UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

ISAAC BARROCAS, Complainant, v. ROSENTHAL COLLINS GROUP, LLC., MICHAEL ERIC HERMANSON, MICHAEL JAMES KUTA, Respondents.	CFTC Docket No. 05-R062

INITIAL DECISION

Introduction

Isaac Barrocas, who had been trading e-mini S&P index futures for three years, opened a non-discretionary, discount account with respondents in March 2005, and began actively day trading futures via an electronic trading platform. After eleven weeks, Barrocas lost almost all of his investment. In selecting his trades, Barrocas primarily relied on his instincts, and on an audio and text-message chat room chaired by Michael Kuta and a newsletter distributed by Kuta twice a day via e-mail. Barrocas' principal claim is that Kuta exaggerated his expertise and distorted the relative risks and rewards of his trading strategy. Barrocas claims that he detrimentally relied on Kuta's alleged misrepresentations and seeks to recover the losses from all of his trades.

In reply, respondents deny that Kuta made any false, deceptive or misleading representations. Respondents assert that Barrocas only partially relied on Kuta's advice, because Barrocas routinely made trades without consulting Kuta and routinely deviated from Kuta's trade recommendations. As discussed below, after carefully evaluating the parties' documentary evidence and oral testimony, I have concluded that Barrocas has failed to show sufficient causal connection between Kuta's advice and Barrocas' trading losses to support a finding of a violation by respondents.

Factual Findings and Conclusions

The parties

Isaac Barrocas, a sixty-four-year-old resident of Philadelphia, Pennsylvania, is an experienced manufacturer's representative in the apparel industry. On his account application, Barrocas indicated that his annual income was between two hundred fifty thousand and five hundred thousand dollars, and that his net worth was between one and five million dollars. Barrocas had worked as a stock broker in his younger days, had invested in stocks and bonds over thirty years, and had been unsuccessfully trading e-mini S&P futures for about three years, before opening his account with Rosenthal Collins Group on March 16, 2005. [*See* pages 7-11, and 53, of hearing transcript.]

Rosenthal Collins Group, LLC ("RCG") is a futures commission merchant with its principal place of business in Chicago, Illlinois. Michael Hermanson is the branch manager of the Professional Services Division ("PSD") of RCG. Hermanson directly supervised Michael Kuta, monitored Kuta's chat room, and reviewed Kuta's newsletters. Hermanson sometimes participated in the chat room, but never spoke to Barrocas. [*See* pages 88-94 of hearing transcript; and ¶ 2 of respondents' joint reply to Barrocas' discovery requests.]

Michael Kuta, an employee of PSD, solicited Barrocas' account, acted as Barrocas' account executive, chaired the PSD "Hotcomm" chat room, and distributed the PSD twice-daily newsletter. Kuta was Barrocas' primary contact at Rosenthal Collins, but spoke with Barrocas only about three times. Kuta has worked on or near the exchange floor for about twenty years, starting as a floor clerk and working up through a variety of floor trading, back office clearing, and operational jobs. As a result, Kuta has developed working relationships with several floor traders and brokers. [*See* pages 62-68 and 92-94 of hearing transcript.]

The chat room and newsletter

Kuta e-mailed to clients a morning newsletter that recommended day trades and an afternoon newsletter that discussed the outcome of the trades. Kuta also chaired a free on-line chat room – "Market Mentors Hotcomm Room" – through which he discussed his recommendations and reported, by voice and by text message, developments in the pit. For the chat-room and the newsletter, Kuta consulted a variety of sources, including charts, industry news, floor traders and brokers.[1] [*See* pages 53-54, and 57 of hearing transcript.]

