U.S. COMMODITY FUTURES TRADING COMMISSION



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

OFFICE OF PROCEEDINGS

PROCEEDINGS CLERK

SHAWN KOHAN, Complainant,

٧.

CFTC Docket No. 00-R050

ADM INVESTOR SERVICES, INC., XPRESSTRADE, L.L.C., and DANIEL EUGENE O'NEIL, Respondents.

INITIAL DECISION

Introduction

This case arises from respondents' liquidation of an under-margined Nasdaq 100 futures position on October 29, 1999, which resulted in a loss of \$6,000. Shawn Kohan and his wife, Linda Kohan, had separate non-discretionary accounts with ADM, which were both traded by Shawn Kohan and both funded from the Kohans' joint bank account. Shawn Kohan had attempted to meet the margin call in his account by e-mailing, before the open, two requests to transfer funds from his wife's account. However, soon after the open but before Linda Kohan had faxed her signed authorization for the transfer, respondents liquidated the Nasdaq position because it had dropped below respondents' "critical" 35 percent margin limit.

Two months before the disputed liquidation, on August 31, 1999, respondents had attempted to restrict ever-increasing transfers of funds between the

two accounts. Kohan does not dispute that he agreed that future inter-account transfers would be limited to margin calls. However, Kohan disputes respondents' contention that they also advised him that, since he was not the owner of Linda Kohan's account, they could not credit his account until they had received, via fax, Linda Kohan's signed authorization to transfer funds from her account. Kohan claims that since he assured respondents that Linda Kohan was aware of each interaccount transfer request and would provide her written approval, they agreed that they would promptly credit his account upon receipt of his e-mailed request, without waiting for Linda Kohan's signed authorization. Kohan claims that he "religiously" only requested inter-account transfers to meet margin calls, and that respondents "routinely" credited his account before receiving Linda Kohan's signed authorization by fax. In contrast, respondents claim that they "strictly" processed Kohan's inter-account transfer request only to meet margin calls and only after Linda had provided her written authorization.

As discussed below, the weight of the evidence does <u>not</u> support Kohan's contentions that he "religiously" requested inter-account transfers only to meet margin calls, or that respondents "routinely" credited his account before receiving Linda Kohan's signed authorization. The weight of the evidence also does <u>not</u> support respondents' contention that they "strictly" limited inter-account transfers to margin call situations. However, and most significantly, the weight of the evidence <u>does</u> support respondents' contention that they never credited Shawn Kohan's account without receipt of Linda Kohan's signed authorization.

As to the disputed liquidation on Friday, October 29, 1999, respondents had e-mailed two margin calls for Shawn Kohan's account - the first after the market close on October 28, and the second at the market open on October 29. In response, Kohan had e-mailed a series of requests, ostensibly by Linda Kohan, to transfer funds from her account to his account to meet the margin call: the first after the market close on October 28; the second before the market open on October 29; and the third well after the market open and well after the liquidation. Also, before the market open, Kohan had cancelled a market order to liquidate the Nasdag position. Because Kohan had e-mailed his inter-account transfer requests to an e-mail address designed to accommodate requests to disburse funds from a customer's trading account to the customer's outside banking account, respondents' e-mail system automatically generated a boilerplate confirmation that stated: "Your funds request will be processed as soon as possible." Each of Kohan's requests also stated that "a fax request will follow;" that is, that Linda Kohan would be faxing a signed authorization for the transfer. However, Linda Kohan would not fax her signed authorization until three hours after the market open. Thus, when the position had deteriorated below the 35 percent "critical" level, just half an hour after the open, respondents liquidated Kohan's position. Soon after respondents had received Linda Kohan's authorization and credited his account, the market would rebound, and Shawn Kohan could have re-established his position at the same, or better, before the close on October 29. But Kohan chose not to re-institute a short position.

Shawn Kohan seeks to recover \$6,000 on the theory that respondents "carelessly and irresponsibly" liquidated the under-margined position by disregarding Kohan's assurances that his wife's signed authorization for the interaccount transfer was forthcoming and by representing that the interaccount transfer requests would "be processed as soon as possible." In reply, respondents assert that they acted reasonably when they required the receipt of a signed authorization as a condition precedent to the transfer of Linda Kohan's segregated funds, and that they acted in good faith when they liquidated the under-margined position after Kohan had failed to take the necessary steps to satisfy the margin call. Respondents further assert that Kohan is not entitled to an award because he failed to re-establish the liquidated futures contract at the same, or better, price on October 29, after his account had been credited.

