



U.S. COMMODITY FUTURES TRADING COMMISSION

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JOHN M. BACHKOSKY, and *
HELEN F. BACHKOSKY, *
Complainants, *
v. * CFTC Docket No. 96-R23
A.G. EDWARDS & SONS, *
INCORPORATED, and *
ROBERT S. KASS, *
Respondents. *

INITIAL DECISION

The Bachkoskys allege that Kass churned their discretionary futures and options account, and that Kass made unauthorized trades after the account was converted to a nondiscretionary account. Respondents deny any violations.

For the reasons set out below, it is concluded that complainants have failed to establish by a preponderance of the evidence any of the alleged violations.^{1/}

The findings and conclusions below are based on the parties' documentary submissions.^{2/}

^{1/} In this connection, the Bachkosky's disregarded a request to produce an affidavit that described in detail their trading objectives, that identified each trade that was either purportedly unauthorized or "not discussed," and that provided their own detailed version of the events that had been set out in convincing detail in the respondents' answer. See Notice dated July 9, 1996.

^{2/} The parties' submissions include the Bachkoskys' complaint and discovery replies; and respondents' answer (with exhibits A (continued...))

Factual Findings

1. John Bachkosky is a well-educated and knowledgeable individual, with a bachelor of science degree in science, who has been a career employee with the Department of Defense, and is currently the Deputy Under Secretary of Defense for Advanced Technology. Helen Bachkosky markets custom-designed exercise clothing to aerobic studios. Although the Bachkoskys opened a joint account with A.G. Edwards, John Bachkosky conducted all of the transactions; therefore, all references are to him unless otherwise indicated.

Bachkosky has extensive investment experience. Since 1975, he has invested in mutual funds and securities, including some high-tech speculative stocks; and since 1994, has traded commodities with several firms, including Prudential, First American Discount and Carrington Financial. [See respondents' March 12, 1996 production.]

2. A.G. Edwards & Sons, Incorporated ("AGE") is a registered futures commission merchant with its principal place of business in Saint Louis, Missouri. Robert Kass is a registered associate person employed at AGE's office in the District of Columbia.

3. In early February 1994, Bachkosky contacted AGE's District of Columbia office to open a commodity account. Bachkosky told Kass that he had devised a petroleum spread

2/ (...continued)
through Q), document submission (filed March 12, 1996) and final verified statement (filed August 22, 1996).

strategy and had successfully traded commodities in the past.

4. On February 3, 1994, the Bachkoskys signed various account-opening documents, including an application and statement of financial condition ("application"), a client agreement, and a risk disclosure statement. [Exhibits A, B and D, respectively, to Answer.]

The Bachkoskys represented in the application that they would be risking \$10,000 to \$20,000 for speculation, and that they had a net worth of \$450,000, total liquid assets of \$385,000 and no liabilities, and an annual income of \$140,000.

5. For each trade, AGE issued a confirmation statement that set forth the trade, the trade price, the gross and the net realized profit or loss, the commission, the beginning and ending balances, open positions, open position equity, and total account equity. AGE also issued monthly account statements that clearly and accurately summarized the futures and options trading activity.

6. The trading activity in the Bachkosky account can be broken into four distinct periods: the first, from February 2 to April 8, 1994, when Bachkosky made just one petroleum spread trade;^{3/} the second, from April 8 to June 9, 1994, when Bachkosky specifically authorized numerous trades recommended by

^{3/} The petroleum spread realized a net profit of about \$545. The net profit for this spread trade was calculated from the February and April 1994 monthly account statements. Neither side has produced the purchase and sale statement confirming the liquidation on April 18, 1994; therefore the commission on this transaction has been estimated to be about \$100, based on the typical commission charged for the other trades in the account.

