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11 **UNITED STATES DISTRICT COURT**
12 **SOUTHERN DISTRICT OF CALIFORNIA**

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14 SECURITIES AND EXCHANGE
COMMISSION,

15 Plaintiff,

16 vs.

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18 TUCO TRADING, LLC and
DOUGLAS G. FREDERICK,

19 Defendants.
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Case No.:

**COMPLAINT FOR VIOLATIONS OF THE
FEDERAL SECURITIES LAWS**

1 Plaintiff Securities and Exchange Commission (“Commission”) alleges as follows:

2 **SUMMARY**

3 1. This case involves ongoing violations of the antifraud and broker-dealer
4 registration provisions of the federal securities laws by Tuco Trading, LLC (“Tuco”), an
5 unregistered Southern California securities day-trading firm, and its controlling principal,
6 Douglas G. Frederick (“Frederick” and collectively “Defendants”).

7 2. Tuco and Frederick provide day-trading capability to over 250 day-traders. A
8 day-trader actively purchases and sells securities, often on the same day, and hopes to make at
9 least a small profit on a large number of buy-and-sell transactions. Tuco and Frederick allow
10 Tuco’s members to day-trade through Tuco’s own brokerage accounts (“master accounts”), by
11 creating “sub-accounts” for each trader. Tuco and Frederick then track the activity in each
12 trader’s sub-account, including trades, balances, commissions, fees, deposits and withdrawals,
13 which Tuco reports to the trader on a daily basis. Tuco, however, is not registered as a broker or
14 dealer with the Commission, in violation of Section 15(a) of the Exchange Act, 15 U.S.C.
15 §78o(a)(1).

16 3. Tuco and Frederick entice traders with services unavailable to day-traders at any
17 registered broker-dealer. First, the Defendants allow a trader to day-trade even if his or her sub-
18 account has less than \$25,000 equity, which, under applicable National Association of Securities
19 Dealers (“NASD”) regulations, is the minimum equity requirement to day-trade. Second, traders
20 at Tuco can use up to \$20 of Tuco’s equity to purchase securities for each \$1 in the trader’s sub-
21 account (*i.e.*, 20:1 buying power). Applicable NASD and New York Stock Exchange (“NYSE”)
22 rules, however, only allow a day-trader to have 4:1 buying power.

23 4. Tuco and Frederick are also violating the antifraud provisions of Section 10(b) of
24 the Exchange Act and Rule 10b-5 thereunder, 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5. On
25 a daily basis, Tuco and Frederick report to the traders their purported equity balances in their
26 sub-accounts. As of December 31, 2007, however, Tuco and Frederick have used approximately
27 \$3.62 million of the traders’ approximate \$10.2 million total equity to pay Tuco’s expenses and
28 to cover trader losses. In reporting the traders’ equity balances, however, Tuco and Frederick

1 have failed to disclose to Tuco's traders that their equity balances are overstated and that Tuco
2 and Frederick have misused approximately 35% of the traders' equity to pay Tuco's expenses
3 and to cover other traders' losses. Defendants' misuse of the traders' equity is continuous and
4 ongoing. As of January 31, 2008, Tuco and Frederick used approximately \$1.35 million of the
5 traders' approximate \$11.4 million total equity to pay Tuco's expenses and to cover trader losses.

6 5. The Defendants' conduct violates the antifraud and broker-dealer registration
7 provisions of the federal securities laws. By this action, the Commission seeks a temporary
8 restraining order, preliminary and permanent injunctive relief, an asset freeze, an accounting, an
9 order preventing the destruction of documents, the appointment of a receiver over Tuco,
10 disgorgement with prejudgment interest of the defendants' ill-gotten gains, and civil penalties.

11 **THE DEFENDANTS**

12 6. Tuco Trading, LLC, is a Nevada limited liability company formed in August 2006
13 and based in La Jolla, California. Tuco is a self-described "trading firm" that creates sub-
14 accounts for members to day-trade securities through Tuco's master brokerage accounts. Tuco is
15 not registered with the Commission as a broker or dealer.

16 7. Douglas G. Frederick, age 38, resides in San Diego, California. Frederick formed
17 Tuco in August 2006 and is its sole managing member. He has held various securities licenses,
18 including Series 6 and 7 since 1993 and Series 55 and 63 since 2002. Frederick has been
19 associated as a registered representative with thirteen broker-dealers since 1993, including GLB
20 Trading, Inc. since April 2006. Frederick is not registered with the Commission in any capacity.

