

UNITED STATES OF AMERICA  
Before the  
COMMODITY FUTURES TRADING COMMISSION

Lorenz Hoff,  
Complainant,

v.

American Futures Group, Inc.,  
Respondent.

CFTC Docket No. 96-R133

FILED

AUG 26 9 14 AM '97

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Appearances:

Lorenz Hoff, pro se;

Gary Sinclair, Esq. for respondent.

Before:

PAINTER, Administrative Law Judge

INITIAL DECISION

Procedural History

Complainant Lorenz Hoff filed this complaint with the Commission on July 18, 1996, alleging that respondent American Futures Group, Inc., mishandled his account, causing a loss of \$33,793.60.<sup>1</sup> Respondent filed both an answer denying any wrongdoing and a counterclaim for \$35,000.

A hearing was held on March 24, 1997, in Washington, DC. Complainant and respondent have filed their post-hearing briefs, and this matter is ready for decision.

<sup>1</sup> Complainant Hoff initially alleged a loss of \$350,000, a figure which includes speculative lost profits. (Complaint 4) Hoff's true out-of-pocket losses are 46,500 deutsche marks ("DM") (Transcript 14), which converts to \$33,793.60 as of the date of his account's liquidation. Wall St. J., Aug. 2, 1995 at C1.

### Findings of Fact

1. In 1995, LORENZ HOFF ("Hoff"), a German citizen, formed an "investment club" with his brother and Mr. Blee, a friend. (Transcript ["T."] 5-6) These three partners have equal shares in the club. (Id.)
2. In April or May of 1995, Futures and Options ("F&O"), an introducing broker, contacted Mr. Blee and convinced him to invest in commodity futures. (T. 6) The club gave F&O power-of-attorney to trade on its behalf. (Id.)
3. AMERICAN FUTURES GROUP ("AFG") is a registered futures commission merchant ("FCM"). (NFA Registration Documents) In early May 1995, Hoff and his partners opened an account numbered 205-00068 [hereinafter "Account 068"] at AFG through F&O. They invested DM 7,500. (T. 5-6, 9)
4. On or around May 23, 1995, Hoff wrote a check to AFG for DM 50,000, intending that it be deposited into Account 068. (T. 7) AFG deposited the DM 50,000 into a second account numbered 205-00071 [hereinafter "Account 071"]. On or around May 26, 1995, after reading reports about the unreliability of F&O and commodity trading in general, Hoff and his partners canceled the DM 50,000 check sent to AFG. (T. 8-9) No one in the club notified AFG of the cancellation, and AFG credited the DM 50,000 check to Account 071 on May 30, 1995. (Joint Exhibit ["Ex."] 16)
5. Hoff testified that he did not intend to open a second account. (T. 7) However, Hoff executed account opening documents for Account 071 on May 25, 1995. (Ex. 1, 11)
6. After learning of the canceled check, F&O contacted Hoff and his partners, convinced them of its reliability, and successfully solicited an additional DM 39,000.<sup>2</sup> (T. 9) On June 6, 1995, Hoff submitted a DM 39,000 check which AFG deposited into Account 071. (T. 10) Hoff testified that he had intended that AFG deposit the DM 39,000 into Account 068. (T. 9-20) As of June 6, 1995, Hoff and his partners had invested DM 7,500 in Account 068 and DM 39,000 in Account 071.
7. On June 6, 1995, AFG's bank, the Frankfurter Sparkasse, received a return note indicating that Hoff had stopped his DM 50,000 check. (Translated Letter of Frankfurter Sparkasse to Mr. Hoff, dated August 21, 1995) That same day, the bank sent the

<sup>2</sup> F&O suggested that Hoff invest DM 39,000 because this sum, when added to the balance in Account 068, totaled DM 50,000. (T. 9)

return note to AFG by surface mail. (Translated Letter of Frankfurter Sparkasse to Mr. Hoff, dated October 13, 1995)

8. On June 9, 1995, AFG received Frankfurter Sparkasse's return note indicating that Hoff canceled the original DM 50,000 check. (Ex. 1) However, due to a clerical error, AFG never recorded the cancellation. (Ex. 1; Answer at 2) Trading continued as if there were a total investment of DM 89,000 in Account 071, not the actual amount of DM 39,000. (Ex. 16)

9. Hoff received his first account statement for Account 071 on or around June 7, 1995. (Ex. 16; T. 10) Hoff was aware on or around June 7, 1995, that AFG had credited the amount of his canceled check for DM 50,000 and his valid check for DM 39,000 to Account 071. (T. 8-10) Hoff made no complaint about the existence of the second account, and neither did he report to AFG that his canceled check had been credited to Account 071. (T. 8-10)

10. Account statements for Account 071 from June 7, 1995 to August 1, 1995, show that AFG failed to correct its records to show that Hoff's DM 50,000 check had been canceled. (Ex. 16) The record fails to show that this error was anything other than a bookkeeping error.

11. On July 17, 1995, Hoff signed papers granting AFG power-of-attorney to trade Account 071. (T. 11) At the time he granted this authority, Hoff knew that the account was erroneously credited with his canceled DM 50,000 check.