Kass; the third, from June 10, 1994, to March 21, 1995, when Kass traded the account with discretionary trading authority; and the fourth, from March 22, 1995 -- when the account equity dropped below the \$10,000 necessary to sustain a discretionary account and Bachkosky authorized Kass to unwind nine positions - to May 3, 1995. Bachkosky also specifically authorized one round-turn trade during the fourth period. The churning claim centers on the third period, when Kass traded the account on a discretionary basis, and the unauthorized trading allegation centers on the fourth period, when Kass unwound the account.

7. Around April 8, 1994, Kass told Bachkosky that he was following a strategy involving short-selling treasury bond futures on market rallies as the Federal reserve raised interest rates. Bachkosky accepted a series of Kass's recommendations implementing this strategy up to June 9, 1994. The trades were predominantly in T-bonds and Euro-dollars, with a few wheat trades. On June 1, Bachkosky began trading corn futures, and on June 8, began trading cattle futures. Also, in May, Bachkosky accepted Kass's recommendation to trade two T-Bond options and one crude oil option.

Between April 8 and June 9, 1994, 20 round-turn trades were made on Kass' recommendation. Out of these 20 trades, about half were short-term trades: nine day trades and two overnight trades. As of June 10, the account had realized a \$506 net profit from futures trading and a \$421 net profit from options trading, and had generated \$1,223 in commissions for futures

trades and \$139 in commissions for options trades. [Exhibit J to answer.]

8. In May 1994, Kass advised Bachkosky to enter a discretionary authority agreement where he would provide Kass with limited trading discretion over Kass's account, because Bachkosky was often out of his office and difficult to contact to make time-sensitive trading decisions. On May 2, 1994, the Bachkoskys signed the discretionary authority agreement, which was approved by AGE effective June 10, 1994. The discretionary authority agreement clearly stated that: "The undersigned acknowledges that frequent trades may be made for the undersigned's account and that the commissions to Edwards may be substantial even if the trades . . . are not profitable."

[Exhibits H and I to answer; see ¶¶ 3 and 4 of Bonnot affidavit, exhibit N to answer.]

The Bachkoskys did not produce a description of the conversations in May and June concerning the execution of the discretionary authority agreement, and otherwise have produced no evidence that Bachkosky told Kass that he expected Kass to limit losses to a certain amount or that he expected Kass to consult with Bachkosky when he altered the volume or frequency of trading and have produced no evidence that Kass made such promises.

9. After obtaining discretionary trading authority, Kass began trading a more diverse mix of contracts, adding currency, feeder, hog, soybean meal, hogs and sugar in July and August 1994. In October 1994, Kass would shift to trading that was

predominately in agricultural contracts, and then in February 1995 would shift back to the T-Bond/grain mix that he had started out with in Spring 1994.

Also, the volume of trading did increase after Kass obtained discretionary trading authority, from an average of 10 round-turn trades per month while the account was nondiscretionary, to 15 round-turn trades per month while the account was discretionary. Conversely, the proportion of short-term trades dramatically decreased from about a half of the trades while the account was nondiscretionary (see finding 7 above) to less than a quarter. Out of 146 round-turn trades completed while the account was discretionary, 33 were short-term trades: 20 day trades and 13 overnight trades.

10. Set out below, is a summary of the futures trading activity in the Bachkoskys' account from April 1994^{4/} to April 1995:^{5/}

Month	Total trades	Day-trades	Over-night trades	Net profit/loss
Apr.	5	2	1	\$ 890
May	11	5	1	4,100
Jun.	17	7	2	2,130
Jul.	18	3	3	395
Aug.	19	3	2	946
Sep.	24	3	3	1,031
Oct.	13	0	1	1,194
Nov.	23	2	2	14
Dec.	4	1	0	(369)
Jan.	3	0	0	455

^{4/} The April 1994 figures do not include the petroleum spread initiated by Bachkosky.

^{5/} The April 1995 figures include the futures positions closed out in early May.

