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GREGORY A. HARRIS,
Complainant

v.

CERES TRADING GROUP, INC.,
IOWA GRAIN COMPANY, and
JEREMY LEE SMITH,
Respondents

CFTC Docket
No. 01-R010

INITIAL DECISION ON SUMMARY DISPOSITION

Earlier this year, the parties were ordered to respond to several questions regarding the timeliness of the complaint since a preliminary review of the record suggested that "[b]oth the Complaint and the Answer in this matter tend to support the affirmative defense raised by respondents that the Complaint was filed beyond the two-year limitations period set out in Section 14 of the Commodity Exchange Act." Those questions, issued pursuant to Rule 12.207(c) and to be answered in detail, "with affidavits provided in support of any factual assertions made in these answers," were answered by both sides. (*See* Order to Produce and Order Staying Discovery.) A review of the answer submitted by the complainant, in conjunction with a review of the record as a whole, leads to the conclusion that summary disposition is appropriate and that the complaint here was filed out of time.

Section 14(a) of the Commodity Exchange Act, 7 U.S.C. § 18(a), provides that a person complaining of damages caused by a registrant's violations of the Act has two years to file a reparations complaint from the time that a "cause of action accrues." By long-standing CFTC interpretation, a cause of action "accrues" when a customer knows, or should know from the information available to him upon reasonable inquiry, facts sufficient to alert him to the general nature of the misconduct that has allegedly caused his losses, even if all the particulars are not known. *See, e.g., Martin v. Shearson Lehman Brothers/American Express*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. ¶ 23,354 (CFTC 1986).

The complaint in this matter was mailed on November 9, 2000. Thus, the question to be decided is whether the complainant's cause of action "arose" before November 9, 1998. Unless otherwise indicated, the following findings of fact are based on complainant's November 5, 2000 narrative attached to his complaint and to account statements attached to that narrative. No fact set out here is alleged by complainant to have been unknown to him at the time it happened. Amounts reflect rounding to the nearest dollar.

1. Complainant opened his account in February 1997 following discussions with respondent Smith, an associated person of respondent Ceres Trading Group, beginning in January 1997. He deposited $7,000 by check on February 20, 1997 and would deposit an additional $806 nine months later, on November 20, 1997.

2. As related in the complaint, Smith's "sales pitch" for the transactions included statements such as "Now is the time to get into the market" and "Don't miss out," as well as representations of how complainant could "make a substantial amount of money." Smith discussed how he expected to take complainant's account to twenty or thirty thousand dollars, and warned complainant that people could lose money "on indecision." Complainant contends that he informed Smith specifically about his desire to invest the money in a fashion that would do as well as his 401K plan since the money was part of a sum he had withdrawn from his 401K plan (he paid off bills with the rest). According to complainant, he informed Smith that he was going through a divorce, that half of the money he would be investing belonged to his wife, and that all profits would be going to his wife but he himself would "absorb any losses."

3. Trading began on February 27, when complainant purchased three July 1997 corn call options and established a partial spread in November 1997 soybeans (buying five 725-strike call options and selling ten 875-strike call options). Complainant's narrative states that he asked Smith to explain the statements he received showing these trades, including a margin request that Smith told him was taken care of, but he also claims that he never could understand the statements. The February 27, 1997 statement attached to the complaint includes a number of handwritten notations, including mathematical calculations, regarding the particulars of these transactions and definitions of several trading terms used on the statement.

4. An analysis of the statements and the margin requests attached to the complaint shows that during the first two months after the initial trades, complainant received several margin calls (stemming from the short side of his soybean option "spread") and that they were met by gradual sales of the corn call options (*see, e.g.,* February 27, 1997 margin call (with notation "Told to ignore. Had to sell 1 corn call to pay fore [sic] this request.") and March 6, 1997 statement; *and* March 31, 1997 margin call and April 7, 1997 statement). Eventually one corn call was left and it expired in June. At that point the complainant's account showed a net liquidation value of $1,930 and was in margin deficit by $723 (June 23, 1997 statement).

5. Several margin calls (all for $725) were issued on June 23, June 25, and June 30. On June 27, complainant bought back three of the 875 soybean calls he had sold, eliminating the margin deficit that day. On July 1 he again reduced his position (and eliminated the margin deficit) by repurchasing four more of the 875 calls he was short and simultaneously liquidated and sold two of the 725 calls he had bought. This day's transactions left him in a balanced spread position: he owned three calls at 725 strike price and had granted three at 875. At the end of the day, the account showed a net value of $352, with a cash balance barely more than $9.

6. No additional trading occurred until the spread options all expired worthless in the last week of October 1997. During that time, by the end of July complainant's cash balance remained at $9 but the net value of his option positions had risen to $1,875, and then it fell again to only $309 by August 29 and to a mere $47 by September 30. The evidence in the record does not reflect whether the option position ever rose during the interim to a value higher than that in July.

