

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

MAGDY ABOELGHAR

v.

R.J. O'BRIEN ASSOCIATES, INC., R.M.
TRADING, LLC and RICHARD MULCAHY

CFTC Docket No. 06-043

OPINION and ORDER

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Respondents appeal the initial decision that found they fraudulently allocated losing trades to complainant Magdy Aboelghar's ("Aboelghar") discretionary account in violation of Sections 4b(a) and 4g of the Commodity Exchange Act ("CEA" or "Act"), 7 U.S.C. §§ 6b(a) and 6g. The Administrative Law Judge ("ALJ") ruled for Aboelghar based on a theory of the case developed from erroneous exchange trade data received in response to his sua sponte discovery requests, and did not reach Aboelghar's allegations.

On review, we find no basis for the fraudulent allocation scheme found by the ALJ. The record, however, requires additional development on the issues of whether respondents' failure to disclose margin rate increases constituted a material omission, and whether such omission, if any, proximately caused Aboelghar's losses. Accordingly, we vacate the initial decision and remand the case for additional factfinding as provided herein.

BACKGROUND

Aboelghar's complaint named his broker Richard Mulcahy ("Mulcahy"); Mulcahy's firm, introducing broker R.M. Trading, LLC ("R.M. Trading"); and R.M. Trading's guarantor futures commission merchant R.J. O'Brien & Associates, Inc. ("R.J. O'Brien"), and asserted claims of

“misrepresentation, nondisclosure, churning, abusive liquidation and misappropriation” based on trades executed for his account from April 18-21, 2006.¹ Aboelghar sought \$32,966.57 in out-of-pocket damages. Aboelghar claimed that Mulcahy allowed him to increase his metals positions on April 19, without informing him that margin rates for copper and silver were being raised, effective at the close of trading that day. As a result, Aboelghar claimed, his account became undermargined and was liquidated on April 20, except for a gold position, which was liquidated at an avoidable loss on April 21. Complaint at ¶ 3.

Respondents’ answer generally denied liability, raised affirmative defenses about Aboelghar’s knowledge and involvement, asserted that Aboelghar’s account was fully margined at all times on April 19, and stated that Aboelghar’s losses resulted from a steep decline in metals prices on April 20. Record Tab 9.²

The case was forwarded to the ALJ on September 20, 2006. Prior to the hearing, the ALJ issued several sua sponte discovery orders requiring respondents to produce notices they had received advising them of NYMEX’s increased margin requirements, copies of office order tickets and floor tickets for trades executed for Aboelghar’s account on April 20, and other documents. The ALJ also asked whether any trades allocated to Aboelghar’s account on April 20 were part of a bunched or block order. First Order for Production, Tab 23; Second Order for Production, Tab 32. Respondents submitted the documents requested and denied that Aboelghar’s trades were part of bunched orders. In response to a query regarding execution

¹ See Record of Proceedings (“Record”) Tab 1 (Original Complaint); Tab 4 (First Amended Complaint); and Tab 6 (Second Amended Complaint). Aboelghar’s account was owned jointly by his wife, Mona, who died while this case was pending before the ALJ, leaving Aboelghar as the sole complainant. Record Tab 24 (Notification of Death). Aboelghar made all decisions respecting the account and conducted all communications with respondents, and is treated as if he were the sole complainant throughout the case.

² Respondents’ answer asserted: “As an example [of downward market volatility], silver opened slightly down on April 20, 2006 from the previous day, and eventually experienced a two dollar drop in price, which is equivalent to a \$10,000 decrease in the value of one silver contract.” Tab 9 at 12, ¶ 2.

times, respondents explained in part that for trades executed electronically after floor trading closed on April 19, Aboelghar's confirmation statement would reflect that the trade was executed on April 20. Amended Response to Second Order for Production at 2, Tab 34.

The ALJ subsequently singled out four transactions and asked respondents to explain why trades apparently ordered during daytime floor trading hours on April 19, were filled early on April 20, when the pit was closed. Third Order for Production at 2, Tab 38. Respondents explained that the trades were limit orders entered through NYMEX's electronic trading system, Access[®],³ on the afternoon of April 19 and filled electronically several hours later during overnight trading. Respondents explained further that Mulcahy received trade confirmations from R.J. O'Brien and time-stamped them on the morning of April 20. Response to Third Order for Production at 3-4, Tab 46.