Feb.	6	3	0	(2,314)
Mar.	15	0	0	(7,498)
Apr.	7	0	0	(3,766)

As can be seen, the frequency and volume of trading significantly dropped in December 1994 and jumped again in March 1995. Neither side has produced any evidence of the conversations between Kass and Bachkosky concerning these changes in trading activity.

In 1994, trading in the account realized \$4,154 in net profits and generated \$9,914 in total commissions (\$8,776 for futures trades and \$1,138 for options trades). The 1994 commissions would represent 78% of the commissions generated throughout the life of the account. In 1995, trading in the account realized \$13,327 in net losses and generated \$2,972 in total commissions (\$1,881 for futures trades and \$1,091 for options trades). The total net loss for the account was \$9,173, and the total commissions were \$12,886. The account was never under-margined. [¶¶8 and 9 of Mitchell affidavit (filed August 22, 1996).]

11. During the period that the account was traded on a non-discretionary basis (April 8 to June 9, 1994), the account experienced three futures trades with losses over \$1,000, and two options trades with losses over \$1,000; and during the period in 1994 that the account was traded on a discretionary basis (June 10 to December 31, 1994), the account experienced six futures trades with losses over \$1,000, the largest a loss of \$4,690. Thus, Bachkosky knew from experience that it was possible to suffer large losses.

12. By letter dated February 2, 1995, AGE reminded the Bachkoskys that their account was discretionary and involved high-risk trading, and invited them to "comment on any aspect of our performance." The Bachkoskys did not reply. [Exhibit O to answer and ¶ 21 of answer.]

13. On February 12, 1995, Kass liquidated a short T-Bond position for a \$2,703 loss; and on February 23, 1995, Kass liquidated a short soybean position for a \$169 loss. The balance of trading activity in February was concentrated between February 24 and 28. These four trades were all profitable, and generated \$158 in commissions.

The February monthly account statement reported that, as of February 28, 1995, seven open futures positions had a total net unrealized loss of \$1,053.

14. On March 7, a Swissfranc-Deutschemerk spread trade realized a \$2,811 loss; and from March 10 to 20, a series of four trades realized an aggregate loss of over \$5,500. When Kass informed Bachkosky that he must deposit additional funds to meet the \$10,000 minimum to support a discretionary account, Bachkosky decided to revoke the power of attorney, and on March 22, 1995 faxed a written revocation. [Exhibit P to answer.] Bachkosky also gave Kass time and price discretion to liquidate the nine open positions in his account. [See ¶ 23 of answer.]^{6/} Kass

^{6/} In contrast to respondents' detailed description of events between mid-March and May 3, 1995 (see ¶¶ 23-25 of Answer), the Bachkoskys' assertions in their complaint were vague and unsubstantiated. By Notice dated July 9, 1995, the Bachkoskys were
(continued...)

liquidated one position on April 3, two on April 5, one on April 11, three on April 12, and two on May 3, 1995.^{7/} These liquidations realized an aggregate net loss of \$1,977. [¶ 8 of Bonnot affidavit, exhibit N to answer.]

15. Bachkosky expressly authorized one more trade: the sale of a July wheat contract on April 24, which was liquidated on May 1, 1995.

16. Throughout the life of the account, Bachkosky never complained about any losses or about the trading frequency and the resulting amount of the commissions.

On May 12, 1995, after the account was closed, Bachkosky faxed a letter to AGE in which he complained for the first time about Kass:

To make a long story short -- I closed my account last week when its value dropped to [below] \$1,000. My first indication of a problem came in March, then April, when I saw [a] precipitous losses. Never during this time did I receive any warning call from Bob [Kass] or your firm that things were heading south. when I would call about the "cash call" notices that I received, I was told not to worry, that they would be taken care of -- and they were.^{8/}

^{6/} (...continued)

asked to include in their final verified statement an affidavit that included a detailed description of their version of certain events described in the Answer, including the events between mid-March and May 3, 1995. However, the Bachkoskys did not file a final verified statement. Thus, the weight of the evidence supports respondents' version of these events.

