U.S. COMMODITY FUTURES TRADING COMMISSION



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

OFFICE OF PROCEEDINGS

William Control of

ZEINAB KHALIL, and A. ELBENDARY, Complainants,

v.

CFTC Docket No. 96-R51

INDEX FUTURES GROUP, INC., Respondent.

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INITIAL DECISION

Zeinab Khalil claims that respondent Index Futures Group failed to disclose that she could not be long and short in the same contract in the same expiration month, and failed to disclose that Index would offset simultaneous long and short positions of the identical futures contract on a first-in first-out ("FIFO") basis. 1/ Khalil also claims that Index improperly liquidated her open positions to meet a margin call, and seeks to recover \$25,586. Index denies any violations and counterclaims for a \$522.91 debit balance.

½/ CFTC rule 1.46(a) requires a futures commission merchant to offset simultaneous long and short positions of the identical futures contract in any non-omnibus account ("long-and-short rule"); and CFTC rule 1.46(b) requires that these trades be offset on a first-in first out ("FIFO") basis. The Chicago Mercantile Exchange similarly prohibits clearing member firms from holding concurrent long and short positions in the same commodity and month for a single account or accounts under common control. Special Executive Report, S-580, April 1979, amended February 1979. The purpose of the long-and-short rule is to prevent a customer from artificially increasing open interest in the market.

Factual Findings

- 1. Zeinab Khalil is a retired professor who taught graduate level courses in finance, business management, organizational behavior and human resources. Khalil has a Bachelor of Sciences two Masters degrees and a Ph.D degree in these fields. Before opening her account with Index Futures, Khalil had 10 years experience trading securities and 3 years experience trading commodities. [See pages 4-7 of hearing transcript.]
- 2. On June 23, 1995, Khalil opened a non-discretionary account (number 34846) at Jack Carl Futures ("Jack Carl"), a discount brokerage division of Index Futures Group, Incorporated ("Index"). On June 28, 1995, Khalil opened a second non-discretionary account with her son, A. Elbendary (number 35165).
- 3. For both accounts, Khalil signed the various accountopening forms, including the customer agreement. [The accountopening forms for the first account were produced as Exhibit A to
 the answer, and the account-opening forms for the second (joint)
 account were produced as Exhibit B to the answer.] Paragraph 1 of
 the customer agreement provided that Index would process each order
 in accordance with applicable law, regulation and rule:

All transactions executed under this Agreement for the Accounts shall be governed by the applicable laws and rules enacted by the exchange and clearing organization, if any, where such transactions are executed, by the applicable self-regulatory organization and by applicable federal and state law and regulations.

Paragraph 4 of the customer agreement set out the standard margin call requirements and provided, in pertinent part, that:

Customer shall make deposits of margin or collateral as

[Index] requests within a reasonable time after such a request. In the absence of unusual circumstances, and in accordance with industry standards and practices, one (1) hour shall be deemed a reasonable; however, [Index] reserves the right to request that deposits be made on shorter notice at its sole discretion.

Paragraph 5 of the customer agreement gave Index the power to unilaterally liquidate open positions to meet unsatisfied margin call, providing, in pertinent part, that:

[Index] may at any time, in it's sole discretion and without notice to the Customer, liquidate any position in the Customer's account . . . in order to satisfy a margin deficiency. . . .

[Exhibits A and B to answer.]

- 4. On August 2, 1995, Khalil offset a short September Swiss Franc futures position by placing an order to buy the same number of September Swiss Franc futures. Between August 2 and August 9, 1995, she would make a total of ten similar trades in both accounts. [See August 1995 monthly account statements, produced by Khalil on February 29, 1996.]
- At the open on August 11, 1995, Khalil was long four 5. September Mid-Am Swiss Franc futures contracts each $account.\frac{2}{}$ That day, Khalil placed an order to sell one September Mid-Am Swiss Franc futures contract in each account. According to Khalil she placed this order, not with the intention to liquidate one long position in each account, but rather to hold one short position in each account to "protect" the four long positions on each account which she wanted to maintain.

^{2/} In the joint account, Khalil was also long one September Deutschemark future and short four September Canadian Dollar call options.