The findings and conclusions below are based on the parties' documentary submissions. After carefully reviewing the record, for the reasons set out below, it has been concluded that the weight of the evidence does not establish any violations causing damages, and thus that Kohan is not entitled to any award.

Unless otherwise noted, dates are in 1999; times are Central Standard Time; amounts are rounded to the nearest dollar; and references are to Shawn Kohan because he was the primary actor.

Factual Findings

The parties

- 1. Shawn Kohan ("Kohan"), and his wife Linda Kohan, are residents of Citrus Heights, California. At the relevant time, Shawn Kohan was employed by Pacific Bell as an account manager; and Linda Kohan was employed part-time by the Bank of America as a banking manager. On his account application, Kohan represented that his investment experience consisted of "paper trading" with Auditrade, and that he had an annual income of \$110,000, a net worth of \$510,000, and \$100,000 in available risk capital. Shawn Kohan placed all the trades for both accounts. On her account application, Linda Kohan represented that her investment experience also consisted of "paper trading" with Auditrade for five months, and that she had an annual income of \$86,000, a net worth of \$380,000, and \$95,000 in available risk capital. Linda Kohan had no communications with respondents, with the exception of seven signed authorizations to transfer funds from her account to Shawn Kohan's account. [See account-opening documents (produced by respondents on November 9, 2000); ¶¶ I, 2a, 2g, 2h and 2l of Shawn Kohan's statement (dated November 6, 2000).]
- 2. ADM Investor Services, Incorporated ("ADM"), is a registered futures commission merchant ("FCM"), with its principal place of business in Chicago, Illinois. Xpresstrade, L.L.C. is a registered introducing broker guaranteed by ADM, also with its principal place of business in Chicago, Illinois.

Xpresstrade's principal business is the operation of an Internet-based brokerage, which offers discounted commission rates to self-directed traders. [First paragraph of O'Neil's affidavit (dated November 21, 2000); and page one of answer.]

Daniel Eugene O'Neil, a registered floor broker and associated person with ADM and Xpresstrade, was the risk manager for Xpresstrade at the relevant time. [Page 2 of answer.] Chuck Padgurskis was the Xpresstrade customer service representative who was responsible for approving money transfer requests at the relevant time. [First paragraph of O'Neil's affidavit (dated November 21, 2000).]

Shawn and Linda Kohan open separate accounts

3. Shawn Kohan maintained his non-discretionary, self-directed, account with ADM and Xpresstrade (account number B3283) from September 9, 1998, to November 2, 1999; and Linda Kohan maintained her non-discretionary, self-directed, account (number B3657) from January 15 to November 3, 1999. The Kohans funded both accounts from their joint bank account.

According to Linda Kohan:

I decided to open my account and trade on my own. [My husband and I] did not always agree on how the market would go and often I would think it would go one way and my husband would think it was going the other way. So, for those times, I wanted to be able to make my own decision to go the way I felt would be profitable to supplement my part-time job.

[¶¶ 3a-3b of Linda Kohan's statement (dated November 6, 2000); see accountopening documents.] However, Linda Kohan's explanation is belied by the manner in which the Kohans actually used the accounts. First, out of the approximately 85 round-turn trades during the life of her account, Linda Kohan could only identify three trades where she went "one way" and her husband the "other way." [¶ 2a of Linda Kohan's statement (dated November 24, 2000).] For the last of these three trades – *i.e.*, the disputed trade – Shawn Kohan represented that <u>he</u> had decided to simultaneously go long in her account and go short in his account, in the same contract. [See footnote 5.] Second, Kohan placed all of the trades for both of the accounts. Third, for extended periods of time Kohan exclusively traded in one account. For example, from April 10 to July 18, Kohan exclusively traded in Linda Kohan's account; and from August 5 to September 9, he exclusively traded in his account. Fourth, as described in more detail in the findings below, after mid-July, the number of trades significantly declined in both accounts, and simultaneously the number of transactions moving funds between, into, and out of, both accounts significantly increased, with the bulk of the deposits into Linda Kohan's account, and the bulk of the inter-account transfers from her account to Shawn Kohan's account.

