



U.S. COMMODITY FUTURES TRADING COMMISSION

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Received
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2009 APR 30 AM 11:38

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AMERICAN PACIFIC COMMODITIES, INC.,
Complainant,

v.

ADM INVESTOR SERVICES, INC.;
ROBERT BRUCE MCGOVERN; and
R.B. MCGOVERN & ASSOCIATES,
Respondents

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* CFTC Docket No. 08-R019
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INITIAL DECISION

Complainant alleges a smorgasbord of violations by respondents, including trading ahead, churning and unauthorized trading, but the principal allegations are that respondents disregarded complainant's trading instructions and breached a promise to limit trading losses on individual trades to \$300. Respondents deny any violations and assert that complainant's allegations, whether viewed individually or collectively, lack any merit and represent a transparent attempt to "get a two bites of the apple." As explained below, after carefully reviewing the parties' documentary submissions and oral testimony, I have concluded that complainant has failed to establish any violations causing damages and thus is not entitled to any award.

This conclusion reflects my determination that neither Bruce Paranay nor Robert McGovern produced oral testimony that was particularly compelling. Neither witness could specifically recall important details of crucial conversations, partly because neither had ever

created notes of those conversations, which took place in 2006. In this connection, McGovern sincerely conceded that he could remember very few particulars, and testified that his records had been “effectively” destroyed in wild fires and mudslides. Similarly, neither witness could reliably recall when they spoke vis-`a-vis when orders had been placed by McGovern. Both witnesses produced testimony that suffered at times from internal consistencies and vagueness. For example, Pararay was not consistent or clear on whether he had regularly received and reviewed the newsletter from McGovern or the confirmation statements from ADM. In addition, various assertions by Pararay concerning the course of dealing with McGovern were contradicted by reliable documentary evidence. For example, in his complaint he alleged that he had “totally” relied on McGovern to select trades and that all trades between January 18 and April 21, with the exception of one spread trade in late March, had been initiated by McGovern. However, an e-mail exchange establishes that Pararay placed an e-mini trade in mid-March without any consultation with McGovern. For his part, McGovern was not clear or consistent on whether he had regularly provided copies of his newsletter to ADM, which acted as his guarantor. In any event, overall, McGovern’s testimony seemed more forthright, focused, and plausible.

Factual Findings

1. American Pacific Commodities (“APC”), located in Las Vegas, Nevada, was a registered introducing broker from March 2000 to April 2006.

Bruce John Pararay, currently a resident of Torrance, California, was the sole owner and officer of APC. Before starting APC, Pararay had been a registered associated person with FSG International from September 1997 to November 1998, and with Robert James Miller for two months in 2000. Pararay had no experience trading futures or options before working for FSG.

At FSG and Miller, he did not perform independent market analysis and passed on trade recommendations generated by other people in the firms.

2. Robert Bruce McGovern, a resident of Laguna Niguel, California, has been registered since 1987, and is the owner of Robert Bruce McGovern, a registered introducing broker, commodity trading advisor and commodity pool operator. McGovern principally trades agricultural commodity spreads and inter-commodity spreads. McGovern credibly asserted that it was his custom to discuss trades with his customers before placing trades.

ADM Investor Services, Incorporated is a registered futures commission merchant, located in Chicago, Illinois. ADM acted as the guarantor for R.B. McGovern & Associates.

3. McGovern regularly published a "Nightly Spread Letter." Pararay produced newsletters dated January 1, 2003; December 30, 2005; and February 10, March 24, April 10 and 21, May 19, and September 11 and 12, 2006.¹ On the evidentiary record in this case: it cannot be determined whether Pararay ever was a paid subscriber to the newsletter, it cannot be determined on what dates during the life of the APC account that McGovern published the newsletter, and it cannot be reliably determined which newsletters Pararay received, beyond those that he has already produced.

The December 30, 2005 newsletter, reviewed by Pararay soon before he opened his account, represented that since 1999 the trades discussed in McGovern's newsletter had consistently realized profits each year, ranging from 2% to 126%, with an average of 60%.

4. On January 5, 2006, Pararay opened an account in the name of APC with a deposit of \$20,000. Pararay filled out an ADM corporate account application, and an ADM "Commodity and Options Corporate Authorization" which authorized Pararay to trade commodity futures and options on behalf of APC.