The ALJ convened a hearing on May 15, 2007, at which the parties' testimony centered on Aboelghar's nondisclosure and wrongful liquidation claims. Aboelghar and Mulcahy gave conflicting testimony as to whether Aboelghar was informed of exchange margin rate increases. Compare Tr. at 22, 28-29 (Aboelghar) with Tr. at 76-78 (Mulcahy).⁴ Aboelghar testified that Mulcahy first informed him about increased margins in an April 20 telephone call when Mulcahy told him that steep price drops had led to a temporary trading halt. Tr. at 28. Aboelghar testified further that he called NYMEX the following day and was informed by an unidentified staff member that margin increases are announced to exchange clearing members in advance of their effective date. Tr. at 29; see also Tr. at 98.

³ Access[®] was NYMEX's proprietary internet-based order entry system in use at the time.

⁴ The Transcript ("Tr.") is filed at Tab 53 of the Record.

Aboelghar testified also that he received conflicting information from Mulcahy and NYMEX regarding the liquidation of his account. According to Aboelghar, Mulcahy told him that the exchange wanted all undermargined accounts liquidated, but the exchange employee told him NYMEX had nothing to do with his broker or the liquidation of his account. Tr. at 28-29, 98. Aboelghar and Mulcahy also presented conflicting testimony regarding which of them made trading decisions for the account. *Compare* Tr. at 8-11, 17-18 (Aboelghar) *with* Tr. at 64-65 (Mulcahy).

During the two-hour hearing, the ALJ questioned Mulcahy extensively about why the term “Globex” was used on order tickets for trades supposedly executed on the COMEX Division of NYMEX. *E.g.*, Tr. at 54-58, 102, 104. Mulcahy testified that he used “Globex” as a generic designation for all electronic trading venues. *Id.* at 54-58. At the hearing’s conclusion, the ALJ issued a final production order from the bench, asking respondents to produce trading records for April 19-20 for their proprietary accounts and to obtain from NYMEX verification for Aboelghar’s trades. In issuing the order, the ALJ stated bluntly his suspicion that Mulcahy may have traded opposite Aboelghar improperly.⁵ Tr. at 103-04. In response, among other information, respondents reported that Mulcahy made a \$4,920 profit on gold trades and lost \$89,750 trading silver. Response to Bench Production Order at 2 and Exh. A (Mulcahy’s confirmation statement), Tab 51.

On May 31, the ALJ informed the parties that four days before the hearing he had asked NYMEX to produce information regarding four trades he described in his third production order

⁵ Regarding his suspicions, the ALJ said: “I want [Aboelghar’s trades] verified when they went through. I want the time, price, quantity of each transaction, and when it went through.... I want verification from NYMEX that these trades were executed, either [on] the Access[®] platform as you call it or on the floor. And it should tell me what I want to know whether there were any proprietary accounts taking the opposite side of Mr. Aboelghar’s trade” Tr. at 103.

as having a significant time spread between the order and fill times. Order to Show Cause, Tab 52. The ALJ advised the parties that, according to NYMEX, silver and gold did not trade at the times and prices reported by respondents. Based on NYMEX's response, which the ALJ shared with the parties, the ALJ asked respondents to show cause why he should not find "that these claimed trades never took place." *Id.* at 2.

In their reply, respondents stated that the ALJ had received information from NYMEX regarding execution times and prices for the morning of April 19, 2006, which was not when the disputed trades in Aboelghar's account took place. Response to Show Cause Order at 1, Tab 54. Respondents resubmitted order tickets showing that the orders in question were placed shortly after 3 p.m. on April 19. They also submitted excerpts from the NYMEX Daily Trade and Position Register ("Trade Register") showing executions cleared through R.J. O'Brien for Aboelghar's account at the prices reported to Aboelghar. The execution times on the Trade Register indicated that the trades took place during the evening of April 19, although the Trade Register bore an April 20 "Business Date." Respondents also submitted Aboelghar's April 20 confirmation statement showing that he obtained the requested fills. Tab 54, Exhs. A-D.