4. Kohan signed an ADM "Electronic Order Entry Services Agreement," under which he agreed to maintain adequate margin as determined at the "sole discretion" of ADM, and agreed that one hour would be a reasonable time to meet any margin calls. [See account-opening documents.]

Trading activity

5. Shawn Kohan placed the trades for both accounts via the Internet without the assistance of a broker. Kohan used his work e-mail address ("sxkohan@pacbell.com") and his home e-mail address ("shawnkohan@jps.net").

Kohan closely monitored both accounts, and was aware "at any given time, day or night" of matters such as market prices, the account balance, pending margin calls, and the status of positions and of orders, because Xpresstrade provided one-minute delayed streaming charts, as well as real-time quotes. [¶ 2k of Shawn Kohan's statement (dated November 6, 2000); see sixth paragraph of O'Neil's affidavit (dated November 9, 2000).]

- 6. In early May, Daniel Eugene O'Neil, the risk manager for Xpresstrade, discovered that Kohan had been placing trades for his wife's account, without her express written permission, and instructed Shawn and Linda Kohan to execute the power of attorney. As a result, on May 3, 1999, Shawn and Linda Kohan signed a "Trading Authorization Limited to Purchases and Sales of Commodities" which authorized Kohan to trade for his wife's account. The terms of the power of attorney did not authorize Shawn Kohan to remove funds from Linda Kohan's account. [Exhibit to addendum to complaint (filed March 18, 2000); see second and fifth paragraphs of O'Neil e-mail, sent November 1, at 1:57 p.m.]¹
- 7. The trading activity in both accounts can be divided into four distinct phases: the first, from September 17, 1998 to January 22, 1999, when only Shawn Kohan's account was open; the second, from January 26 to April 9, when Kohan actively traded in both accounts; the third, from April 14 to July 13, when Kohan exclusively traded in Linda Kohan's account; and the fourth, from July 19 to November 3, when Kohan traded mostly in his own account, and dramatically

¹ The various e-mails between the parties have been collectively produced by Kohan as exhibits to the complaint, and by respondents on November 9, 2000.

increased the number of deposits (mostly into Linda Kohan's account) and interaccount fund transfers (mostly from Linda Kohan's account). [See monthly account statements (produced by respondents on November 9 and 16, 2000).] ²

During the first trading phase, from September 17, 1998, to January 22, 1999, Kohan actively and profitably traded a variety of futures contracts.

During the second phase, from January 26 to April 9, 1999, Kohan made 31 trades in Linda Kohan's account, and 15 trades in his account. The Kohans made no inter-account funds transfers during this phase.

During the third phase, from April 14 to July 13, Kohan exclusively traded in Linda Kohan's account, making 38 trades. The Kohans made no inter-account funds transfers during this phase.

During the fourth phase, from July 14 to the close of the accounts on November 3, Kohan resumed trading in both accounts, with most of the trading volume in his account. However, the overall trading frequency in both accounts significantly decreased, while the frequency of deposits, withdrawals and interaccount funds transfers dramatically increased. As a result, between July 14 and October 29, Kohan made almost as many inter-account transfers, withdrawals and deposits (28), as he did trades (32). [See monthly account statements; and "Account History" summaries for both accounts (produced by respondents on November 16, 2000).]

²Kohan's trading in both accounts would realize an overall net loss of about \$9,920.

