. Moreover, while Gail did not have Friedman's experience, Corbett established that she had been a registered associated person of various firms

---

[113] CX-8-8.

[114] The fraudulently solicited trade resulted in a profit. CX-9-16, CX-9-22.

[115] Because Corbett did not try to prove that Gail fraudulently solicited his account and due to the passage of time between Gail's initial fraudulent statement and the effects to which the later misrepresentations contributed, a causal nexus is not self-evident. In addition, the record does not relate Gail's first proven misrepresentation to later trades or even a later deposit of funds. CX-9-33. In addition, Corbett failed to prove that what occurred later was, on October 1st, so foreseeable that we can find it to have been a proximate cause of later losses. Consequently, the October 1st trade will not be included in the damages calculations.

[116] CX-8-11.

[117] CX-8-12.

since 2001[118] and knew promises of certain profit and no loss were false.[119] Thus, the complainant established that Gail violated Rule 33.10.[120]

---

[118] CX-9-96; CX-43-3.

[119] Corbett introduced the transcript of a Division deposition in which Gail testified, "They have to always know that it's a risk, a risk investment. And that they can lose their investment." CX-43-16.

[120] Corbett also charged Gail with aiding and abetting Friedman. Amended Complaint at 1. The Act codified vicarious responsibility based on aiding and abetting in Section 13(a), 7 U.S.C. §13c(a). It states,

> Any person who commits, or who willfully aids, abets, counsels, commands, induces, or procures the commission of, a violation of any of the provisions of this Act, or any of the rules, regulations, or orders issued pursuant to this Act, or who acts in combination or concert with any other person in any such violation, or who willfully causes an act to be done or omitted which if directly performed or omitted by him or another would be a violation of the provisions of this Act or any of such rules, regulations, or orders may be held responsible for such violation as a principal.

7 U.S.C. § 13c(a). As explained more fully in In re Wright, in order to establish aiding and abetting liability, a complainant must prove that the respondent: (1) knowingly associated himself with an unlawful venture, (2) participated in it as something that he wishes to bring about and (3) sought by his actions to make it succeed. [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,412 at 54,765 (CFTC Feb. 25, 2003) (quoting In re Richardson Sec., Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,145 at 24,646 (CFTC Jan. 27, 1981)). We cannot find that a respondent engaged in knowing participation unless the evidence provides "a reliable basis for inferring that, more likely than not, the facilitating respondent knew of the wrongful nature of the" illegal acts "at the time of his participation." In re Bear Stearns & Co., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,994 at 37,665 (CFTC Jan. 25, 1991). In other words, the respondent must be proven to have known that the person he was aiding was engaging in activity that was illegal, injurious, heedless, unjust, reckless or unfair. Wright, [2003-2004 Transfer Binder] ¶29,412 at 54,766.

(continued..)

Corbett Established Causation

In fraud cases such as the one at hand, establishing causation usually means proving reliance, its existence, justifiability and duration.[121] To determine whether a complainant relied on misrepresentations, precedent requires us to consider: (1) the complainant's sophistication and expertise in matters of finance, and securities and commodity trading; (2) the existence and features of the business or personal relationships between the parties; (3) the complainant's access to relevant information; (4) the existence of a fiduciary relationship between the parties; (5) the respondents' concealment of the fraud; (6) the complainant's opportunities to detect the fraud; (7) the degree to which the complainant initiated or sought to expedite the transactions that may be

---

(..continued)

In this case, Corbett did not introduce direct evidence that Gail was aware of Friedman's misrepresentations. In addition, Corbett did not prove, by a preponderance of the evidence, that Gail knew anything about Freidman's handling of the account other than the trades that occurred and the account's status. Consequently, the record does not permit us to find that Gail possessed the knowledge and acted with the specific intent that aiding and abetting liability requires.

[121] Kaseff v. Americas Global Traders, Inc., [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,604 at 55,600 (CFTC Oct. 30, 2003); Wirth v. T & S Commodities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,271 at 38,876-77 (CFTC Apr. 6, 1992); Jakobsen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,812 at 31,392 (CFTC Nov. 21, 1985).

the result of the fraud(s); and (8) the generality or specificity of the misrepresentations to which the complainant was subjected.[122]

Corbett testified that he relied on the respondents' recommendations[123] and the coincidence of the respondents' proven trading recommendations with the complainant's trades supports that proposition.[124] In addition, he testified that he had been new to options trading,[125] Gail touted Friedman's track record[126] and Friedman tried to reduce Corbett's exercise of critical thought by using high-pressure sales tactics that made him feel rushed.[127] Moreover, Friedman often touted trades (during what will end up as the relevant period) by relating them to specific phenomena[128] and, thus, avoiding direct

---

[122] Schreider v. Rouse Woodstock, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,196 at 32,514 (CFTC July 31, 1986).