7. Despite the fact that complainant had lost his entire initial investment in the eight months of trading through October 1997, he purchased another soybean option on November 13, but this time he chose to take the opposite position from the bullish expectation evidenced by his earlier spread. Instead, he purchased a put option in the January 1998 futures contract with a 725 strike price. This transaction cost complainant $650 in premium and $161 in commissions. After exchange fees were imposed and the existing several dollar cash balance was applied to the purchase, the trade left complainant in a deficit of slightly over $805, which he met with a deposit of $806, leaving a cash balance of 72 cents. Complainant's narrative does not discuss this transaction.

8. The soybean put rose in value to over $1,280 within a week (*see* November 20, 1997 statement, also reflecting the deposit of $806). By the end of the month it had fallen but still showed a net overall profit and was worth $844. But it rose again and on December 12, complainant sold that put and received net proceeds of about $1,413, thus achieving a profit of almost $590.

9. The next trade occurred eleven days later, on December 23. On that date, complainant ventured into the heating oil market. According to his narrative, Smith told complainant that heating oil would "skyrocket" because of the expected "hard winter" and therefore complainant bought 2 March 1998 heating oil calls. This trade cost complainant a total of $1,422.32 (of which $322 represented commissions). By the end of the day, the two calls on heating oil had lost over 11% of their value.

10. The heating oil calls fell in value to $588 by the end of December 1997 and complainant sold them on January 27, 1988 for $432.

11. Within a week, this remaining sum was again tapped for trading. On February 4, complainant purchased a single call option in the July 1998 cotton futures contract. This option cost complainant $161 in commissions while the option was so far out of the money that the premium was a mere $275. In percentage terms, the commissions amounted to a sum equal to some 58.5 % of the premium, and more than 36 % of his total transaction once other fees are included. Put differently, complainant would have had to hope for the option to rise in value by more than 58 % just to break even. Complainant's narrative does not mention this cotton option.

12. For reasons unstated, the commission on the February 4 transaction was adjusted the following day by crediting complainant with $75. Even with the adjustment, complainant's option premium value would have had to rise by over 30 % before he could expect to break even.

13. Through the end of May 1998, the cotton call option appears from the month-end account statements attached to the complaint to have ranged in value between roughly one-half and two-thirds of complainant's premium when he bought it. The final trade in complainant's account occurred on June 2, 1998, when he sold that call option. After a commission adjustment the next day, complainant had approximately $151 in a cash balance that subsequently was returned to him by Iowa Grain (*see* signature page of complainant's November 5, 2000 narrative, and January 27, 1999 statement).

14. Overall, complainant deposited some $7,806 and lost $7,655 of that amount. He paid nearly $3,400 in total commissions. It appears that at no point was complainant's account profitable overall, and the only profitable position appears to have been the soybean put.

15. Complainant contends in his narrative that during the "18 months" he traded (actually barely more than 16) he was never able to understand the account statement sent to him. Eventually, he says, he lost not only the money he invested but also still had to pay $5,000 to his wife who was, it may be recalled, supposed to be the beneficiary of any profitable transactions. He claims he was "ripped off" by Smith because the actual account performance "was clearly not what Mr. Smith presented as potential earnings for my investment."

Discussion

Preliminarily, one contention made by respondents must be rejected emphatically. Respondents assert that the complaint is barred by a contractual one-year limitations period found in the customer agreement signed by complainant (Motion to Dismiss, at pp. 2-3; Answer at "Affirmative Defenses" Part A). The cases cited by respondents in support of their argument merely emphasize the importance of a *statute* of limitations, and do not stand for the proposition that a period shortened by contract is enforceable. Moreover, so far as the undersigned is aware, the Commission has never given any indication that the limitations period set by Congress in Section 14(a) of the Commodity Exchange Act is prospectively waivable by a customer seeking to avail himself of the reparations forum. Since respondents have the burden on this issue, their argument fails. The sole issue is whether respondents' alternate affirmative defense is correct, *i.e.*, whether the *statutory* limitations period bars the complaint.[1]

The detailed rendition of the trading above demonstrates that there can be no question but that complainant was fully exposed to all aspects of his account performance both long before he finished trading and well before the limitations "window" began in November 1998. As set forth previously, trading began in February 1997 and the funds invested then were entirely lost within a year. The trade occurring in cotton in February 1998 required an additional deposit of over

[1] Respondents also raise this contractual limitations period in their "Reply to Complainant's Answer" to the Rule 12.207(c) questions (*see* Reply at 2-3). Oddly, although the Order to Produce focused solely on the statute, respondents addressed the contract instead and mention Section 14(a) only as an afterthought. If the complaint had been filed beyond the contractual period but within the statutory period, respondents likely would find themselves without a valid timeliness defense.