Inter-account transfers

8. Set out below is a summary of the movement of funds into, out of, and between the two accounts from July 14 to November 3:

Date	Amount	Fund transaction
July 14	\$ 4,100	transfer from B3657 (Linda) to B3283 (Shawn)
July 26	1,000	disburse from B3657 (Linda)
July 28	2,000	disburse from B3283 (Shawn)
July 30	500	transfer from B3657 (Linda) to B3283 (Shawn)
Aug. 3	500	transfer from B3283 (Shawn) to B3657 (Linda)
Aug. 11	900	transfer from B3657 (Linda) to B3283 (Shawn)
Aug. 13	500	transfer from B3657 (Linda) to B3283 (Shawn)
Aug. 17	500	disburse from B3283 (Shawn)
Aug. 18	500	disburse from B3657 (Linda)
Aug. 19	550	transfer from B3657 (Linda) to B3283 (Shawn)
Aug. 25	400	transfer from B3657 (Linda) to B3283 (Shawn)
Aug. 25	460	transfer from B3657 (Linda) to B3283 (Shawn)
Aug. 31	900	transfer from B3283 (Shawn) to B3657 (Linda)
Sep. 1	450	transfer from B3657 (Linda) to B3283 (Shawn)
Sep. 7	400	transfer from B3657 (Linda) to B3283 (Shawn)
Sep. 7	400	disburse from B3283 (Shawn)
Sep. 8	1,400	transfer from B3657 (Linda) to B3283 (Shawn)
Sep. 9	3,200	deposit to B3657 (Linda)
Sep. 10	2,500	deposit to B3657 (Linda)
Sep. 16	11,000	deposit to B3657 (Linda)
Sep. 23	11,800	deposit to B3657 (Linda)
Sep. 23	9,887	transfer from B3657 (Linda) to B3283 (Shawn)
Sep. 29	7,900	transfer from B3657 (Linda) to B3283 (Shawn)
Oct. 13	3,000	transfer from B3283 (Shawn) to B3657 (Linda)
Oct. 14	9,000	transfer from B3283 (Shawn) to B3657 (Linda)
Oct. 18	6,000	transfer from B3283 (Shawn) to B3657 (Linda)
Oct. 22	8,500	transfer from B3657 (Linda) to B3283 (Shawn)
Oct. 29	15,500	transfer from B3657 (Linda) to B3283 (Shawn)
Nov. 2	2,000	deposit to B3657 (Linda)
Nov. 2	17,850	disburse from B3283 (Shawn)
Nov. 3	16,747	disburse from B3657 (Linda)

From July 14 to November 3, the Kohan's made no deposits into Shawn Kohan's account, but deposited a total of \$30,500 into Linda Kohan's account; the Kohans transferred a net \$28,547 from her account to Shawn Kohan's account (\$50,947 total transferred from her account to his account, and \$22,400 total transferred from his account to her account); and the Kohans withdrew \$18,197 from her account and \$20,750 from his account (including the final withdrawals at the closing of the accounts). [See monthly account statements.]

Of the thirteen transfers from Linda Kohan's account to Shawn Kohan's account — on July 14 and 30; August 11, 13, 19 and 25; September 1, 7, 8, 23 and 29; and October 22 and 29 — only four transfers — on September 1 and 8, and October 22 and 29 — have been conclusively established as relating to a margin call. [See second and third paragraphs of Padgurski's affidavit (dated November 9, 2000); O'Neil e-mail sent August 31, at 8:20 a.m.; e-mail exchange on September 7; Kohan's reply to paragraph 2b of order dated October 26, 2000; and equity runs (produced by respondents on March 27, 2001).]⁴

As to the six transfers before August 31, when respondents restricted interaccount transfers to margin-call situations, Padgurski's statement to Kohan on August 25 that he could see "no substantial reason" for the transfers suggests that those transfers were not being used to meet margin calls. For example, the transfer

³ From September 9 to 29, when the Kohan's deposited \$28,500 into Linda Kohan's account, and transferred \$17,500 from her account to his account, both accounts were inactive.

⁴ Neither side produced a copy of any e-mail or fax correspondence relating to the transfers in July and August, and on September 1, 7 and 8, and October 22. See Kohan's reply to ¶¶ 2b and 2d of Order dated October 26, 2000; Kohan's reply to ¶¶ 1 of Order dated November 17, 2000; and respondents' reply to ¶¶ 2d and 2e of Order dated October 26, 2000.

of \$500 to Shawn Kohan's account on Friday August 13, was followed by a disbursal of that same amount from his account on Tuesday August 17. [Padgurski e-mail, sent August 25, at 6:47 a.m.; see first paragraph of Padgurski's affidavit (dated November 9, 2000); and first paragraph of O'Neil's affidavit (dated November 9, 2000).]