21 **RELATED NON-PARTY**

22 8. GLB Trading, Inc. ("GLB Trading") has been registered with the Commission
23 since 2003 as a broker-dealer. It is an introducing broker-dealer based in Irvine, California, and
24 clears through Penson Financial Services, Inc. Tuco maintains its principal master accounts at
25 GLB Trading.

26 **JURISDICTION AND VENUE**

27 9. This Court has jurisdiction over this action pursuant to Sections 21(d)(1),
28 21(d)(1)(3)(A), 21(e) and 27 of the Securities Exchange Act of 1934 ("Exchange Act"), 15

1 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e) & 78aa. Defendants have, directly or indirectly, made
2 use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a
3 national securities exchange, in connection with the transactions, acts, practices, and courses of
4 conduct alleged in this Complaint.

5 10. Venue is proper in this district pursuant to Section 27 of the Exchange Act, 15
6 U.S.C. § 78aa, because the defendants reside and transact business in this district and certain of
7 the transactions, acts, practices, and courses of conduct constituting violations of the federal
8 securities laws alleged in this Complaint occurred within this district.

9 **GENERAL ALLEGATIONS**

10 **Tuco's Operations**

11 11. Tuco describes itself on its website as a “private equity firm” that provides
12 “trading solutions for the active trader.” Frederick is Tuco’s only Class A “owner member” and,
13 as such, has exclusive managerial authority over Tuco and is vested with the sole and exclusive
14 power to transact business on Tuco’s behalf. Frederick also actively participates in Tuco’s day-
15 to-day activities, controls all of Tuco’s trading and bank accounts, and is the only person
16 authorized to withdraw funds from Tuco’s accounts. Frederick also controls and monitors the
17 daily trading activity of Tuco’s traders and determines each trader’s maximum buying power.

18 12. To trade through Tuco, customers contribute funds to Tuco and sign Tuco’s
19 Operating Agreement as a “Class B” member, and sign Trader Agreements and Confidentiality
20 Agreements with Tuco. There is no minimum initial capital contribution amount required by
21 Tuco or Frederick for a customer to open an account. New traders come from referrals by
22 Tuco’s existing traders or vendors, or through Tuco’s website, which Tuco uses to advertise its
23 day-trading brokerage services.

24 13. As of December 31, 2007, Tuco had 274 traders, with 330 sub-accounts. Of
25 those, 186 traders had 229 sub-accounts with positive equity balances totaling approximately
26 \$10.2 million. Significantly, 157 of the 229 sub-accounts that had positive equity balances had
27 equity balances below \$25,000, the minimum equity required by NASD day-trading rules.

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1 14. As of January 31, 2008, Tuco had 261 traders, with 335 sub-accounts. Of those,
2 198 traders had 257 sub-accounts with positive equity balances totaling approximately \$11.4
3 million. Significantly, 159 of the 257 sub-accounts that had positive equity balances had equity
4 balances below \$25,000, the minimum equity required by NASD day-trading rules.

5 15. Tuco pools its traders' funds in bank, brokerage and commodity futures accounts
6 in Tuco's name, all of which are controlled by Frederick. Tuco has three brokerage accounts at
7 GLB Trading, and Frederick is the registered representative on each account. Tuco also allows
8 customers to trade commodity futures through two commodities accounts in Tuco's name which
9 are also controlled by Frederick. Tuco also maintains two bank accounts, both controlled by
10 Frederick, which Tuco uses to receive traders' initial and additional contributions, to send
11 withdrawals or distributions to traders, and to pay Tuco's expenses. Frederick is the only person
12 authorized to withdraw funds from Tuco's accounts.

13 16. Tuco uses its own back office system to create sub-accounts for each trader
14 through which the trader can day-trade securities through Tuco's master accounts. All but 1% of
15 Tuco's business consists of equity trading, and 99% of that trading occurs in Tuco's master
16 accounts at GLB Trading. Traders can conduct their trading activities at Tuco's six offices
17 located nationwide, its two foreign offices, and at a remote location of the customer's choosing.
18 Tuco provides trading platform software from several vendors, which enables a trader to use his
19 or her sub-account to place trades through Tuco's master accounts. Tuco also uses the trading
20 software to monitor each trader's profits and losses on a real-time basis and whether the trader is
21 incurring substantial trading losses.

22 17. Under Tuco's Operating and Trader Agreements, Tuco determines how much of
23 Tuco's funds each trader may use in trading securities and can stop the trader from trading at any
24 point. Frederick sets each trader's buying power based upon the amount of funds in the trader's
25 sub-account and the trader's trading experience. New traders begin with 6:1 to 10:1 buying
26 power (*i.e.*, a new trader can use \$6 to \$10 of Tuco's equity to purchase securities for each \$1 in
27 the trader's sub-account). Approximately 80% of Tuco's traders have between 10:1 and 20:1
28 buying power, far in excess of the 4:1 buying power maximum imposed by applicable NASD

1 and NYSE rules.