[123] CX-8-2, CX-8-7, CX-8-13; CX-27-2.

[124] Corbett seems to have followed all of Gail's and Friedman's advice until December 9, 2004. CX-8-14 - CX-8-15; CX-27-2. See supra note 71.

[125] CX-27-3.

[126] CX-8-7. While Corbett did not prove such representations to be false, they are relevant to reliance.

[127] CX-8-7 - CX-8-9.

[128] CX-8-8 ("Marsha said 'The hurricanes are wiping out our supply. . . The war in Iraq, the hurricanes, [C]hina's demand, Russian's Yukos, all were going to keep the price of oil high. . . .'"); CX-8-9 ("Marsha said, 'Oil was going to $60 . . . Some Texan Boone Pickens said it was going to this price. This will be a big winner. This guy had correctly predicted the price of oil in the past.'"); CX-8-10 ("' . . . Greenspan is going to raise the interest rates and the bonds have to come down . . .'"). The record does not adequately support findings that the representations concerning these events and conditions were false and made with scienter.

contradictions between her statements and written disclosures.[129] Thus, although there is no evidence that Corbett had a previous relationship with any Worldwide employee and he could have conducted some lay research to verify Friedman's claims, we find that he actually and justifiably relied upon Friedman's misrepresentations when he entered into his second trade and at least some of the subsequent trades. We also find that, through her fraudulent misrepresentations, Gail substantially contributed to Corbett's decision to continue following Friedman's advice[130] and that this reliance was, for a time, also justifiable. Thus, Corbett proved that Gail and Friedman actually and proximately caused at least some of his trading losses by committing fraud.

---

[129] Written disclosures might have precluded a finding of justifiable reliance because they contradicted some of the misrepresentations to which he had been exposed. Webster, [1998-1999 Transfer Binder] ¶27,578 at 47,714 n.463. However, a writing must flatly contradict the oral statement and not merely suggest falsity with equivocal words. Jakobsen, [1984-1986 Transfer Binder] ¶22,812 at 31,392-93. In addition, a broker can vitiate the effectiveness of written disclosures when it acts to minimize the likelihood that a customer would take the disclosures seriously. Reed v. Sage Group, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,943 at 34,299 (CFTC Oct. 14, 1987). Cf. Schreider, [1986-1987 Transfer Binder] ¶23,196 at 32,515. In this case, there is evidence that Worldwide customers received Commission-mandated disclosure documents. CX-25-53 - CX-25-55.

[130] Corbett proved that Gail's later misrepresentations were calculated to convince him to continue trading. CX-8-8, CX-8-11 - CX-8-12. In addition, the evidence tends to show that, through these misleading statements, she substantially influenced the complainant's decisions to continue following Friedman's advice. CX-8-11 - CX-8-12.

Corbett's Reliance Eventually Became Unjustifiable

The real world tends to eventually cut off justifiable reliance on fraudulent (and even lulling) representations.[131] This dose of reality often takes the form of reported trading results.[132] In this case, Corbett testified to the following. By late October or early November of 2004, "I was beginning to be very nervous about what was going on. Marsha was having me do so many trades. I began to wonder if Marsha seen (sic) me as an easy target for a continued commission stream."[133] On November 8th or 9th, he called Gail "to say, 'I was worried about how much I was losing.'"[134] On or about November 12, 2004, "I called to tell them to say I was really concerned especially with all the losses from the crude and heating oil."[135]. Moreover, by mid-November,

---

[131] See Modlin v. Cane, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,059 at 49,551-52 (CFTC Mar. 15, 2000); Wirth, [1990-1992 Transfer Binder] ¶25,271 at 38,876-77.

[132] See Modlin, [1999-2000 Transfer Binder] ¶28,059 at 49,551-52; Muniz, [1990-1992 Transfer Binder] ¶25,225 at 38,651.

[133] CX-8-10.

[134] CX-8-11. He described the effect of the early-November losses by stating,

> I am (sic) so worried and anxious everyday about what Marsha is doing with my account. . . .
>
> I was having trouble sleeping. I found myself worrying all the time. I found it hard to concentrate at work and was very moody to my co-workers as well as my family and friends.

CX-8-11.

[135] CX-8-12.