As to the seven transfers after August 31, the record establishes that the transfers from Linda Kohan's account on October 22 and 29 were to meet a margin call. The record also establishes that the transfers on September 23 and 29 were made when Shawn Kohan's account was dormant, and thus clearly do not relate to margin calls. [See September monthly account statements; Padgurski e-mail, sent September 27, at 8:38 a.m.; and October 21 and 22 equity runs.]

Kohan has produced no reliable evidence contradicting respondents' assertion that Kohan "adhered to the [Xpresstrade] policy" from September 1 to 23, *i.e.*, on September 1, 7, 8 and 23. [Fifth paragraph of O'Neil's affidavit (dated November 21, 2000.] However, the circumstances around two of these transfers — on September 7, when Kohan simultaneously transferred \$400 from Linda's account to his account and withdrew the same amount from his account; and on September 23, when his account had no open position — shows that Xpresstrade did permit inter-account transfers when no margin calls were pending, apparently as an accommodation to Kohan. Nonetheless, the fact that respondents explicitly rejected an inter-account transfer request on September 27 to meet a margin call because Linda Kohan had not provided her written authorization supports the conclusion

that, after August 31, respondents consistently required Linda Kohan's written authorization before crediting Shawn Kohan's account. [See finding 12, below.]

9. For each request to transfer funds between accounts, Kohan e-mailed the request to respondents' e-mail address which was designed for requests to disburse funds from a customer's trading account to the customer's outside banking account. As a result, each time, respondents' e-mail system automatically generated a boilerplate reply that stated, in pertinent part:

Your funds request will be processed as soon as possible. . . . If you are requesting a wire transfer and we do not have your wire instructions on file, we need your bank name, address & account number and your ABA routing number.

[See, e.g., September 7 and 23 e-mails.]

- 10. On August 25, Padgurski e-mailed Kohan that Xpresstrade viewed Kohan's recent inter-account transfers as a "source of concern" because they were "excessive" and apparently "unjustified." Padgurski indicated that the e-mail had been prompted by Kohan pestering Xpresstrade with phone calls to confirm the transfers. Thus, Padgurski explained how quickly Xpresstrade would typically process inter-account transfer requests, and asked Kohan to refrain from calling to confirm transfers and otherwise to "bear in mind [Xpresstrade's] concerns" set out in the e-mail. [Padgurski e-mail, sent August 25, at 6:47 a.m.; see first paragraph of Padgurski's affidavit (dated November 9, 2000).]
 - 11. On August 31, 1999, O'Neil sent the following e-mail to Kohan:

Please telephone me immediately, Sir. I have been hearing about your internal transfers for several weeks, and I would like to discuss this matter with you. We shall process your request today, since account 3283 is on margin call. However, in the absence of margin

12. As noted above, no problems arose in connection with the inter-account transfers on September 1, 7, 9 and 23.

However, on September 27, Kohan sent an e-mail requesting a transfer from Linda Kohan's account, without her signed authorization and when no margin call was pending. As a result, Padgurski e-mailed Kohan that he would not process the request:

At 8:38 a.m. you wrote:

DEAR XPRESSTRADE:

PLEASE TRANSFER \$7900 FROM MY ACCT 3575 TO ACCT #3283 (SHAWN KOHAN) THANK YOU LINDA KOHAN

Dear Mr. and Mrs. Kohan:

This notice is to inform you that I will not process the above request. You have been warned repeatedly that we will no longer process these <u>unsubstantiated internal transfer requests</u>, yet you keep sending them.

Given your transaction histories, the only reason we would process any transfer request between B3657 and B3283 would be to satisfy a <u>margin call</u>.

If you would like funds disbursed to your bank accounts of record, we would be happy to process such request.

[Underlining added for emphasis; capitalization and abbreviations in original, (exhibit J to complaint); see third and fourth paragraph's of Padgurski's affidavit (dated November 9, 2000); first through third paragraphs of O'Neil's affidavit (dated November 9, 2000); and page 2 of answer.]