2 18. Frederick monitors how much trading power each trader uses by checking Tuco's
3 back office system daily. Tuco's master accounts at GLB Trading are limited to 4:1 power. If a
4 master accounts exceeds the 4:1 limit, Tuco receives a margin call from GLB Trading, which
5 Tuco satisfies by borrowing funds from third parties. Each week, Tuco borrows and pays back
6 from \$500,000 to \$2.3 million to meet these margin calls.

7 19. Under Tuco's Operating Agreement, the trader is responsible for all of the trading
8 profits and losses in his or her trading account and does not share in other traders' profits and
9 losses. The Operating Agreement also states that the trader may withdraw any of the trader's net
10 trading profits. Tuco is required under the Operating Agreement to adjust, on a daily basis, the
11 amount of funds in the trader's account by the amount of the trader's trading profits and losses,
12 net any commissions, expenses, or other charges that Tuco may take. If a trader suffers losses in
13 excess of his or her contributions, resulting in a negative equity balance, under the Operating
14 Agreement, the Class A member (*i.e.*, Frederick) is solely responsible for the negative equity
15 balance.

16 20. Each trader can log onto Tuco's back-office system and see the activity in his or
17 her sub-account. The back office system displays, as of the previous day, the sub-account's
18 equity and account history (trades, trade breaks, commissions, fees, deposits, and withdrawals),
19 and purports to represent the balance available to the trader for withdrawal or distribution.

20 21. Tuco's traders are conducting substantial amounts of day-trading through Tuco's
21 master accounts at GLB Trading — both in terms of the dollar amount of the trades and the
22 number of trades. For example, in December 2007, one trade was worth \$42.7 million. The
23 most recent monthly account statement for Tuco's principal master account is over 10,000 pages,
24 representing hundreds of millions of shares traded each month.

25 **Tuco's Commissions, Fees and Expenses**

26 22. Tuco charges its traders commissions on their securities trades. Frederick
27 negotiates with each trader the commissions that will be charged but typically sets the
28 commission rate for new traders at \$5 per 1,000 shares traded. Commissions range from \$0.20

1 to \$8 per 1,000 shares traded. Tuco also charges its traders certain additional fees, such as for
2 wiring of funds withdrawn from Tuco, sending withdrawal checks by overnight mail, and for
3 providing software, stock quotes and news feeds.

4 23. The trading software calculates Tuco's commissions, which are then downloaded
5 daily into Tuco's back office system and then debited from the trader's sub-account. The
6 commissions are collected at GLB Trading's clearing firm, Penson Financial, which also
7 receives a copy of the commission calculations generated by the trading software. Penson
8 Financial and GLB Trading then subtract from the calculated commissions various expenses and
9 fees, and GLB Trading's share of the commission. GLB Trading then pays the net commissions
10 to Frederick, which Frederick then deposits into Tuco's bank accounts to pay Tuco's expenses or
11 to pay trader withdrawals, or deposits into Tuco's master accounts.

12 24. Through their trading activity, Tuco's traders have generated substantial
13 commissions for Frederick as the registered representative on the Tuco-GLB Trading accounts.
14 From December 2006 through October 2007, Frederick received approximately \$1.12 million in
15 net commissions from GLB Trading, of which more than 90% has come from trading in Tuco's
16 accounts. Frederick's commissions skyrocketed to \$2.14 million in November 2007 alone, the
17 increase being largely attributable to a new trader, which is itself a day-trading firm with
18 approximately 150 traders.

19 25. Tuco incurs substantial costs that its pays through its transaction-based
20 commission charges to its traders. These expenses include the costs associated with purchasing
21 and operating the trading software and back office system, salaries, consulting fees, interest
22 charges, travel, website maintenance and office expenses. Tuco is only able to pay its expenses
23 using the transaction-based commissions it receives.

24 **Tuco's and Frederick's Material Misrepresentations and Omissions and Tuco's**
25 **Multi-Million Dollar Shortfall**

26 26. In connection with its solicitation and enrollment of new traders, Tuco and
27 Frederick provide to each new trader, among other things, a copy of Tuco's Operating
28 Agreement. Each new member is required to execute a counterpart signature page to the

1 Operating Agreement in order to become a member of Tuco, in which the trader acknowledges
2 receipt of the Operating Agreement and agrees to be bound by its terms.