The morning newsletter summarized market, financial, business and political news, and recommended trades for the Treasury Bond, NASDAQ, large S&P index, and e-mini S&P index futures contracts. The recommendations typically set out a combination of exit and entry points, support and resistance levels, buy-stop and sell-stop areas, and profit and loss targets. For example, March 29th newsletter included the following June e-mini S&P day-trade recommendation:

Support and Resistance -- S&P's: Day-Trade (June):

- Support starts out at 1172.10, 1169 with major at 1161.30
- Resistance comes in at 1181.50, 1186.70 with major at 1192.00

[1] RSG produced copies of the text transcripts from the chat-room, from March 18, to May 26, 2005. RSG did not record the audio transmissions in the chat room.

- (E-mini S&P's) The floor is short a day trade position from 1178.25, risking a breakthrough of 1183.50. Profit target is 1170.00 or MOC.

Consistent with this example, Kuta almost always recommended a single day trade, and never advised frequent in-and-out trading in the e-mini S&P future.

The afternoon newsletter typically reported trading results. For example the March 29th afternoon newsletter reported that for the June e-mini S&P:

> The floor was short a day position at 1178.25 and 1177.25 covered at 1171.50 for a profit of +39 handles or +$650.

The afternoon newsletter also reported the cumulative results for the recommended e-mini S&P trades. For example: the March 29th afternoon newsletter reported:

> March Totals: +79.00 handles or +$3,950.00 (80% Win/Loss Ratio)
> Year to Date: +122.25 handles or +$6,112.50 (71% Win/Loss Ratio).

Similarly, the April 29th afternoon newsletter reported:

> April Totals: -4.50 handles or -$225.00 (0% Win/Loss Ratio)
> Year to Date: +118.50 handles or +$5,925.00 (70% Win/Loss Ratio);

and the May 24th afternoon newsletter reported:

> May Totals: -26.50 handles or -$1,325.00 (0% Win/Loss Ratio)
> Year to Date: +90.00 handles or +$4,500.00 (60% Win/Loss Ratio).

Nothing in the record suggests that the reports of trading success in March and trading setbacks in April and May were inaccurate. The chat-room participants never questioned the accuracy of these numbers, and their text messages tended to confirm the daily reports of winning and losing trades. For example, after winning trades, the customers, but not Kuta, would often generate celebratory text messages [*See* ¶¶ 1-6 of Kuta's reply to Barrocas' discovery requests; PSD newsletters, and chat-room text transcripts, dated March 14, to May 26, 2005; and pages 21-24, 66-67, 75-80 of hearing transcript.] [2]

Finally, the morning and the afternoon newsletter featured a clearly displayed warning that "The risk of loss in trading futures and options can be substantial . . . ."

Account opening

In early 2005, Barrocas had been trading e-mini S&P futures on his own with disappointing results. In hopes of improving his performance, he sought better real-time information and entered a trial subscription to the "Squawk-Box" voice call service from the S&P pit, which provided live reports of who was selling and who was buying. Unfortunately, access to the live reports did not translate into profits for Barrocas.

Meanwhile, as part of the trial subscription package, Barrocas had been receiving Kuta's newsletter via e-mail. Barrocas noticed that Kuta had been on a winning streak during the first quarter of the year, and surmised that Kuta "could lead me in the right direction." [Page 53 of hearing transcript.] Thus, sometime in mid March, Barrocas called Kuta. Barrocas briefly described his professional and financial status and investment experience, and made it clear to Kuta that he was interested in paying discounted commissions and wanted to continue making his own trades. Barrocas but did not discuss in great detail his specific trading objectives, his risk tolerance, the information he would be using to make trading decisions, the frequency of trades, or the amount available risk capital. Kuta told Barrocas that he had been working in or near the pits twenty years as a clerk, runner, back office worker and trader, and explained how he gathered information for the newsletter and chat room. Kuta explained that in the chat

[2] RSG produced copies of the newsletters from March 14, to May 26, 2005.

room, as he had been doing in the newsletter, he would report the support and resistance levels, and that Barrocas could use that information to select trades.

