

UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION

John Hussain,
Complainant

v.

Saul Stone and Company, LLC
Respondent.

CFTC Docket No. 98-R153

Initial Decision

Appearances:

For the Complainant: John Hussain, *pro se*

For the Respondent: Gloria J. Mathews, Esq., of McDermott, Will & Emery

Before: Painter, ALJ

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Procedural History

On May 28, 1998 John Hussain, complainant, filed a hand-written complaint with the Commission citing "misrepresentation [and] non-disclosure." (Initial Filing, CFTC form 30). The next day, complainant filed supporting documents. (Complainant Ex. A). Following the resolution of deficiencies in these filings, the complaint was served on Saul Stone and Company, L.L.C ("SSC") on June 10, 1998.

Respondent SSC was granted leave to extend its time to answer. On June 30, 1998 SSC filed an answer praying to dismiss and expunge the claim, and filed a counterclaim for the final debit balance of Complainant's account in the amount of \$56,822.29, plus interest and fees. (Answer, 9). On August 4, 1998, the Office of Proceedings received SSC's notification and payment regarding its decision to proceed under the Commission's formal procedure. Ten days later the matter was assigned to this Court.

On August 17, 1999 the Court issued a Prehearing Order. Following discovery and unsuccessful settlement negotiations, a trial was held on December 16, 1998 in Washington, D.C. SSC filed a timely posthearing brief and the matter is now ready for decision.¹

Findings of Fact and Conclusions of Law

1. On or about March 20, 1998, complainant opened a self-directed Futures Direct Account, number 18590, at SSC. ("account"). Because of complainant's experience and sophistication, including various commodity and securities registrations, he was afforded certain privileges by SSC. Unlike the usual customer, complainant was granted direct telephone access to the trading floor. An account executive was not assigned to his account. (Tr. 9, 25-31, 41; Answer at 1).

2. On April 27, 1998 complainant purchased futures and options. The market moved against his position and the account fell to a debit balance of \$31,620.22.(Account statements; Answer at Exhibit 3; Tr. 97).

3. Complainant had an arrangement with SSC to receive a facsimile report on all of the previous day's transactions at or before 5:00 a.m. each day. (Tr. 44-46; Answer at Exhibit 3).

4. Complainant was well aware that the account was under margin before the open on April 28, 1998. He discussed the status of the account with Thompson, a risk manager for SSC. Complainant advised Thompson that he was unable to meet the margin requirement at that time, but he asked SSC not to require immediate liquidation. (Tr. 9-11, 46, 71-72; Respondent's Exhibit 5A). Thompson discussed the matter with his superior, who offered to permit the account to remain open provided the complainant agreed that SSC would keep the account

¹ At the hearing complainant was instructed to file a posthearing brief within 45 from his receipt of a transcript, or that if he did not wish to purchase a transcript the Court would establish a date certain in order to receive his brief. Despite a subsequent explicit Order, issued January 8, 1998, warning complainant that, absent extenuating circumstances, the Court would not consider complainant's posthearing brief unless it was filed on or before February 22, 1999, complainant did not file a posthearing brief. Complainant did file other motions in subsequent documents. Those motions are DENIED.

“delta neutral” until complainant met the margin call (of \$79,825.00) or satisfied the debit balance.²

5. Complainant agreed to the delta neutral strategy. The strategy required adjustments with market movements to ensure a limit on liability. Complainant could have refused to accept the strategy, in which case SSC would have immediately liquidated the account. (Tr. 72-73, Thompson).

6. Despite the use of a delta neutral strategy, the account continued to lose money. Complainant did not provide additional funds, and the last transaction on the account was executed on or about May 8, 1998, resulting in a debit balance of \$56,822.29.³ (Account statements filed with the initial complaint). SSC counter-claimed for the payment of this debit balance, plus costs and fees. (Answer 8).

7. The evidentiary record fails to show that SSC entered any unauthorized trades on complainant’s account. Complainant authorized SSC to place the account in delta neutral in lieu of immediate liquidation.

8. Contrary to complainant’s allegations the evidence fails to show that SSC at any time modified the terms of its customer agreement.

Discussion

To open the account at issue, complainant was required to sign a broadly worded customer agreement; in effect, SSC retained the right to increase margin requirements at any time deemed necessary “in its sole discretion.” In a separate customer acknowledgement Hussain further agreed to keep the account balance in excess of \$5,000. (Answer at Exhibit 2). Hussain signed the papers and SSC executed orders on Hussain’s behalf at Hussain’s direction.