3 27. In the Operating Agreement, Tuco and Frederick represent that they will create a
4 separate sub-account for each trader through which the trader can conduct day-trading activities.
5 In the Operating Agreement, Tuco and Frederick further represent that the profits (and losses)
6 generated by each trader within the trader's sub-account shall be allocated pursuant to a certain,
7 agreed upon "payout percentage." In practice, the agreed upon payout percentage is always
8 100%. In other words, Tuco and Frederick agree and represent to the trader that 100% of the
9 trader's net profits shall be allocated to the trader for the trader's exclusive benefit.

10 28. In the Operating Agreement, Tuco and Frederick further represent that Tuco's
11 books shall reflect, among other things, the trader's initial and additional funds deposited and the
12 amount of the net trading profits that has been credited to the trader. Tuco and Frederick further
13 represent that the only amounts that shall be debited from the trader's sub-account shall be the
14 amount of money (or property) distributed by Tuco to the trader and the amount of any net
15 trading losses assessed to the trader.

16 29. In the Operating Agreement, Tuco and Frederick further represent that Tuco will
17 maintain true and correct books and records, in which shall be entered all transactions of Tuco,
18 and all other records necessary, convenient or incidental to recording Tuco's business and
19 affairs, which shall be sufficient to record the allocation of net income and net losses and
20 distributions to traders as provided by the Operating Agreement.

21 30. In connection with the daily trading activity of Tuco's traders, and to induce
22 Tuco's traders to continue trading with Tuco and to generate commissions and other charges for
23 Tuco's brokerage services, Tuco and Frederick make additional representations to Tuco's traders
24 through the operation of Tuco's back office system, which traders can log onto to see the activity
25 and current balances in their designated sub-accounts. Tuco's back office system displays, as of
26 the previous day, the trader's account equity, which is purportedly the amount of money
27 available to the trader for trading, distribution or withdrawal.

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1 31. Tuco and Frederick knew, or were reckless in not knowing, that each of the afore-
2 mentioned material statements were false and misleading, in that the sub-accounts, Tuco's books
3 and records, and Tuco's back office system and associated software did not accurately reflect the
4 traders' net equity balances or the actual amount of money available to the trader for distribution
5 or withdrawal.

6 32. Indeed, Tuco and Frederick have misused and continue to misuse various amounts
7 of the traders' net equity to pay Tuco's expenses, to cover other traders' trading losses, and to
8 otherwise maintain and continue Tuco's operations. The Defendants' misuse of the traders'
9 funds was neither authorized by, nor disclosed to, Tuco's traders.

10 33. As of December 31, 2007, there was approximately a 35% shortfall between what
11 traders saw when viewing their sub-accounts on Tuco's back office system and what Tuco
12 actually held for its traders in its accounts. As of December 31, 2007, Tuco and Frederick
13 represented to its traders that the traders had positive net equity totaling approximately \$10.2
14 million. As of that date, however, Tuco's bank, brokerage and commodities accounts had net
15 assets of only approximately \$6.59 million. Therefore, approximately \$3.62 million of the
16 trader's funds, or about 35%, was unaccounted for.

17 34. As of January 31, 2008, there was approximately a 12% shortfall between what
18 traders saw when viewing their sub-accounts on Tuco's back office system and what Tuco
19 actually held for its traders in its accounts. As of January 31, 2008, Tuco and Frederick
20 represented to its traders that the traders had positive net equity totaling approximately \$11.4
21 million. As of that date, however, Tuco's bank, brokerage and commodity futures accounts had
22 net assets of only approximately \$10.05 million. Therefore, approximately \$1.35 million of the
23 trader's funds, or about 12% was unaccounted for.

24 35. These misused funds were used to pay Tuco's operating expenses and to cover
25 other traders' losses. Tuco's and Frederick's use of those funds was improper and contrary to
26 Tuco's and Frederick's representations set forth in Tuco's Operating Agreement, in which they
27 represented that traders' net profits would not be used to meet Tuco's operating expenses or to
28 cover other traders' trading losses. Needless to say, Tuco and Frederick failed to disclose to

1 Tuco's traders that their net trading profits were being used to meet Tuco's and Frederick's
2 expenses and liabilities and that there were insufficient funds in Tuco's accounts to cover all of
3 its traders' net positive equity balances.

4 36. Tuco and Frederick are continuing Tuco's operations and allowing traders to day-
5 trade securities through Tuco's accounts. Tuco and Frederick are also continuing to solicit new
6 traders, receive deposits from and pay withdrawals to traders, and receive commissions. Tuco
7 and Frederick are also continuing to make false and misleading statements to traders and
8 continuing to misuse traders' funds.