12. On July 19, 1995, AFG executed a large trade in yen. (Ex. 16) This was the first trade that went beyond the actual DM 39,000 investment in Account 071. (Ex. 16; T. 11)

13. On August 1, 1995, AFG contacted its bank regarding the canceled check.<sup>3</sup> (Translated Letter from Frankfurter Sparkasse to Mr. Hoff, dated October 13, 1995) Once again, Frankfurter Sparkasse mailed and faxed a copy of the return note on the check as well as a table of all returned checks at AFG. (Id.; Ex. 9)

14. The table of returned checks shows all canceled or dishonored checks. According to this table, Account 071 was in

<sup>3</sup> Although AFG stated that it contacted the bank on August 1, 1995, Frankfurter Sparkasse had no record of the date and believed AFG called on August 3, 1995. (Translated Letter from Frankfurter Sparkasse to Mr. Hoff, dated October 13, 1995) Because AFG liquidated Hoff's account on August 1, 1995, I find that AFG must have contacted Frankfurter Sparkasse on August 1, 1995. (See Findings of Fact 14, 15, *infra*)

deficit by DM 2,382.39 on August 1, 1995. Although there are two dates printed on this fax, I find that this table is credible evidence of the status of Account 071 on August 1, 1995. (Ex. 9)

15. On August 1, 1995, after receipt of Frankfurter Sparkasse's fax revealing Account 071's deficit, AFG liquidated all positions in Account 071. (Answer 2; Ex. 16)

16. Hoff testified that AFG never contacted him about liquidating his account. (T. 12) On or around August 3, 1995, F&O informed Hoff that his account was in deficit, and that AFG had contacted its bank regarding the canceled check. (T. 11) F&O suggested that Hoff cover the debit equity by depositing more money. (T. 11) Before Hoff could send a check, F&O called Hoff again to inform him that AFG had already liquidated all positions in his account. (Id.) Hoff testified that he would have invested additional funds to protect the positions. (T. 11-13) There is no probative evidence in the record to suggest that Hoff made any effort to re-establish his position in yen with AFG or any other brokerage service.

17. On August 2, 1995, AFG transferred the remaining funds in Account 068 to Account 071 to reduce the debit balance. (Ex. 16) As of September 29, 1995, Account 071 still had a debit balance of DM 5,146.08. (Ex. 16)

18. Hoff lost a total of DM 46,500: DM 7,500 in Account 068 and DM 39,000 in Account 071. (T. 13-14) On August 1, 1995, this amount converted to \$33,793.60. Wall St. J., Aug. 2, 1995 at C1.

19. The parties stipulated that trading in Account 071 generated commissions of DM 20,000 with a commission-to-equity ratio of 36% for the three-month life of the account. (T. 14) This figure is based upon the actual equity in the accounts, not the equity that AFG believed was in the accounts. It is apparent that trading on this scale was based on the misperception that Hoff had deposited DM 89,000 in Account 071 instead of DM 39,000.

## DISCUSSION

The issues that complainant Hoff raises stem from AFG's failure to record Hoff's cancellation of his DM 50,000 check. Hoff alleges that AFG's failure was a deliberate ploy to bleed his account, accumulate commissions, and liquidate the account to Hoff's detriment. (Complainant's Post-Hearing Brief ["CPHB"] at 5-6) To prevail in this matter, Hoff has the burden of proving by a preponderance of the evidence that he sustained monetary damages by reason of wrongdoing on the part of AFG.

To prove his allegation that AFG cheated him in violation of Section 4b of the Act, Hoff must demonstrate that AFG acted intentionally or with reckless disregard for its duties under the Act. Hammond v. Smith Barney, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617 at 36,659 (CFTC Mar. 1, 1990). A reckless action "departs so far from the standards of ordinary care that it is very difficult to believe the [actor] was not aware of what he was doing." CFTC v. American Metals Exchange Corp., 775 F. Supp. 767, 775 (D.N.J. 1991) (citing First Commodity Corp. v. CFTC, 676 F.2d 1, 7 (1st Cir. 1982)). "Negligence, mistake, or inadvertence" is not sufficient to satisfy this scienter requirement of Section 4b of the Act. Id.

There is some confusion surrounding Accounts 071 and 068, and Hoff has much to do with that confusion. On or about May 23, 1995, Hoff elected to invest an additional DM 50,000 in Account 071 at AFG. On May 26, 1995, Hoff changed his mind and, without notice to AFG, placed a stop on the check. Approximately one week later, Hoff decided to invest DM 39,000 which, along with the equity in Account 068, totaled DM 50,000, precisely the amount of the stopped check. It is indisputable that on July 17, 1995, the day he gave AFG power-of-attorney to trade his Account 071, Hoff knew that this account remained credited with the DM 50,000 check that he had canceled.