¹ In several instances, Pararay only produced the first page of the multi-page newsletter.

On the account application, Paraney made contradictory representations about whether he intended the account to be discretionary. At the top of the page, he checked off that the account was discretionary, but lower down on the page he checked the “no” box in response to the question: “Will this account be traded or managed on your behalf by anyone else? If yes, please identify the trader and attach a copy of the power of attorney.” Consistent with this particular representation, Paraney did not execute a power of attorney. As a result, respondents treated the account as non-discretionary.

In this connection, Paraney’s assertion that McGovern told him that the Corporate Authorization also would work as a power of attorney granting McGovern discretionary trading authority was particularly implausible. At one point, Paraney had been trained as an attorney, and when he opened the account he was a licensed commodity professional. The terms of the Corporate Authorization clearly exclusively concerned Paraney’s authority to approve trades on behalf of his firm. Thus, even if McGovern had told Paraney that the Corporate Authorization was the functional equivalent of a power of attorney granting McGovern discretionary trading authority, it would not have been reasonable for Paraney to rely on such a patently inaccurate statement. Similarly, it would have been unreasonable for Paraney to unilaterally conflate the Corporate Authorization into an instrument giving McGovern discretionary trading authority.

Paraney also prepared a document on APC letterhead titled: “Corporate Account Trading Instructions.” Paraney’s instructions stated, in pertinent part:

I . . . hereby grant Bob McGovern the authority to trade the account of [APC] in a manner that duplicates those trades which he executes on behalf of his model \$20,000 portfolio account.

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It is understood that Bob McGovern will utilize e-mail to transmit notification of each trade . . . on the date of trade entry.

In this connection, neither Pararay nor McGovern produced copies of any e-mails which notified Pararay of trades. However, during the life of the account, Pararay never complained that McGovern had failed to send such e-mails.

5. Pararay maintained his account from January 17, to September 13, 2006. A total of \$1,774 was charged in commissions and fees. Pararay deposited a total of \$20,000, and received back \$14,113, for an aggregate net loss of \$5,887.

The trading activity can be broken into two distinct periods: first, from January 18, to April 21, and second, from June 1, to September 12, 2006. Between April 22, and May 31, no trades were made.

During the first period, twenty-one round-turn trades were executed. Almost all trades were agricultural commodity calendar and inter-commodity spreads, and all but a handful were single-lot trades and were trades that were open a week or longer. Fifteen of the trades realized net losses. At the end of January, the account was down \$231. At the end of February, the account was down \$3,025. At the end of March, the account had partially recovered and was down \$1,125, and at the end of April, the account was down \$3,826.

During the second period, nine round-turn trades were executed. These trades were all straight purchases of either corn or e-mini S&P futures. All but one was a one-lot trade. The corn trades were open for several days or weeks. The e-mini S&P trades were of shorter duration, with two day trades.

6. McGovern credibly asserted that he discussed each trade with Pararay. McGovern also credibly asserted that while he typically recommended trades, Pararay often suggested modifications to the trades. In contrast, Pararay asserts that McGovern placed most trades

without any consultation. However, this assertion was undercut by the fact that Pararay also asserts that they spoke on average at least once or twice a week, a frequency of calls that roughly comports with the frequency of trading.

McGovern produced an itemized phone bill, and both sides produced affidavits which listed the dates of conversations that they can recall. These three submissions did not completely match-up, but did partially overlap. These three submissions also did not appear to be complete. For example, none identifies any calls in April, when Pararay and McGovern agree that they had spoken with each other, at length, several times. Thus, these three submissions are at best only partially reliable indicators for when Pararay and McGovern consulted about trades. According to these submissions, Pararay and McGovern spoke the day before, the day of, or the day after, the date that an order was placed for about half of the trades during the first period, and for all of the trades during the second period.

7. Between January 18, and February 2, six trades were initiated, of which five were spreads. Three of the spreads were two-lot trades. On February 3, one of the spreads was liquidated for a \$1,700 loss.

On February 8, Pararay e-mailed McGovern to complain about that loss:

Bob, please explain why you are not complying with my trading directive for this account. When I opened this account I provided written trading instructions that requested that you trade this account in the exact manner that you trade your model \$20,000 portfolio account. I opened this account based on your published results (1988-2005) for your model portfolio, not some variant thereof.