9 **FIRST CLAIM FOR RELIEF**

10 **UNREGISTERED BROKER-DEALER**

11 **VIOLATIONS OF SECTION 15(a) OF THE EXCHANGE ACT**

12 **(AGAINST TUCO)**

13 **AIDING AND ABETTING VIOLATIONS OF SECTION 15(a) OF THE EXCHANGE ACT**

14 **(AGAINST FREDERICK)**

15 37. The Commission realleges and incorporates by reference paragraphs 1 through 36
16 above.

17 38. Defendant Tuco, by engaging in the conduct described above, directly or
18 indirectly, made use of the mails and other means or instrumentalities of interstate commerce to
19 effect transactions in securities, without being registered as a broker or dealer pursuant to Section
20 15(b) of the Exchange Act, 15 U.S.C. § 78o(b), in violation of Section 15(a) of the Exchange
21 Act, 15 U.S.C. § 78o(a).

22 39. Defendant Frederick knowingly provided substantial assistance to Tuco's
23 violation of Section 15(a) of the Exchange Act, 15 U.S.C. § 78o(a). By engaging in the conduct
24 described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e),
25 defendant Frederick aided and abetted defendant Tuco's violations of Section 15(a) of the
26 Exchange Act, 15 U.S.C. § 78o(a).

27 40. By engaging in the conduct described above, defendants Tuco and Frederick
28 violated, and unless restrained and enjoined will continue to violate, Section 15(a) of the

1 Exchange Act, 15 U.S.C. §78o(a).

2 **SECOND CLAIM FOR RELIEF**

3 **FRAUD IN CONNECTION WITH THE PURCHASE OR SALE OF SECURITIES**

4 **VIOLATIONS OF SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 THEREUNDER**

5 **(AGAINST TUCO AND FREDERICK)**

6 41. The Commission realleges and incorporates by reference paragraphs 1 through 36
7 above.

8 42. The defendants, and each of them, by engaging in the conduct described above,
9 directly or indirectly, in connection with the purchase or sale of a security, by the use of means
10 or instrumentalities of interstate commerce, of the mails, or of the facilities of a national
11 securities exchange, with scienter:

- 12 a. employed devices, schemes, or artifices to defraud;
- 13 b. made untrue statements of a material fact or omitted to state a material
14 fact necessary in order to make the statements made, in the light of the
15 circumstances under which they were made, not misleading; or
- 16 c. engaged in acts, practices, or courses of business which operated or would
17 operate as a fraud or deceit upon other persons.

18 43. By engaging in the conduct described above, each of the defendants violated, and
19 unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act, 15
20 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

21 **PRAYER FOR RELIEF**

22 WHEREFORE, the Commission respectfully requests that the Court:

23 **I.**

24 Issue findings of fact and conclusions of law that the defendants committed the alleged
25 violations.

26 **II.**

27 Issue orders, in a form consistent with Fed. R. Civ. P. 65(d), temporarily, preliminarily
28 and permanently enjoining defendant Tuco and Frederick and their officers, agents, servants,

1 employees, and attorneys, and those persons in active concert or participation with any of them,
2 who receive actual notice of the order by personal service or otherwise, and each of them, from
3 violating Sections 10(b) and 15(a), of the Exchange Act, 15 U.S.C. §§ 78j(b), 78o(a), and Rule
4 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

5 **III.**

6 Issue in a form consistent with Fed. R. Civ. P. 65, a temporary restraining order and a
7 preliminary injunction freezing the assets of defendants Tuco and Frederick; appointing a
8 receiver over defendant Tuco; prohibiting each of the defendants from destroying documents;
9 and ordering accountings from the defendants.

10 **IV.**

11 Order defendants Tuco and Frederick to disgorge all ill-gotten gains from their illegal
12 conduct, together with prejudgment interest thereon.

13 **V.**

14 Order defendants Tuco and Frederick to pay civil penalties under Section 21(d)(3) of the
15 Exchange Act, 15 U.S.C. § 78u(d)(3).

16 **VI.**

17 Retain jurisdiction of this action in accordance with the principles of equity and the
18 Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and
19 decrees that may be entered, or to entertain any suitable application or motion for additional
20 relief within the jurisdiction of this Court.

21 **VII.**

22 Grant such other and further relief as this Court may determine to be just and necessary.

23
24 DATED: March __, 2008

25 _____
26 ROBERTO A. TERCERO
27 Attorneys for Plaintiff
28 Securities and Exchange Commission