Kuta acknowledged that he had been on a winning streak, but reminded Barrocas that trading the e-mini S&P index future was highly risky, and otherwise did not promise, or strongly imply, that Kuta was certain to continue picking consistently profitable trades. At the conclusion of this initial conversation, Barrocas decided to open a discount non-discretionary account with the minimal deposit of $5,000. [*See* pages 11-17, 53-56, and 62-69 of hearing transcript; Kuta's statement in reply to Barrocas' discovery requests (produced October 26, 2005); PSD newsletters dated March 15, to May 26, 2005 (produced October 26, 2005).]

On March 16, 2005, Barrocas signed the account-opening documents, which included the RCG futures customer agreement, the RCG electronic trading agreement and risk disclosure statement, and the RCG futures and options risk disclosure statement. On March 21, 2005, Barrocas wired his $5,000 deposit.

Trading the account

From March 29, to June 9, 2005, Barrocas exclusively day-traded the June e-mini S&P futures contract. During this time, Barrocas regularly read Kuta's newsletter and monitored Kuta's audio and text message reports in the chat room. However, as described below, Barrocas only partially followed Kuta's trade recommendations in the chat room and newsletter: That is, Barrocas routinely would pick the short or long entry point designated by Kuta, but then would sharply deviate by frequently trading in and out on significantly narrower price ranges.

Barrocas was in total charge of his trading. Barrocas placed all of his orders through an electronic trading platform. Barrocas never personally consulted with Kuta before placing a trade, and never asked Kuta to evaluate Barrocas' high-frequency improvisations on Kuta's recommended strategies. It made no difference to Barrocas when Kuta went on vacation, and did not generate trade recommendations, for an entire week. Barrocas traded each day of that week and realized $387 in total losses. [*See* pages 17-37,and 45-46 of hearing transcript.]

Barrocas followed Kuta's newsletter recommendations on just nine out of the thirty-eight days that he traded: April 1, 6, 13, 14 and 26; and May 12, 16, 18 and 25. Trading on these dates realized a total net profit of $411. [*See* spread-sheet trading summary, Exhibit 3 of respondents' joint discovery reply; and page 34 of hearing transcript.] Barrocas realized his greatest profits on days that he did not follow Kuta's advice: March 29 ($138 profit), April 14 ($138), April 26 ($150), and April 28 ($375). Barrocas also realized his greatest losses on days when he did not follow Kuta's advice: April 7 ($1,163 loss), April 21 ($300), May 3 ($300), May 4 ($300), May 9 ($650), and June 1 ($1,350).

Kuta almost always recommended a single e-mini S&P day trade. On most days, Barrocas deviated from Kuta's single day-trade recommendation, by frequently trading in and out on narrow price changes. For example, on the first day of trading, March 29, Kuta had recommended a single June e-mini S&P day trade, shorting at 1178.25, and exiting at or near 1170.00 or MOC. However, Barrocas deviated by trading in and out seven times, at prices between 1172.00 and 1182.50. This series of trades generated $57 in commissions and fees, and realized a gross profit of $138, for a net profit of $79.

On several days, Barrocas traded in and out more than ten times. For example, on May 5th he traded in and out eighteen times, buying and selling a total of 38 contracts, and in the process generated $192 in commissions and fees, and realized a gross profit of $375, for a net profit of $183. Not surprisingly, Barrocas' frequent in-and-out trading strategy accumulated commission charges that steadily diminished his working equity. By the end of April, Barrocas had realized an aggregate net loss of $848; by the end of May, Barrocas had realized an aggregate net loss of $3,254; and by June 9th, when he closed out the last trade, his losses had mounted to $4,660. In the end, Barracas' active trading generated approximately $2,500 in commissions, which consumed half of his investment and constituted over half of his net losses. Barrocas acknowledged that he had routinely deviated from Kuta's recommended strategy, and explained that his trading decisions had been the product of a mixture of confusion, impatience, and a firm belief that the spread between Kuta's entry and exit points was too wide. [*See* pages 28, 32, 37-38, 49-50, 53-54, 60-61, and 68-77 of hearing transcript.]