^{7/} Three of these positions had been initiated in October 1994, one in November 1994, two in December 1995, one in February 1995 and two in early March 1995.

^{8/} The record contains no evidence of any margin calls, and neither side has addressed the "cash calls" mentioned in this letter.

. . . .

As I explained to Bob, I have been investing over 30 years -- including four very successful ventures into commodities. During this time, I never have had an experience such as this -- a combination of huge losses coupled with virtually no communication.

I am totally disappointed in Bob Kass, specifically, and AG Edwards, generally; and -- for being too trusting -- myself, personally. I am writing to suggest that you owe it to your clients -- and your reputation -- to be more vigilant, or to tell your clients to be more vigilant and less trusting.

[Emphasis added, Exhibit P to answer.] As can be seen, Bachkosky focussed here on the speed and severity of the losses that occurred between March 7 and April 14, 1995, and did not complain about any unauthorized trades or about the commissions.^{2/}

Conclusions

To prove churning, the Bachkoskys must show that: (1) Kass controlled the volume and frequency of trading; (2) the overall volume of trading was excessive, in light of the Bachkoskys' trading objectives, and (3) Kass acted with intent to defraud or in reckless disregard of the Bachkoskys' interests. *Hinch Commonwealth Financial Group, Inc.*, slip opinion at page 8 (CFTC May 13, 1997), citing *Johnson v. Don Charles & Company*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,986 (CFTC 1991). Here, the control element has been established by the

^{2/} As noted in finding 10, Kass made fifteen round-turn trades in March, and seven in April. In March, the Bachkoskys paid \$619 in commissions for futures trades and \$402 in commissions for options trades. In April, the Bachkoskys paid \$573 in commissions for futures trades. The Bachkoskys paid no commissions for options in April, but paid \$86 in commissions for an options trade on May 3, 1995.

discretionary authority agreement in effect from June 10, 1994 to March 21, 1995. As to determining whether Kass traded the account excessively for the purpose of generating commissions without regard for the Bachkoskys' trading objectives, the Commission has identified the following factors as relevant, non-exclusive factors:

(1) a high commission-to-equity ratio, (2) a high percentage of day trades, (3) the broker's departure from a previously agreed upon strategy, (4) trading in the account while undermargined, and (5) in-and-out trading.

Hinch, at pp. 10-11 citing *In re Paragon Futures Association*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,266 at 38,847 (CFTC 1992) and *In re Lincolnwood Commodities, Inc., of California*, [1984-1986 Transfer Binder] Comm. L. Rep. (CCH) ¶21,986 at 28,250 (CFTC 1984). Here, undermargined trading and in-and-out trading are absent, and the percentage of day trades and overnight trades significantly declined when Kass exercised discretionary trading authority. Most importantly, by failing to produce a detailed description of their investment objectives the Bachkoskys have obviously precluded an meaningful analysis of the trading activity in light of their objectives. Thus, the Bachkoskys have failed to establish an excessive level of trading and their churning claim must fail.

The Bachkoskys' failed to identify any specific trade which they alleged to be unauthorized, and at best claimed that the allegedly unauthorized trades occurred when Kass was principally

liquidating open positions. The inherent implausibility of the Bachkoskys' claim that Kass initiated nine positions with authority and then closed them without authority is underscored by the absence of any timely protest by Bachkosky when he received the confirmation statements for these purportedly unauthorized transactions and by the absence of any protest in his letter soon after the last trade. Thus, the Bachkoskys have failed to establish any unauthorized trades.

Finally, to the extent that Bachkoskys have raised the failure to supervise issue, the record supports the conclusion that A.G. Edwards had in place, and followed, an adequate system for supervising Kass's discretionary trading activity. [See ¶¶ 18 and 31 of answer.]

ORDER

No violations causing damages having been shown, the complaint in this matter is DISMISSED.

Dated June 23, 1997,


Philip V. McGuire,
Judgment Officer