The ALJ made a second request for information to NYMEX, asking whether silver had traded at the prices reported to Aboelghar "at the same hour during the evening – p.m. rather than the morning – a.m. – hours" on April 19. Tab 62 at 2. NYMEX replied that silver did not trade at the relevant times and prices "on April 18, which was part of the April 19 Access[®] session." *Id.* at 1. The ALJ admitted NYMEX's submissions to the record and invited the parties to respond. Order, Tab 61 at 3.

Respondents filed an Amendment to Post-Hearing Brief ("Amend't to Br."), arguing that the ALJ's conclusions again were based on the wrong trading data. Amend't to Br. *passim*, Tab

65. They contended that the trades at issue were executed for Aboelghar's account during the evening of calendar day April 19, which was part of the April 20 Access[®] trading session, while NYMEX had provided data for trading that took place during the morning of April 19 and the evening of April 18. *Id.* at 3, 4.

In addition to the above-described post-hearing activity, the parties filed post-hearing briefs that argued the issues raised in their initial pleadings and prehearing memoranda. Aboelghar reiterated that he had excess equity of \$20,555.79 in his account after trading closed on April 19, which he said was not enough to handle both the increased margin rates on his existing contracts and the new positions he ordered. Comp. Post-Hearing Memorandum at 1, Tab 57. Respondents countered that Aboelghar had enough equity for both purposes and that his account became undermargined when prices fell the next day. Resp. Post-Hearing Br. at 4, 5, Tab 59.

INITIAL DECISION

The ALJ issued an initial decision that found for Aboelghar and awarded him the amount he sought in damages. *Aboelghar v. R.J. O'Brien, Inc.*, [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,681 (CFTC Sept. 10, 2007) ("I.D."). The initial decision did not resolve the claims Aboelghar raised in his complaint and at the hearing. Instead, the ALJ relied on the NYMEX submissions to find that Mulcahy fraudulently allocated losing trades to Aboelghar's account and attempted to conceal his conduct through "manufactured trade tickets," I.D. at 61,172, and the "fabrication of counterfeit documents." *Id.* at 61,173. The ALJ rejected the explanations contained in respondents' amended post-hearing brief and other pleadings, finding instead that "[r]espondents provided incorrect and unreliable records in a deliberate effort to discredit or undermine overwhelming evidence that the gold and silver transactions attributed to

Complainant's account were fictitious." I.D. at 61,170. He concluded that because "[r]espondents distorted the record, the Court can't establish with certainty exactly what trading occurred for Aboelghar's account[,] and inferred that all of Aboelghar's losses stemmed from respondents' misconduct. I.D. at 61,173. The ALJ found respondents in violation of Sections 4b(a) and 4g of the Act. He found Mulcahy liable personally, R.M. Trading liable for the acts of its agent Mulcahy, and R.J. O'Brien liable for the misconduct of its guaranteed introducing broker. I.D. at 61,173.

DISCUSSION

On appeal, respondents reiterate their post-hearing arguments that the ALJ decided the case on an erroneous basis and that Aboelghar's stated theories of recovery lack merit. "As a general rule, the Commission defers to the factual determinations of its presiding officers." *Secrest v. Madda Trading Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,627 at 36,696 (CFTC Sept. 14, 1989). This policy of deference does not obviate, however, our responsibility to ensure the basic integrity of the factfinding process. *Gilbert v. Refco, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,081 at 38,057 (CFTC June 27, 1991). "[W]hen a presiding officer commits the type of clear error that undermines our trust in the overall soundness of his factual determinations, we have a duty to intervene and order appropriate corrective action." *Id.* Because the ALJ relied on NYMEX data from the wrong time periods, as explained below, his decision is founded on clear error.

