



**U.S. COMMODITY FUTURES TRADING COMMISSION**

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581

OFFICE OF  
PROCEEDINGS

JUL 28 11 27 AM '98  
OFFICE OF PROCEEDINGS  
PROCEEDINGS CLERK

---

LAP CHING CHEUNG,  
Complainant,

v.

ALARON TRADING CORPORATION,  
CMB MANAGEMENT CORPORATION, and  
GRACE HSU,  
Respondents,

---

\*  
\*  
\*  
\*  
\* CFTC Docket No. 97-R154  
\*  
\*  
\*  
\*  
\*

**INITIAL DECISION**

Lap Ching Cheung alleges that two unauthorized futures trades – on May 12 and June 22, 1997 – were placed in his account by his CMB account executive, Grace Hsu.<sup>1</sup> Hsu and CMB failed to file answers, and by Default Order dated February 3, 1998 were found in default.<sup>2</sup> Alaron Trading Corporation, CMB's guarantor,<sup>3</sup> filed an answer in which it denied any direct violations by Alaron, asserted that it acted properly in accepting orders from CMB, and asserted that the hold-harmless clause in the customer agreement defeated the complaint.

---

<sup>1</sup> Hsu was a registered associated person and principal of CMB.

<sup>2</sup> The Default Order became a final order of the Commission on March 18, 1998, after Hsu and CMB failed to file a motion to vacate the Default Order.

<sup>3</sup> CMB was guaranteed by Alaron from April 28 to July 12, 1997. [NFA records.]

The findings and conclusions below are based on Cheung's complaint, reply to Alaron's answer (filed December 26, 1997), reply to the order dated February 3, 1998, and reply to the Order dated March 12, 1998; and on Alaron's answer and reply to the Order dated February 3, 1998. Both sides waived discovery<sup>4</sup> and filing final verified statements.

### ***Violations by Hsu and CMB***

Alaron has produced no reliable evidence rebutting Cheung's allegations that Hsu placed these trades in Cheung's account without authorization,<sup>5</sup> and has not disputed that the losses from the two disputed trades totaled \$6,690. Therefore, Cheung has established by a preponderance of the evidence that Hsu made unauthorized trades in violation of Sections 4b and 4d of the Commodity Exchange Act, that Cheung's violations proximately caused \$6,690 in damages, and that CMB is liable for Hsu's fraud pursuant to Section 2(a)(1)(A) of the Act.

### ***Alaron's Liability as Guarantor***

The express terms of the guarantee agreement, and the regulations upon which the agreement is based, clearly establish that Alaron's statutory obligation as CMB's guarantor is absolute and unconditioned. The exculpatory clause in Alaron's customer

---

<sup>4</sup> Alaron served discovery requests, but did not file a motion to compel Cheung's replies to those requests.

<sup>5</sup> Significantly, the evidence produced by Alaron indicates that Hsu committed similar fraud in connection with other CMB accounts. See tape recording produced February 5, 1998.

contract<sup>6</sup> controverts Alaron's voluntarily undertaken statutory obligation and for the reasons set out below is found be flatly inconsistent with the purpose of CFTC rule 1.10, and thus unenforceable.

Commission rule 1.10(j) sets forth the requirements for a guarantee agreement that may be used to satisfy the minimum financial requirements of an introducing broker ("IB") in CFTC rule 1.17(a)(2)(ii). 17 C.F.R. §§ 1.10(j), and 1.17(a)(2)(ii) (1997). When the Commission adopted rules permitting the use of a guarantee agreement as an alternative minimum capital mechanism for certain IBs to protect the customers of the IB, it stated that the "alternative adjusted net capital requirement embodied in the guarantee agreement is consistent with two of the factors upon which an adjusted net capital requirement for IBs should be based: (1) insuring that IBs are not judgment proof; and (2) providing coverage for potential liabilities of IBs arising from business operations and customer relations." Emphasis added; 48 Fed. Reg. 35248, 35264 (August 3, 1983).<sup>7</sup>

---

<sup>6</sup> Paragraph 33 of the customer agreement provides that: "Customer understands that [Alaron] is responsible for executing and confirming transactions effected for Customer's account; segregated funds . . . ; and margining Customer's account as well as mailing customer statements and reports of all transactions. [CMB] . . . is responsible for entering orders for Customer's account and risk; supervising sales practices; and collecting funds. . . . Customer agrees to indemnify and hold-[Alaron] harmless from all damages and or liability arising from conduct of [CMB]."