Corbett's decisions to continue trading resulted, in part at least, from the desire to recoup his losses.[136]

Given this testimony, it appears that, by the end of business on November 12, 2004, Corbett was aware that Friedman and Gail's promises concerning the risk of loss and the likelihood of profit inherent in the trades they recommended were false. Consequently, in the absence of effective lulling, their misrepresentations ceased causing proximate injury, even misrepresentations that postdated November 12th.

Although Corbett introduced evidence that Gail and Friedman tried to bolster his confidence in them,[137] reliance stemming from such efforts must

---

[136] He testified,

> . . . I was put in an environment where I had to let Marsha try to get my money back. I had no choice. . . . I was devastated by the losses and how out of control it all was. . . .
>
> . . . Marsha created this environment where she made all these promises of money and then I had to continue to trade in order to get my money back. . . .
>
> . . . .
>
> . . . I am so stressed out and I feel powerless. I am forced to continue. I am so angry.
>
> . . . .
>
> In hopes of getting my money back, I am forced to do what she says.

CX-8-12.

[137] Corbett testified that, on or about November 8th (the day he first realized significant losses),

(continued..)

also be justifiable to extend the causal chain. To do this, lulling representations must somehow address or obscure the falsifying information.[138] In this case, the lulling that Corbett attributes to them takes

---

(..continued)

> I called to say, "I was worried about how much I was losing[.]" . . . Debbie said, "Don't worry, let us worry[.]". . . Debbie would calm me down and tell me how valuable my other contracts were and how I was going to make lots of money. Debbie said, "Don't worry, Marsha is watching things all the time. She's good. She's been doing this a long time."

CX-8-11. In describing activity that occurred on November 15, 2004, Corbett testified,

> Around this time (I think), I was down about $50,000.00, I told Debbie, "I need an exit strategy to save what I have left[.]" . . . Debbie was upset to hear me say this. Then I was given another pep talk and [she] just told me that I had good trades that were going to make me money.
>
> I want this to stop but Marsha keeps telling me to stick with her because she has to get my money back. I WANT ALL MY MONEY BACK - WHAT HAS SHE DONE!! I am so stressed out and I feel powerless. I am forced to continue.

CX-8-12 (emphasis in original).

[138] Justifiably effective lulling would seem to take two general forms. First, such lulling may occur through representations that are sufficient to convince a victim that no fraud has been committed (or someone else committed it). See Republic of Columbia v. Diageo North America Inc., 04-CV-4372 (NGG), 2007 U.S. Dist. LEXIS 44366, at *213-15 (E.D.N.Y. June 19, 2007); Errion v. Connell, 236 F.2d 447, 455-56 (9th Cir. 1956). In addition, reliance may be extended by joining the old chain to one that is new, for example, by making "fresh" representations that justifiably indicate that a tortfeasor will behave differently (for example, by communicating the assignment of new personnel to the victim's business or the intent to follow a new, seemingly credible methodology).

three forms: (1) representations that his still open positions had value, (2) claims that Friedman was good at her job and motivated to help Corbett recoup his losses, and (3) recommendations for new trades that sounded much like recommendations for trades that had resulted in realized losses.[139] In other words, they said nothing to refute the proposition that, when Friedman and Gail represented that the trades they proposed were sure to generate profits and unlikely to result in losses, they misrepresented the truth. In addition, trades that are motivated by a desire to make up for past losses (or what the Commission in Wirth described as a "salvage effort")[140] that resulted from earlier fraud that has become known to the customer are not the proximate result of that fraud.[141] For these reasons, continued reliance on Gail and Friedman's fraudulent misrepresentations became unjustifiable on November 12th even though the two continued to commit fraud.

---

[139] CX-8-10 - CX-8-14.

[140] [1990-1992 Transfer Binder] ¶25,271 at 38,877.

[141] Rizka v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. M-80-1418, 1981 U.S. Dist. LEXIS 11774, at *12-14 (D. Md. Jan. 28, 1981) (holding that a plaintiff could not recover for losses that resulted from holding onto bonds, after learning of the alleged fraud, in an attempt to recoup losses). Ruling otherwise would effectively mean that defrauded customers who discovered that they have been cheated could continue running up losses in hopes of hitting the jackpot. Commission precedent denies customers such license. See Sansom Refining Co. v. Drexel Burnham Lambert, Inc., [1987-1990 Transfer Binder] Comm. Fut. Comm. Fut. L. Rep. (CCH) ¶24,596 at 36,562 (CFTC Feb. 16, 1990).