² The term delta is defined as the change in option value divided by a one-unit change in futures price. Expressed in absolute terms, deltas represent a ratio between one and zero, where one is completely exercisable and zero is completely worthless. The Futures Industry Institute in its Futures and Options Course explains:

Both puts and calls have deltas. Because puts increase in value when the futures price goes down, the delta for a long put always goes down, the delta for a long put is always negative, ranging from 0 to -1. In contrast, the delta for a short put, which increases in value as the futures price rises, ranges from 0 to +1, the same as the delta for the long call position, that also increases in value as the futures price rises.

Futures and Options Course 54-55 (1995) (Futures Industry Institute). A delta neutral strategy usually involves keeping the sum of delta positions equal to zero.

³ Two out of the money puts expired worthless on May 15, 1998.

When the account lost money, and was actually in a negative balance, SSC contacted Hussain to request additional funds.

Hussain did not deposit additional funds. However, he requested that the account not be liquidated. Thompson, a risk manager with SSC, discussed the matter with his superior and it was agreed that the account would not be liquidated provided the account was kept in delta neutral until funds were deposited to eliminate the deficit or bring the account up to margin. Complainant knew at the time he agreed to the delta neutral strategy that market movements would require position changes. In self-serving letters written after the fact, Hussain argues that had SSC followed his advice, the account would have made money. Of course, had Hussain maintained proper margin, he could have traded the account as he pleased. Complainant could have ordered the immediate liquidation of the account at any time; this he did not do. The market continued to move against the account, and it was properly liquidated.⁴

Complainant's contract modification and/or estoppel claims rest on the substance of conversations he held on April 28, 1998 with Thompson, a risk manager with SSC. (Tr. 99). Regarding these conversations, Thompson testified that the two spoke before the market opened, and that he explained to Hussain that "to limit the risk and stop the margin call from growing that Mr. Soman [the Chief Operating Officer at SSC] had determined that it would be best to create a delta neutral position in the account." (Tr. 73). He further testified that he told Hussain six purchases would be made in the account and that Mr. Hussain stated "okay." (Tr. 73).

A detrimental reliance argument based on the substance of the April 29th phone conversation, if it is being propounded, fails. The discussions between Hussain and Thompson were within the context of the fact that SSC had full authority to close an under margined account. Hussain was aware at all times that he could liquidate his account and limit future losses. Representations by Thompson did not fraudulently induce Hussain leave the account open and incur additional risk. Hussain knew the account was in deficit and subject to liquidation. He sought to keep the account open by adopting the delta neutral strategy that SSC made available to him. (Tr. 9, 11, 73, Thompson; Respondent's Exhibit 4D). SSC informed

⁴ When, as in the case at bar, an account falls into a debit balance, a FCM: "is free to exercise its power to demand the deposit of additional funds by its customer and to liquidate an account without hesitation if the demand is not met." Baker v. Edward D. Jones & Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,167 at 24,772 (CFTC Jan. 21, 1981).

Hussain that it would adopt a delta neutral position in order to allow him time to keep the account open. In accepting these terms Hussain granted SSC discretion to maintain the account in delta neutral. The record does not show that SSC abused that discretion. In short, complainant Hussain has not established any *prima facie* case. His claims for relief are DENIED.

Respondent filed a counter-claim for the debit balance on the account. Hussain alone is responsible for the losses incurred, and he is indebted to SSC for the full amount of the debit balance of \$56,822.29.

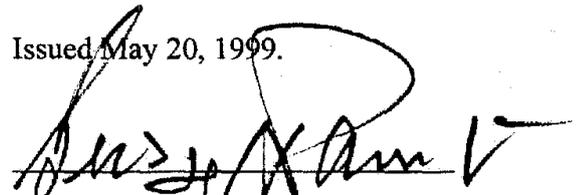
In addition to the debit balance, SSC seeks to recover costs and reasonable attorneys' fees. In effect, SSC takes the position that this Court must enforce the customer agreement against complainant. This Court does not concur with that view. *See, Pal v. Refco, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,274 (CFTC, ALJ April 6, 1998) (discussing attorney fees and, more generally, the enforceability of private contracts, under the Commodity Exchange Act). As the evidence fails to show that complainant acted in bad faith, the request for costs and attorney fees is DENIED.

ORDER

Complainant has failed to establish by a preponderance of the evidence that he sustained monetary damages by reason of unlawful conduct on the part of the respondent. The complaint is DISMISSED WITH PREJUDICE.

Respondent SSC has established by the weight of the evidence that complainant is responsible for the losses on the account in question. Complainant Hussain is ORDERED to pay SSC the sum of \$56,822.29 plus interest at 4.27% per annum from May 15, 1998 to the date the award is paid.

Issued May 20, 1999.



George H. Painter, ALJ