<sup>7</sup> Similarly, the National Futures Association recently amended its arbitration rules and its handbook for arbitrators, *Legal and Procedural Issues in NFA Arbitration*, to clarify the obligations of guarantor FCMs. The NFA revised its handbook to state that "[w]hen determining FCM liability for the actions of the FCM's guaranteed IBs, the arbitrators must resolve only two issues: (1) whether the alleged conduct of the guaranteed IB involved an obligation of the IB under the [Commodity Exchange] Act or any CFTC regulation; and (2) whether the conduct occurred while the agreement was in effect." The NFA also amended its arbitration rules to provide that a guarantor FCM may be suspended if its guaranteed IB fails to pay an arbitration award or honor a settlement agreement. Section 10(g) of the NFA Code of Arbitration.

The Commission emphatically and unambiguously reaffirmed this policy in *Paragon Futures* by stating that where a futures commission merchant enters into a guarantee agreement with an introducing broker, it shall be, at a minimum, jointly and severally liable for all violations by the introducing broker of the Commodity Exchange Act or CFTC rules. *In re Paragon Futures Association*, [1990-92 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,266, at 38,851 (CFTC 1992).<sup>8/</sup>

The Commission has not specifically addressed contractual waivers of significant statutory rights and remedies in the context of guarantee agreements. *See, e.g., Kline v. Atlantic Mercantile Group, Inc.*, Order Denying Review, slip opinion at p. 4 (CFTC docket no. 92-R119, August 20, 1993) (declining to take interlocutory review on the issue of such a waiver, but agreeing with ALJ that the "interplay between contractual and statutory rights is often 'subtle and difficult to assess.'") However, the Commission in *dicta* has signaled that it most likely disapproves of such waivers. *See Sansom Refining Co. v. Drexel Burnham Lambert, Inc.*, [1987-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,596 (CFTC 1990) (noting that no weight will be accorded contractual provisions that are contrary to the Commodity Exchange Act or CFTC rule); and *Volken v. Refco, Inc.*, [1987-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,509, at 36,188 n.2 (CFTC 1989) (citing with approval Judge Easterbrook's concurrence in *Cange v. Stotler and Co., Inc.* 826 F.2d 581, 596 (7th Cir. 1987) ("[p]rivate bargains are subject to attack if

---

<sup>8/</sup> Similarly, NFA Compliance Rule 2-9 imposes a direct duty on guarantor FCMs to supervise the activities of their guaranteed IBs. *See* NFA Interpretive Notices 9008 (November 7, 1988), and 9019 (October 6, 1992); *see also* NFA Compliance Rule 2-23 (imposing strict liability on guarantor FCMs for violations of NFA rules and requirements by their guaranteed IBs).

enforcement would do too much damage to the statutory system"). Here, the hold-harmless provision of Alaron's customer contact obviously would nullify the result in *Paragon Futures* by bargaining away a significant statutory remedy – that is, by barring customers from asserting legitimate claims against CMB or its guarantor Alaron – and is flatly inconsistent with the purpose of CFTC rule 1.10 and thus unenforceable.<sup>9/</sup>

### ORDER

Lap Ching Cheung has established by a preponderance of the evidence that Grace Hsu and CMB Capital Management Corporation placed unauthorized trades in Cheung's account in violation of Sections 4b and 4d of the Commodity Exchange Act and causing \$6,690 in damages, and that CMB Capital Management Corporation is liable for Hsu's violations pursuant to Section 2(a)(1)(A) of the Act. As CMB's guarantor, Alaron Trading Corporation is strictly liable for these violations, and is thus ORDERED to pay to Lap Ching Cheung reparations of \$6,690, plus interest on that amount at 5.375% compounded annually from May 22, 1997, to the date of payment, plus \$125 in costs for the filing fee.

Dated July 28, 1998.

  
Philip V. McGuire,  
Judgment Officer

---

<sup>9/</sup> Recent federal court decisions have voided exculpatory clauses in guarantor FCM customer contracts on the grounds that they are contrary to strong public policy. *Skipper v. Index Futures Group, Inc.*, 1995 WL 493435 (N.D. Ill. Aug. 15, 1995); and *First Commercial Financial Group, Inc. v. Baghdoian*, 812 F. Supp. 837 (N.D. Ill. 1993).