Gail is Jointly and Severally Liable For Some of the Damages That Friedman Caused

As found above, Gail's fraudulent misstatements substantially contributed to Corbett's decision to continue following Friedman's advice. Thus, Freidman's presence as an intervening actor does not necessarily sever the chain of actual causation and, provided the intervening acts were reasonably foreseeable, proximate causation may not be cut off either.[142] In addition, if Friedman and Gail's wrongs merged in such a manner as to create a single, indivisible harm, they will share joint and several liability.[143] In this case, the possibility that Corbett would continue to lose money by following Friedman's advice was reasonably foreseeable to a person in Gail's position. Thus, Friedman's success in convincing Corbett to continue trading did not sever the causal chain stemming from Gail's fraud. Moreover, by wrongfully playing a substantial role in extending Corbett's relationship with her co-worker, the injury Gail caused merged with that attributed to Friedman so as to create a single indivisible harm from November 8, 2004 until reliance on the two became unjustifiable (November 12th). Consequently, the two APs will share joint and severally liability for losses incurred during that period.

---

[142] See Sementilli v. Trinidad Corp., 155 F.3d 1130, 1139-40 (9th Cir. 1998).

[143] Restatement (Second) of Torts §875 (1979) ("Each of two or more persons whose tortious conduct is a legal cause of a single and indivisible harm to the injured party is subject to liability to the injured party for the entire harm.").

Damages

In his complaint, Corbett request $114,347.35 in compensatory damages.[144] Because he did not prove that Gail and Friedman proximately caused all of his trading losses, we will award a lesser amount. The fact that proximate causation ended in mid-stream can complicate matters. However, in the case, Corbett's evidence allows us to "capture" the injury for which Gail and Friedman are responsible.

In Stoller v. Siegel Trading Co., Inc., the Commission explained the degree of certainty that evidence must provide for us to quantify damages by stating,

> It is beyond challenge that the fact of damages, as distinguished from the amount, must be proved. When the record demonstrates a causal link between respondent's violation and a loss for complainant, the amount of the loss need not be proved with mathematical precision, rather proof to a reasonable certainty is sufficient. Uncertainty as to the precise amount of damages should be resolved against the wrongdoer.[145]

---

[144] Amended Complaint at 1. In the posthearing memorandum, Corbett asked for punitive damages. Posthearing Memorandum at 5. Issues of fair notice aside, the plea fails as a matter of law. Section 14(a)(1)(B) limits this type of relief to actions "arising from a willful and intentional violation in the execution of an order on the floor of a registered entity." 7 U.S.C. §18(a)(1)(B). Congress defined "registered entity" to mean either a board of trade that the Commission has designated as a contract market, a registered derivatives transaction execution facility or a registered derivatives clearing organization. 7 U.S.C. §1a(29). Corbett did not allege nor did he prove that any wrongdoing occurred on the floor of any such entity. Consequently, the complainant did not meet his burden of proof on the issue of exemplary damages.

[145] [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,224 at 29,210 (CFTC June 6, 1984) (citations and quotations marks omitted).

The calculation of damages that Friedman caused includes one relatively certain portion, the net losses that Corbett realized, on or prior to November 12th, in connection with the trades that Friedman recommended, $39,943.60.[146] In addition, at the time that Corbett's justifiable reliance on his brokers' misrepresentations ended, he had a number of open positions that Friedman had fraudulently touted and that were generating losses that had yet to be realized.[147] His account statements provide adequate value information concerning these positions on November 12th and, as a result, we can include net unrealized losses as of that day, $12,431.35,[148] in the damages calculation. The account statements also provide a reliable basis for calculating the extent of Gail's (joint and several) liability. Gail is jointly liable for $15,372.20, a sum comprised of: (1) the increase in net unrealized losses from November 8th to November 12th for positions that were established prior to the former date and

---

[146] CX-8-5; CX-9-10, CX-9-20, CX-9-22, CX-9-24, CX-9-27, CX-9-30, CX-9-34, CX-9-38, CX-9-39, CX-9-41, CX-9-43, CX-9-45, CX-9-47, CX-9-49, CX-9-51, CX-9-55, CX-9-59, CX-9-61, CX-9-71.

[147] CX-9-34, CX-9-38, CX-9-45.