After July 17, 1995, AFG based its trading in the account on two unfortunate occurrences: (1) Hoff's deliberate failure to inform AFG of his cancellation of the DM 50,000 check, and (2) AFG's inadvertent error in not correcting its books. AFG never attempted to hide its error from Hoff--the error was recorded on the account statements for the life of the account. AFG placed itself at risk by this bookkeeping error and, in fact, AFG still has not recovered the deficit in Hoff's account. I find that AFG simply blundered. Hoff has failed to show by a preponderance of the evidence that AFG either intentionally or recklessly failed to correct its records to reflect cancellation of the DM 50,000 check.

Hoff must prove three elements to establish a churning claim: (1) AFG exercised control over Hoff's account; (2) AFG used this control to effect excessive trades for its profit; and (3) AFG acted in reckless disregard of Hoff's interests. In re Paragon Futures Ass., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266 at 38,847 (CFTC Apr. 1, 1992). It is indisputable that AFG had control over Hoff's account. However, Hoff has failed to set forth facts sufficient to prove that AFG used its control for the purpose of generating commissions, or that AFG acted in reckless disregard of Hoff's interests.

There are five factors which, in the absence of direct evidence, help determine whether a broker excessively traded a customer's account. DeAngelis v. Shearson/American Express, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,753 at 31,138 (CFTC Sept. 30, 1985). These factors are: (1) high commission-to-equity ratio; (2) high percentage of day trades; (3) the broker's departure from an agreed-upon strategy; (4) trading an account while it is undermargined; and (5) in-and-out trading. Id. at 31,138. In this case, Hoff has not proved the existence of any of these five factors.

A commission-to-equity ratio of 18% or more per month is deemed potentially excessive. In re Lincolnwood Commodities, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,986 (CFTC Jan. 31, 1984). Hoff and AFG stipulated to a 36% ratio which compared the total commissions and various fees over the three-month life of the accounts to the total actual investment in the accounts. However, throughout the life of these accounts, AFG traded the accounts based on its belief that Hoff had deposited DM 89,000 instead of DM 39,000. This misperception of the equity in Hoff's accounts undermines the reliability of the commission-to-equity ratio. Accordingly, this factor fails to help determine excessive trading.

Hoff also has failed to prove by a preponderance of the evidence that AFG executed any day trades, short-term trades, or in-and-out trades. Likewise, Hoff has offered no evidence that AFG departed from an agreed-upon trading strategy, or that AFG acted with reckless disregard of Hoff's trading interests. AFG entered a reasonable amount of trades based on its understanding of the equity amount. The weight of the evidence does not show that respondent AFG churned the accounts.

Hoff also argues that AFG wrongfully liquidated Account 071 and presumably Account 068. He suggests that AFG planned to liquidate Account 071 from its inception. (CPHB 6-8) Unless a complainant can prove bad faith on the part of an FCM, the FCM

has a right to liquidate a complainant's accounts based on its best business judgment. An FCM is not required to expose itself to risk by holding onto a complainant's positions in the market. Baker v. Edward D. Jones & Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,167 (CFTC Jan. 27, 1981).

Once again, there is no evidence that AFG acted in bad faith when it liquidated Account 071 or Account 068. Rather, the evidence reveals that AFG liquidated the positions in Account 071 only after discovering its clerical error and realizing that the account was in deficit. Because Account 071 was still in deficit after liquidation, AFG liquidated Account 068 to reduce that deficit.

#### COUNTERCLAIM

AFG seeks to recover not only the debit balance in the account, but the costs of defending itself in this proceeding. AFG hardly made reference to the debit balance during the course of this proceeding. AFG argues that despite its notice of the canceled check in early June 1995, Hoff is liable to AFG for AFG's failure to record the cancellation of the check. I find that AFG was in part responsible for the debit balance because it failed to correct its books to show Hoff's dishonored check, and thus AFG should not recover on its counterclaim.

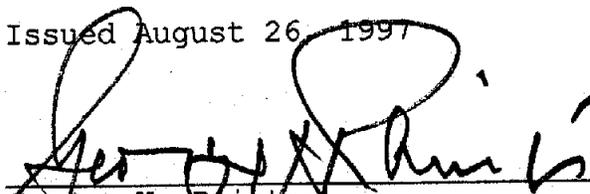
To receive attorneys' fees and costs, AFG must show that Hoff's behavior is frivolous, vexatious or in bad faith. Sherwood v. Madda Trading Co. et al., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,728 at 23,024-025 (CFTC Jan. 5, 1977). AFG has failed to show that Hoff acted in bad faith by initiating this proceeding.

ORDER

Complainant Hoff has failed to establish by the weight of the evidence that respondent AFG violated the Act or Commission Regulations. Accordingly, Hoff's claim is **DISMISSED WITH PREJUDICE**.

Respondent AFG has failed to establish by the weight of the evidence that complainant Hoff violated the Act or Commission Regulations, or engaged in bad faith, frivolous, or vexatious conduct by filing this complaint. Accordingly, AFG's counterclaim is **DISMISSED WITH PREJUDICE**.

Issued August 26, 1997



George H. Painter  
Administrative Law Judge

Attorney-Advisor:  
Elizabeth V. Parker