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JOHN F. BERENTSON, Complainant v. PETER E. KLINGENSMITH, MARK VANSANDS MORRISON, and SPIKE TRADING, L.L.C., Respondents	CFTC Docket No. 98-R019

INITIAL DECISION

The following facts in this case, set out in the narrative portion of the complaint, are not disputed: Complainant desired to open an account that would be traded according to signals generated by the "R-MESA" S&P day-trading program developed by a firm that is not a party to this case, Mesa Software. Mesa referred complainant to Spike Trading, one of the firms authorized by Mesa to use its trading program. Complainant discussed the R-MESA program with a Spike spokesman and with another firm, and decided to open an account with Spike because it had eight other customers following the R-MESA trading system and the other firm had none. He leased the R-MESA program from Mesa Software for $600, opened an account at Spike with a $20,000 deposit, and entered into an agreement by which respondents Klingensmith and Morrison (Spike employees) would "enter trades for [complainant's] account in accordance with the trading signals generated by the system" (Attachment to Complaint, Letter of Direction, page 1). According to complainant, he desired to trade a single contract at a time.

Complainant asserted in the complaint that all trades entered under the R-MESA trading program were to be day trades and were to be placed with a simultaneous three-point (i.e., $1,500) stop-loss order (Complaint, page 2). That assertion was admitted by Spike (Spike Answer, ¶5), which answered separately from its former employees (*id.*, ¶7) and has since settled with complainant (Settlement Agreement and Release, dated April 3, 1998). Respondents Morrison and Klingensmith (the term "respondents" will refer solely to these two individuals in this Initial Decision), filed a joint answer, agreeing that the R-MESA trading program was a day-trade program (Joint Answer, ¶5). However, an email sent to complainant from a Mesa Software employee (the genuineness of which has not been challenged by respondents) attached to the complaint confirms complainant's contention that a three-point stop was required (John Ehlers email, dated August 19, 1997).

The dispute here occurred because on Friday, August 15, 1997, Spike placed complainant in one contract *without* the normal stop-loss order, and that contract was held over the weekend (Complaint, page 2; Joint Answer, ¶7). Respondents liquidated the position through a Globex order on August 18 (Complaint, page 2; Joint Answer, ¶8). The total loss suffered by complainant on the unprotected position was 25.25 points, or $12,625. Complainant seeks $11,632.69 in damages, representing the loss he suffered beyond the point where the trading program required his exit ($11,125), plus the value of his unused R-MESA lease, which he calculated to be $507.69 (Complaint, page 3). The parties agree that complainant's account did not have sufficient margin to continue trading the R-MESA system after this loss (Complaint, page 2; Joint Answer, ¶9).

Respondents concede that they failed to place the stop-loss order. Their defense is two-fold. According to respondents: (1) complainant's agreement with respondents by which they were to enter trades under the third-party trading program absolved them of any liability for failing to place trades (Joint Answer, ¶¶12-17); and, in the alternative, (2) "mere failure to enter a trade is not necessarily a violation of the Commodity Exchange Act" (Joint Answer, ¶¶19, 20, and 7). Respondents sought summary judgment in their favor based on these arguments, but the motion was denied by order dated July 23, 1998.

As to respondents' initial argument, that they were absolved in advance by complainant's agreement with them, that argument is based on a tortured interpretation of the contract. The provision cited by respondents (Letter of Direction, ¶10) provides as follows:

> 10. Neither Account Executive [previously identified on page 1 of the agreement as "Morrison/Klingensmith"] nor Spike shall have any liability of any kind whatsoever for entering and executing orders for my account in accordance with the trading signals generated by the system, and I shall never attempt to nor shall I hold either Account Executive or Spike liable for their respective actions or inactions in accordance with the trading signals generated by the system....

Respondents contend that the language means that complainant agreed--in advance--that respondents were under no obligation to actually take any actions in accordance with the trading signals.

Clearly, the provision in question simply protected the brokers from liability for following the trading program's signals when the program signaled *action* or *inaction* when hindsight might reveal that other choices might have been better for the customer. The agreement's purpose was to protect Spike and its employees from being held responsible for somehow supervising the wisdom of the trading program's signals (*see, e.g.*, ¶¶4, 5, 6, and 8). Respondents' argument is defeated by the actual wording of Paragraph 10, a wording entirely ignored by respondents that absolves respondents for liability for "inaction in accordance ***with*** the signals of the trading program." Respondents would interpret this phrase to mean "inaction ***not*** in accordance with the signals of the trading program," but that interpretation is patently specious.

With regard to respondents' second argument, their assertion that their conduct constituted mere negligence is unconvincing. Indeed, Commission precedent has taught for the better part of two decades that an account executive acts carelessly if he fails to discharge special obligations assumed on behalf of a customer. *See Avis v. Shearson Hayden Stone, Inc.*, [1980-1982 Transfer

Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,379 at pages 25,830-32 (CFTC April 13, 1982). Here, brokers who agreed to manage an account under strict trading guidelines, failed to place the trailing stop-loss order that was in integral part of the trading program. There is no assertion that respondents tried to place the order but were unable to do so, or any other evidence that would mitigate the level of respondents' misconduct.

However, there is no need to analyze the "scienter" issue because the actual violation here was not the failure to place the stop-loss order. It was the unauthorized act of placing an initial order without the required stop-loss order to accompany it, since the severely limited "Letter of Direction" gave respondents permission to place trades only "in accordance with the signals generated" by the R-MESA trading system. No unprotected order was generated by the trading system, and therefore the order was unauthorized. Under these circumstances, respondents violated Rule 166.2. (The violation was likely repeated with the Globex liquidation, since the R-MESA system did not generate any trade not to be executed during the CME day trading sessions.)

The measure of damages for unauthorized trading is the amount of actual loss caused by the unauthorized transaction. That amount, undisputed by respondents, was the $12,625 loss, plus commissions and fees of $20.27 (August 18, 1997 statement). Although complainant's petition for reparations sought only the difference between the loss he suffered and the amount he would have lost through a three-point stop, he did not authorize an unprotected position. Therefore it belonged to respondents and the entire loss is theirs. Subtracting the amount received by complainant from Spike in settlement, the proximate damages occasioned by the violation is $7,645.27, which is the amount of the reparation award to follow. Complainant's request for the unused portion of his software lease will not be awarded since he could have continued using that lease and any failure to receive the value of that contract was simply the result of his own decision to not deposit additonal funds to margin his ongoing trading.

Violations having been found, respondents Klingensmith and Morrison are ORDERED to pay reparations in the amount of $7,645.27, plus prejudgment interest compounded annually at the rate of 5.375% from August 18, 1997, to the date of payment, plus costs in the amount of $125.00. LIABILITY IS JOINT AND SEVERAL.

The complaint as to respondent Spike Trading is DISMISSED.

Complainant's request for losses associated with the unused portion of his lease is DENIED.

Dated: July 30, 1998

Joel R. Maillie

JOEL R. MAILLIE
Judgment Officer