Later that day, O'Neil and Padgurski assert, they reminded Kohan that they would not process any inter-account transfer until they had received Linda Kohan's

signed authorization. Subsequently, Linda Kohan faxed her signed authorization, and Xpresstrade transferred the funds on September 29. [See second page of factual description to complaint; and ¶ 2g of Shawn Kohan's statement (dated November 6, 2000).]

The disputed trade

13. In mid-October, Kohan decided to go long in Linda Kohan's account and go short in his account in the identical contract. However, he did not enter the orders simultaneously. On October 11, Kohan sold for his account one December Nasdaq 100 index future, at 259.800. This is the contract that is the subject of the disputed liquidation. Then on October 12, Kohan bought for Linda Kohan's account one December Nasdaq 100 index future, at 261.100. As a result of this asynchronous entry, Kohan effectively locked in a \$1,300 net loss: *i.e.*, from October 12 to 27, the negative liquidating value of the long "leg" in Linda Kohan's account always exceeded the profitable liquidating value of the short "leg' in Shawn Kohan's account by \$1,300. However, in the end, Kohan would not simultaneously liquidate, and would realize a total loss of \$11,100 on both legs. ⁵

14. From October 12 to 19, the Nasdaq declined, and then on October 20, the Nasdaq reversed. At this point, Kohan became aware that his two-legged two-

.

⁵ On November 1, after O'Neil had informed Kohan that the Kohans had violated exchange rules by simultaneously going long and short in the same contract, Kohan would explain his strategy: "[The simultaneous long and short] is part of a trading system to take a position that I feel market is going to go first and then put a stop on the other account so that if the market goes against me it would leave me with a gap, and wait for the market to favor my original position and then get out of my second position." [Kohan e-mail sent November 1, at 4:20 p.m.; see O'Neil e-mail sent November 1, at 1:57 p.m.] Kohan has not alleged that respondents should have detected and warned him of the violation at an earlier date.

account strategy would require that he closely monitor and quickly react to market gyrations, principally by moving large sums of money back and forth to maintain adequate margin in both accounts. On October 13, 14, 18 and 19, Kohan made four transfers totaling \$21,000 to meet margin calls in Linda Kohan's account. Then on October 20, when the market rebounded, Kohan transferred \$8,500 from Linda Kohan's account to meet a margin call in his account. At the close on October 27, Shawn Kohan's account had \$3,555 in excess margin, and Linda Kohan's account had \$1,378 in excess margin. Although this left Kohan very little operating room in either account, he did not deposit additional funds into either account. [See equity runs.]

15. On Thursday, October 28, the stock market rose dramatically, with the December Nasdaq opening at 250.500, and closing at 256.200. As a result, the short leg in Shawn Kohan's account substantially deteriorated (from a liquidating value of over \$21,000 on October 19, to a liquidating value of just under \$4,000); and the long leg in Linda Kohan's account substantially improved (from a negative liquidating value of over \$22,000 on October 19, to a negative liquidating value of just over \$5,000). Nonetheless, the long leg was liquidated when the market temporarily dipped and hit a trailing stop order, which resulted in a loss of \$5,100.6 Next, Kohan chose to buck the market, and neither immediately re-instituted the long leg, nor immediately liquidated the short leg which continued to worsen.

⁶ Kohan had unsuccessfully attempted to cancel the stop order in fast market conditions. See Kohan e-mail, sent November 1, at 2:53 p.m.

16. At the close on October 28, respondents e-mailed a \$4,700 margin call to Kohan. In response, at 9:14 p.m., Kohan e-mailed to Xpresstrade's Customer Service department a request to transfer \$8,000 from Linda Kohan's account to his account to meet the margin call. The e-mail concluded: "Thank you Linda Kohan . . . I'll be sending you this request by fax [Friday] morning." Kohan has not offered an explanation for why Linda Kohan could not have faxed her authorization before she left work in the evening of October 28 — by which time Shawn Kohan already knew both that her account was dormant and held a cash balance over \$20,000, and that his account was cash-strapped with an unhedged and deteriorating position.

Also, during the evening of October 28, Kohan placed a market order to liquidate the short position, which he would cancel before the market open the next day. Kohan has also not offered an explanation for why he placed, and then cancelled, this market order, at the same time that he was sending e-mail requests to transfer funds from Linda Kohan's account to meet the margin call. [See Kohan e-mail sent October 29, at 1:06 p.m.]