This is the only evidence of any complaint -- during the life of the account -- by Pararay concerning deviations from these trading instructions.

In a follow-up phone call, Pararay advised McGovern that since McGovern had used one-lot trades in the model account, he should not have placed two-lot trades in the APC

account. As a result, on February 8, one lot in each of the remaining open spreads was cancelled, and the account was re-credited the commissions and fees for these cancelled trades. In addition, the account was credited \$816, which put the account near where it would have been if the spread closed out on February 3rd had been a one-lot trade.

8. In his February 10 newsletter, McGovern explained that due to unexpected volatility he would be holding spreads for shorter periods in order to capture short-term profits, and that he would be setting a \$300 “mental stop” on new spreads: “I feel that I can no longer accept losses on a particular spread of more than \$300 plus commissions.”

Neither Pararay nor McGovern have described any conversation where they discussed the \$300 mental stop. Similarly, Pararay has not asserted that he ever informed McGovern during the life of the account that he expected him to limit losses to no more than \$300 per spread.

After February 10, seven spreads realized losses greater than \$300. For these seven trades, the losses exceeded \$300 by \$18 to \$275, for an average \$125 loss beyond McGovern’s \$300 mental stop. In this connection, Pararay testified that he did not expect each trade to be profitable and understood that no one could guarantee to limit losses to a particular amount. [See Pages 26, 30, 34, 36 and 38 of hearing transcript.]

9. On Friday March 17, Pararay placed an order to short a June e-mini S&P future. On Monday March 20, McGovern e-mailed Pararay asking him to notify McGovern whenever he placed orders on his own. Pararay replied with an e-mail that authorized McGovern to liquidate the e-mini position at his discretion.

10. In his April 21 newsletter, McGovern announced that he was going to “back off,” and not place any spread trades “for awhile,” since the model account was down 29%, which roughly

comported with the APC account which was down 19%. No trades would be made for APC's account until June 1.

11. On May 8, Pararay e-mailed McGovern:

Bob, please do not execute any of your proposed trades in my account yet.

On May 11, McGovern replied:

Just to be sure. You have instructed me not to do any spread trades. Please confirm.

Pararay replied in the affirmative.

12. On June 1, trading activity resumed. McGovern did not dispute Pararay's assertion that he had instructed McGovern to place the same trades in the APC account that McGovern was making for his personal account.

In September, Pararay became convinced that McGovern had not followed these instructions and closed the account.

Conclusions

Complainant has the burden to establish violations by respondents by a preponderance of the evidence. Here, he has listed sixteen out of twenty-one trades during the first trading period for which he alleges McGovern deviated from his general instruction to trade the APC account exactly like the model account.² Three of these deviated trades were the two-lot trades for which complainant received adjustments as soon as he complained. As for the other alleged trade deviations, Pararay never complained about them during the life of the account. Pararay has not explained how each such trade deviated from the corresponding trade in the model account, has not explained the materiality of the deviation, and has not explained how the deviation caused a greater loss than that realized in the model trade. The fact that the APC account suffered smaller

² Complainant listed these trades in his post-hearing submission. In his pre-hearing submissions and his oral testimony, Pararay had only identified a handful of trade deviations.

losses than the model account over the same time strongly suggests that if there were any deviations, the deviations worked to complainant's advantage. In these circumstances, Pararay has failed to show that APC suffered any losses as the result of any deviation from his general trading instructions.

Pararay similarly has failed to show that he is entitled to recover any damages for the seven spread trades that lost more than the \$300 mental stop announced by McGovern in his February 10th newsletter. McGovern was simply informing his customers that he was adjusting his trading strategy and would be trying to limit losses to \$300 per trade. It is unreasonable to conflate this into a promise to strictly limit losses to \$300 or less, particularly where Pararay never informed McGovern that he was relying on him to strictly limit losses in such a manner.

Finally, Pararay has failed to produce a scintilla of reliable evidence in support of his other allegations.

ORDER

Complainant has failed to establish any violations causing damages by respondents.

Accordingly, the complaint is dismissed.

Dated April 30, 2009.


Philip V. McGuire,
Judgment Officer