Khalil failed to provide any special instructions or otherwise to inform the order desk of her unusual intentions.

Khalil could not identify a single representation by Index that she could be long and short in the same contract in the account; and could not identify a single instance where the firms carrying her previous accounts had permitted her to be long and short in the same contract in the account. Not surprisingly, Khalil also could not explain how being out of the market, rather than being long and short the same time, had resulted in a different financial outcome. [See pages 11-18, 44-45, 55-59, and 72-73 of hearing transcript.]

- 6. On August 14, after Khalil received the account statements for August 11, she called Index to protest the liquidations. Patrick Pinkerton and David Nicholai informed Khalil that CFTC and exchange rules required Index to offset simultaneous long and short positions of the identical futures contract in any non-omnibus account, and that such trades must be offset on a first-in first-out ("FIFO") basis, absent instructions from the customer to the contrary. After Index refused her request for a correction or an adjustment, Khalil then instructed Index to do nothing while she decided whether or not to transfer the account to another desk or another firm.
- 7. On August 15, both accounts became undermargined. After unsuccessfully attempting to contact Khalil by phone, Index liquidated both accounts, which resulted in a \$522.91 debit balance in the joint account. [See pages 60-64 and 74-75 of hearing

transcript.]

Conclusions

Khalil has failed to produce a scintilla of evidence in support of any of the alleged violations or in defense to Index's counterclaim. Khalil has produced no evidence that Index was under an affirmative duty to disclose each and every applicable law and rule before accepting an order, especially a facially routine buy order. Admittedly, Index was in a principal-agent relationship with Khalil and thus necessarily stood in a fiduciary relationship with her. As fiduciary, Index was bound to handle Khalil's orders in good faith and with special care, as well as to disclose material information, whether or not Khalil asked for it. 3/

The determination of whether certain information is material turns on an objective test. In this case, the issue is whether the information not disclosed would have significantly altered the total mix of information available to a reasonable trader in Khalil's position. In other words, is it substantially likely that specific knowledge of the long-and-short rule would have been important to a reasonable trader's decision to place a simple buy order, where that trader had previously placed numerous identical or similar orders without her broker's advice, where those orders had resulted in routine offsets, and where she had been silent on her specific trading strategy? Since the materiality test is essentially objective, Khalil's subjective beliefs are relevant but

 $[\]frac{3}{}$ See Grist v. Shearson Lehman Brothers, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,962 (CFTC 1990).

not dispositive. 4/ Nothing in the facts and circumstances of this case supports the conclusion that a broker must orally disclose the long-and-short rule to a customer who directs her own trading without the advice of the broker. As long as that broker provides written confirmation of the trade and is available to give oral confirmation on request by the customer, the broker has adequately discharged his fiduciary duty.

Furthermore, the record indicates that Khalil left respondents in the dark on her mistaken assumption that she could hedge by being simultaneously long and short in the same contract. Khalil's reticence prevented respondents from discovering her mistaken — and patently illogical — assumption, which denied them the opportunity to correct her ignorance of well-established industry practice and to assist her in implementing a legitimate hedge. Thus, Khalil's conduct, and not respondents', proximately caused her losses.

Khalil's previous trading experience, where she never attempted (or was allowed) to be long and short in the same contract at the same time, underscores the absurdity of her expectation that Index specifically had to disclose the long-and short rule before accepting a simple buy order. Finally, Khalil has failed to show that Index acted unreasonably in connection with

⁴/ See Grist supra; Madel v. Anspacher & Associates, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,412 (CFTC 1989); and Sudol v. Shearson Loeb Rhoades, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,748 (CFTC 1985).

 $[\]frac{5}{}$ See Avis v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,379 (CFTC 1982).

the account liquidation. In these circumstances, Khalil's complaint and defense to the counterclaim must fail.

ORDER

No violations having been shown, the complaint in this matter is DISMISSED. Zeinab Khalil and A. Eldenberry are ORDERED to satisfy the debit balance in their joint account by paying to Index Futures Group, Incorporated a reparation award in the amount of \$522.91, plus interest on that amount at 5.65%, compounded annually from August 15, 1995, to the date of payment. Complainants' liability is joint and several.

Dated July 16, 1997.

Philip V. McGuire Judgment Officer