Discussion and Conclusions

To prevail on his claim, Barrocas must prove, by a preponderance of the evidence: that Kuta intentionally exaggerated his expertise and distorted the relative risks and rewards of his e-mini S&P trading strategy; that Barrocas reasonably relied on such misrepresentations; and that such misrepresentations proximately caused Barrocas' financial damages. Here, Barrocas has failed to establish that Kuta's message about his expertise or trading strategy was unbalanced, deceptive or false. Kuta may have been in the midst of a winning streak when first contacted by Barrocas. However, Kuta did not assert or imply that the winning streak was long-lived, durable or immutable. Kuta otherwise did not portray his trading approach as low-risk or portray his information sources as infallible. Furthermore, Kuta was under no obligation to disabuse Barrocas of any unreasonable expectations, because Barrocas -- a mature and assertive individual, and an experienced and relatively sophisticated speculator -- had not informed Kuta that he assumed that profits would be assured if he monitored Kuta's advice.[3]

More significantly, Barrocas has failed to show the intertwined elements of reasonable reliance and proximate causation. In order to show proximate causation, Barrocas must show that Kuta's conduct was a "substantial factor" in bringing about Barrocas' losses, and that Barrocas' losses were a "reasonably probable consequence" of Kuta's conduct. *Steen v. Monex Int'l. Ltd.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,245, at 38,723 (CFTC 1992). Here, by the time that he began receiving Kuta's newsletter, Barrocas had already been unprofitably trading e-mini S&P futures. Barrocas, hoping to improve his performance by trying a new trading approach and using a new source of information, thus chose Kuta to give him "some direction." However, Barrocas remained in command of his trading, and from the first trade on, showed only partial reliance on Kuta's advice. Barrocas never personally consulted with Kuta before placing a trade, and never asked Kuta to evaluate Barrocas' high-frequency improvisations on Kuta's recommended strategies. Barrocas continued trading for a week without any input from Kuta while he was on vacation.

[3] Similarly, Kuta was under no obligation, as Barrocas suggested at the hearing, to advise Barrocas to stop trading or to stop improvising, because Kuta never promised to provide that type of advice, and because Barrocas: had confirmed that he would be controlling the trading; had never informed Kuta about his specific trading objectives; had never consulted with Kuta about his trades; and had never made it known that he intended to rely on Kuta to provide such special service. *See Avis v. Shearson, Hayden Stone, Inc.*, [1988-82 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,379, at 25,831 n.8 (CFTC 1982) (Notification from customer that he intends to rely on the broker for a specified service may create a special fiduciary duty.)

Barrocas' reliance on Kuta's advice in the newsletter and chat room was restricted by Barrocas' opinion that Kuta's entry and exit points were too wide. As a result, Barrocas accepted Kuta's entry points, but routinely rejected the balance of Kuta's advice by engaging in frequent in and out trading. In these circumstances, the connection between Kuta's advice and Barrocas' trades is too weak to support a finding of reliance or proximate causation. This conclusion is underscored by the fact that Barrocas realized overall profits for the trades on the few days that he actually closely followed Kuta's advice.

Finally, Barrocas has produced no evidence that Kuta's judgment, analysis and market predictions lacked a reasonable basis. The mere fact that Kuta hit a losing streak at the same time that Barrocas began trading, or that Barrocas became disenchanted with Kuta's advice, does not create an inference of a violation. Barrocas otherwise has not produced sufficient evidence to shift the burden to respondents to further articulate and justify the basis for Kuta's advice. *See Syndicate System v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1986-1987 Transfer Binder] Com. Fut. L. Rep. (CCH) ¶ 23,289 (CFTC 1986). Put differently, it should come as no great surprise to an experienced speculator that the markets can be unpredictable and that brokers can be wrong.

ORDER

Isaac Barrocas has failed to establish any violations by respondents. Accordingly, the complaint in this matter is dismissed.

Dated August 3, 2006,

Philip V. McGuire

Philip V. McGuire,
Judgment Officer