Our findings, based on our independent review, are as follows. At the relevant time, trading at NYMEX consisted of open outcry in the pit followed by overnight electronic trading on Access[®]. Open outcry trading hours for gold and silver were respectively, 8:20 a.m. through 1:30 p.m., and 8:25 a.m. through 1:25 p.m., Eastern time. NYMEX Rule 104.02. Weekday

trading hours on Access[®] for gold and silver began at 2:00 p.m. and extended through 8:00 a.m. the next morning. Amend't to Br., Exh. D. For recordkeeping purposes, each NYMEX trading session started on Access[®] and extended through the next day's open outcry session. Because a single trading session took place over two calendar days, NYMEX used the second day as the trading session's date.⁶ *Id.* Accordingly, the April 20 trading session for gold and silver began during the afternoon of April 19 on Access[®] and ended when the pit closed on April 20.⁷

Aboelghar ordered the trades in question on the afternoon of April 19, early in the April 20 Access[®] trading session. NYMEX's responses to the ALJ's inquiries addressed prices on the evening of April 18 and the morning of April 19. Tab 62. Because the ALJ's factual findings are based on data lacking relevance to his decision finding that respondents fraudulently allocated trades to Aboelghar's account, we vacate his findings and conclusions. The NYMEX Trade Register submitted by respondents shows that the trades Aboelghar ordered were executed properly. We find that no fictitious trading or fraudulent trade allocation occurred that resulted in harm to Aboelghar, who obtained the fills he wanted at the prices he sought at the times those prices traded on NYMEX. Tab 62.

We turn now to the claims Aboelghar alleged in his complaint. Aboelghar presented no testimony or other evidence to support his churning claim and we accordingly deem it abandoned. *Lehoczky v. Gerald, Inc.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,441 at 42,921 (CFTC June 12, 1995) (claims may be abandoned at the hearing). In any event, the weight of the evidence indicates that respondents did not control trading in the

⁶ The exchange uses a 24-hour clock to report trading data. This opinion refers to time using a 12-hour clock, *e.g.*, 13:00 in NYMEX records would be stated as 1:00 p.m. in this opinion. The record is further complicated by the fact that respondents' order tickets used calendar dates and a 12-hour clock set for Central time.

⁷ See also Aboelghar's Reply to respondents' Answer, in which he stated: "Please observe that the disputed date is April 20, 2006 NYMEX announced on April 18, 2006 a margin increase ... beginning at the close of business on Wednesday [April 19, 2006]. Which means the start of the [April] 20th market...." Tab 10 at 2.

account, despite the ALJ's finding to the contrary, thereby precluding a finding that churning occurred. Although Aboelghar granted Mulcahy discretionary trading authority upon opening the account, Aboelghar testified that he and Mulcahy spoke five or six times a day, conversations that he described as brainstorming. Tr. at 10. Aboelghar also viewed his account on-line and subscribed to real-time market quotes and market data sources. Tr. at 19-20. His testimony is consistent with Mulcahy's testimony that after making a handful of discretionary trades when the account was first opened, subsequent trading decisions were made in consultation with Aboelghar. Tr. at 64-65. Thus, we conclude that the account was discretionary in name only and that for purposes of a churning analysis, Mulcahy did not control the account.

Remaining are Aboelghar's claims for misrepresentation, nondisclosure, misappropriation of funds and wrongful liquidation. These claims are intertwined. All concern Mulcahy's alleged failure to inform Aboelghar of NYMEX's increase in margin rates that took effect at the close of business on April 19, which Aboelghar contends ultimately resulted in the next day's liquidation of his positions. The ALJ declined to credit Mulcahy's testimony that he informed Aboelghar of margin changes the same day that the exchange announced them. We defer to the factfinder's determination, but are unable to determine on the record before us whether the omission was material in this instance.

"[T]here is a duty to disclose all material facts to a customer." *Sharp v. FGL Commodity Services, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,970 at 37,541 (CFTC Dec. 12, 1990) (citing *Madel v. Anspacher & Associates, Inc.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,412 (CFTC Mar. 14, 1989)). "A statement or omitted fact is material if it is substantially likely that a reasonable investor would consider the matter important in making an investment decision." *Sudol v. Shearson Loeb Rhoades, Inc.*, [1984-

accuracy of their calculations. Moreover, respondents' assertions are countered by Aboelghar, who alleges that the margin increase, combined with the new positions, caused the account to be undermargined and who testified that "had I known there's a margin increase that day, I wouldn't have entered." Tr. at 98. A better developed record is needed to determine whether the higher cost of carrying silver and copper would have mattered to a reasonable person in Aboelghar's position in deciding whether to continue holding his existing positions and whether to establish new ones.⁸ *Cf. Human v. Alaron Trading Corporation*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,806 (CFTC Oct. 18, 1996) (concurring opinion) (50 percent margin increase is material to futures customer who adds 20 contracts to an already undermargined account).