[148] The net unrealized losses are calculated by comparing the value of open positions at the close of November 12, 2004 to the prices that Corbett paid to initiate those positions and subtracting, from the difference, the net transaction costs necessary to initiate and close those positions. CX-9-34, CX-9-38, CX-9-45, CX-9-47, CX-9-49, CX-9-51, CX-9-53, CX-9-55, CX-9-59, CX-9-61, CX-9-71, CX-9-73. Cf. Gilbert v. EMG Advisors, Inc., No. 97-17256, 1999 U.S. App. LEXIS 4719, at *10-11 (9th Cir. Mar. 17, 1999) (affirming an award for unrealized losses based on fiduciary duty violations when the defendant investment advisor was fired before the plaintiffs liquidated the securities positions at issue); Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 651 F.2d 615, 620-21 (9th Cir. 1981).

liquidated after latter date ($4,375.15),[149] (2) the net unrealized losses for positions that Corbett established on or after November 8th but did not liquidate until after the 12th ($2,651.80),[150] and (3) the net loss for the one position that was liquidated on November 12th and established after November 8th ($8,345.25).[151]

Conclusion

For the reasons set forth above, we **ORDER** the following: (1) the complaint is **DISMISSED** with respect to the charges against respondents Universal and Worldwide, (2) respondents Gail and Friedman shall pay Corbett (a) $15,372.20 plus interest accruing from November 5, 2004[152] at an annual

---

[149] CX-9-39 - CX-9-40, CX-9-45, CX-9-46. Because Corbett did not prove that Gail substantially contributed to the decision to establish these positions, she is not jointly and severally liable for the commissions and other fees that were paid to establish and liquidate these positions. Corbett did not liquidate, on or prior to November 12th, any of the positions that he established prior to November 8th and carried through the 8th.

[150] CX-9-38, CX-9-45, CX-9-51, CX-9-55, CX-9-71, CX-9-77. Because Corbett proved that Gail substantially contributed to the decision to initiate these trades, she is jointly and severally liable for the net commissions and fees that were paid to establish and liquidate these positions.

[151] CX-9-41, CX-9-45, CX-9-47.

[152] Rule 12.314(c) permits us to award prejudgment interest. 17 C.F.R. §12.314(c). The Commission has instructed that, once a complainant has proven that he is entitled to compensation in reparations, a grant of prejudgment interest "is the rule rather than the exception." Modlin, [1999-2000 Transfer Binder] ¶28,059 at 49,553. When a complainant was wrongfully induced to make multiple deposits into his account over the relevant period of time, calculating prejudgment interest could become too complex. Fortunately, the Commission requires only a fair method of compensating a complainant for the lost time value of his funds rather than a high degree of precision. Id. For example, in Modlin, the complainant made seven deposits into his account over

(continued..)

rate of 2.04 percent[153] and (b) $250 (an amount equal to the filing fee that Corbett paid to initiate this proceeding),[154] and (3) Friedman shall pay the complainant an additional $37,002.75 plus interest accruing from November 5,

---

(..continued)

a seven month period. Id. at 49,553 n.24. The Commission used the "date upon which [the complainant] had deposited exactly half of [the awarded damages]" as the starting point for prejudgment interest accrual. Id. at 49,553

In this case, a Modlin-like approach is workable and does not seem to be inferior to any other method that we could apply to the record. From September 23, 2004 (the date of Friedman's first proven misleading solicitation) until November 12th, Corbett deposited $96,541 in six installments. CX-9-12, CX-9-23, CX-9-26, CX-9-36, CX-9-43. The fourth transfer during this time, a deposit of $25,206, occurred on November 5th. CX-9-36. It and the previous three deposits totaled $55,781, roughly 58 percent of the relevant transfers. CX-9-12, CX-9-23, CX-9-26, CX-9-36. Accordingly, we choose November 5, 2004 as the date upon which prejudgment interest begins to accrue.

[153] The rate of interest is determined by referring to the most recently reported "weekly average 1-year constant maturity Treasury yield." 28 U.S.C. §1961(a); Newman v. Bache Halsey Stuart Shields, Inc., [1984-1986 Transfer Binder] ¶22,432 at 29,919 (CFTC Nov. 19, 1984) ("The relevant date for ascertaining the rate for all postjudgment interest, and for those cases where, as here, the presiding officer decides to award prejudgment interest, shall be the date of the initial decision.").

[154] 17 C.F.R. §12.314(c).

2004 at an annual rate of 2.04 percent.[155]

IT IS SO ORDERED.

On this 25th day of February, 2008

Bruce C. Levine
Administrative Law Judge

[155] Any party may appeal this initial decision to the Commission by filing a notice of appeal with the Proceedings Clerk no more than 20 days after the initial decision is served. 17 C.F.R. §§12.10(b), 12.401(a). If no party perfects an appeal and the Commission does not place the case on its docket for review, the initial decision shall automatically become the final decision of the Commission 30 days after it is served. 17 C.F.R. §12.314(d).