$800. Although complainant contends that he could never understand the statements, he does not allege that he did not know he was wiped out – and not just once but twice. Moreover, his notations on the first trading statement – the most complicated of them all, since it involved two separate types of transactions in three different options, and included a sizeable unbalanced spread – suggest that he was aware of the transactions' particulars at the time.

Whether complainant knew or should have known facts sufficient to alert him to the possibility of wrongdoing depends on the wrongdoing alleged. Complainant's explanations for how Smith "ripped [him] off" include four potential Act violations: first, Smith's discussion of the possibility of doubling and tripling complainant's investment suggests the possibility that he fraudulently emphasized profits without a counterbalancing emphasis on risks; second, Smith's urgency to get complainant to invest quickly implicates concerns about whether that urgency dissuaded complainant from adequately considering disclosures about risks; third, Smith's choices of investment vehicles for complainant – including the unbalanced spread transaction – may have constituted trading without a reasonable basis; and finally, the combination of the overall level of commissions, the types of vehicles that were selected, and the fact that options were sold in a quantity sufficient to bring in substantial premiums that allowed a level of commissions disproportionate to the size of the account, suggest the possibility that the account was churned.

There is simply no possibility that complainant was blind, reasonably or unreasonably, to any of these four types of possible violations. As to the first two, they generally involve issues of fraudulent solicitation and improper risk disclosure. Any possible misrepresentations as to how the account would be profitable were clearly mooted when the account lost all its funds, and even allowing for difficulty in reading the statements, complainant had to know he was depositing additional money to fund the final purchase. Likewise, the account was open long enough for complainant to realize that acting quickly had not helped him – and the account traded enough different types of commodity options for him to be alerted to the fact that acting quickly in an alternate to his first purchase could not guarantee him success. The funds were not lost in the first hours or days – these values eroded over time, so any statements about how profitability would be enhanced by acting quickly were clearly lies. In addition, even if the complainant had no time to read the risk disclosures carefully when he began trading, the subsequent 19 months surely offered him sufficient time to read them and to realize he had rushed into his investment without a full understanding of the materials that would have alerted him. Finally in this regard, the fact that complainant invested an additional sum of $800 exactly nine months after making his first investment, *after losing his entire initial $7,000*, demonstrates that it was not a lack of awareness of the risks of investing that led complainant to part with his funds – he increased his stake long after losing his innocence and his naïveté must have evaporated.

The other two types of possible violations here can be characterized generally as potential trading violations: trading with no reasonable basis and trading to generate commissions. As with the solicitation allegations, any violations should have been apparent to complainant long before he closed his account and within two years thereafter. If the trades made no sense to complainant, he could have inquired. If the trades differed from his expectations, he was in possession of account statements that informed him of all trading particulars. If any statements given to him by Smith to support the trades were in fact untrue, complainant had ample time to research the true facts. If the trading generated commissions beyond his willingness to accept, or exposed him to risks of which he was not aware, he had many months in which to voice his discontent and to file a claim.

Most importantly, when asked in the Order to Produce why he waited so long to file his complaint, complainant has never stated that he was unaware of the fact that he was, as he put it, "ripped off." Instead, complainant has merely asserted that he did not understand the statements and that he did not know there was a limitations period for filing a complaint. In his Answer to the Order setting out the Rule 12.207(c) questions, complainant says he was told by a friend that he could file a complaint in reparations and thereafter (he gives no date) he obtained a reparations packet from the CFTC Office of Proceedings. His Answer then goes on to discuss his reasons for believing he was "swindled" during what he terms his "short trading experience," but he never suggests being unaware of the swindling when it was happening or soon enough to file a claim. Unfortunately for complainant, being unversed in a limitations period is unrelated to whether he knew within the limitations period that he had been wronged, and thus does not excuse taking no action whatsoever within the time set by Congress for seeking redress for such alleged wrongs.

For the reasons stated, the complaint in this matter is DISMISSED ON SUMMARY DISPOSITION.[2]

Dated: September 21, 2001

Joel R. Maillie

Joel R. Maillie
Judgment Officer

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[2] Complainant and respondents were specifically asked in the Order to Produce to address whether discovery or an oral hearing would be needed to make the determination as to whether the complaint was filed late. Complainant has suggested that tapes made by Smith could be helpful (especially to demonstrate his inexperience) and that there might be additional margin statements that he had discarded. He also suggested that evidence might exist showing that Smith was instructed to commit the alleged violations by supervisors. Finally, complainant stated that if an oral hearing were held witnesses could include Iowa Grain representatives and Smith's supervisor, although he admitted he had never had contact with any of these people.

These responses address only complainant's concern that there might be additional evidence demonstrating how badly he had been treated. They do not suggest that discovery or oral proceedings would materially assist in determining whether the complaint was filed out of time and, if so, whether complainant's untimeliness would be excusable. Accordingly, pursuant to Rule 12.207, it has been determined that Summary Disposition is appropriate because all necessary evidence is available on the parties' pleadings and replies to the Order to Produce.