Nevertheless, a finding by the ALJ that a material omission occurred does not necessarily mean that Aboelghar's losses were proximately caused by that omission. Silver traded limit down by mid-morning on April 20, leading to a temporary trading halt. *See* Resp. Appeal Br. Exh. 7 at 9, showing no trading between approximately 10:35 and 10:50 a.m. Gold, which traded the prior evening as high as 645.90, Exh. 8 at 12, 13, traded as low as 611.40 on April 20. Exh. 9 at 66. It is at least possible that the steep market drop was the supervening or only cause of Aboelghar's losses. Issues of causation and damages, however, were not addressed by the ALJ and cannot be ascertained without additional factfinding, which the ALJ should conduct on remand.⁹

⁸ At the close of the April 19 trading session, Aboelghar's account held two long copper, four long gold, two long silver, one long sugar and one short U.S. dollar index futures. During the evening, he sold two gold contracts and one silver contract, and bought three silver contracts and one gold contract, leaving him with three gold contracts, a net decrease of one, and four silver contracts, a net increase of two, along with his positions in other commodities.

⁹ Aboelghar agreed to liquidate his account after Mulcahy told him that the exchange required all undermargined accounts to be liquidated by the end of the day. Tr. at 97-98. He said he lost faith in Mulcahy after speaking to NYMEX staff on April 21, when he learned that clearing members receive advance notice of margin rate changes and that NYMEX did not order the liquidation of his particular account. Tr. at 98. At that point, Aboelghar

Finally, Aboelghar complains of the manner in which his last gold contract was liquidated. According to Aboelghar, after he agreed to liquidate all his metals positions during the morning of April 20, respondents failed to sell one open gold position that he had established on April 18. This position was not liquidated until mid-afternoon on April 20. Aboelghar contends that the delayed sale resulted in an avoidable loss.

Respondents concede the delayed offset and explain as follows. Market orders to sell Aboelghar's three gold positions were entered and executed within one minute, at 617.¹⁰ Within five minutes Aboelghar bought two long gold futures at 619. An hour later, he bought another gold future at 626.00. In the minute before open outcry trading ended, he sold two gold contracts at 623.50. R. App. Br. at 18, 20 n.17. About three hours later, Aboelghar sold his remaining open gold contract at 615.20. Respondents explain that under applicable clearing procedures, all day trades are matched before any overnight trades are matched. Aboelghar's April 20 gold purchases were offset against his sell orders entered that day, leaving open his older April 18 purchase. *Id.* at 20, n.17 (internal citations to transcript omitted). *See also* Tr. at 94 (explaining R.J. O'Brien's practice of offsetting day trades before overnight trades). This explanation is coherent, plausible and supported by Aboelghar's account statements. Respondents state correctly that "[t]he effect is neutral, because the account's equity value, which would include the market value of the open position, would be the same no matter which trade was matched." R. App. Br. at 20, n.17. Accordingly, this claim is without merit.

concluded that his losses stemmed from the margin rate increases, not any decline in metals prices, and that respondents concocted a story about a forced liquidation by NYMEX to conceal their failure to inform him about increased margins. Tr. at 98. For reasons unexplained in the record, the option of posting additional margin does not appear to have been considered. Aboelghar does not complain of being denied an opportunity to post additional margin.

¹⁰ *See* Tabs 30 and 34, showing the sale of three gold futures at 617.

CONCLUSION

Based on the foregoing, we vacate the initial decision and remand this matter to the ALJ for further factfinding on the issue of how the silver and copper margin increases, and Aboelghar's transactions on the evening of April 19, affected his account. The ALJ shall determine whether the nondisclosure of the margin rate increases constituted a material omission. If so, the ALJ shall determine whether such omission proximately caused any of the losses Aboelghar suffered on April 20.

IT IS SO ORDERED.

By the Commission (Chairman GENSLER and Commissioners SOMMERS, CHILTON and O'MALIA) (Commissioner DUNN not participating).



David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: May 17, 2010