17. At 7:10 a.m., on Friday, October 29, Kohan e-mailed a second request to transfer an additional \$5,000 from Linda Kohan's account. The e-mail similarly concluded: "Thank you Linda Kohan. I'll be faxing you this request as well." At about 7:30 a.m., Kohan spoke with Padgurski about the trade in his wife's account the day before. Kohan asserts that neither he nor Padgurski mentioned the pending margin call. Otherwise, neither side has described this conversation. Also, Kohan has not offered a reason why he did not mention the margin call. [See third page of

factual description to complaint; and ¶3b of Shawn Kohan's statement (dated November 24, 2000).]

At 9:00 a.m., Xpresstrade's Customer service department simultaneously e-mailed two standard — and by now familiar to Kohan — boiler-plate responses that acknowledged receipt of Kohan's first two requests, and that stated "Your funds request will be processed as soon as possible."

At the market open, the liquidating value of Kohan's position fell to 50 percent of the initial margin requirement, and respondents e-mailed a second margin call.

At 9:07 a.m., the liquidating value fell below 35 percent of the initial margin requirement, and Xpresstrade liquidated the position, at 265.800. At 9:30 a.m., Xpresstrade e-mailed notice of the liquidation, well before Mrs. Kohan would fax her signed authorization at 11:00 a.m. [See ¶¶ 10-12 of O'Neil's affidavit (dated November 21, 2000); third paragraph of O'Neil e-mail sent November 1, at 11:57 a.m.; fourth paragraph of O'Neil e-mail sent November 1, at 4:00 p.m.; and second and third paragraphs of O'Neil e-mail sent November 2, at 8:11 a.m.]

Meanwhile, at 9:47 a.m., Kohan e-mailed a third request to transfer an additional \$2,500 — for a total request of \$15,500 — from Linda Kohan's account to his account. The e-mail similarly concluded: "A fax request will follow. Thank you Linda Kohan."

At 11:00 a.m., Linda Kohan arrived at work and faxed her signed authorization to transfer \$15,500 from her account. [See ¶¶ 2l and 2m of Shawn

Kohan's statement (dated November 6, 2000); and ¶¶ 3g and 3h of Linda Kohan's statement (dated November 6, 2000).]

18. Also on October 29, Kohan made a Nasdaq day trade in Linda Kohan's account, realizing a \$3,900 profit.

The aftermath

19. As to the liquidated short position, on Friday, October 29, Kohan could have re-entered the market at the liquidation price, or better, from 10:54 a.m. to 12:13 p.m., and 2:01 to 2:31 p.m. [See CME time and sales report (produced by respondents November 9, 2000).]

Kohan chose not to re-enter the market that day, for a variety of implausible reasons. According to Kohan, he did not re-enter on October 29 because he considered the fact that respondents had not credited his account before receipt of Linda Kohan's signed authorization or had not telephoned Linda Kohan to be "a grave failure to follow a simple request;" and, as a result, his "trust in [respondents'] ability and good faith [was] in question." Kohan also claimed that did "not really know the market prices on October 29." [¶ n Shawn Kohan's statement (dated November 24, 2000).] However, the fact that as recently as September 27 respondents had rejected an inter-account transfer without Linda Kohan's signed authorization precludes finding that Kohan could have reasonably construed it to be a "grave failure " for respondents not to credit his account on October 29 before receipt of her authorization. Moreover, Kohan's assertion that he did not sufficiently trust respondents to re-enter the market on October 29 is belied by the fact that he

made a trade that day in Linda Kohan's account, the fact that before noon that day respondents had credited his account for \$15,500, and the fact that on November 2, he would deposit an additional \$2,000 into Linda Kohan's account. Finally, Kohan's assertion that he was not aware of market prices was undermined by the fact that he had access to real time quotes, that he had traded the Nasdaq that day in Linda Kohan's account, and that he had exclusively and actively traded Nasdaq index futures throughout October.

- 20. Meanwhile, at 1:06 p.m., Kohan sent an e-mail to Padgurski in which he represented that he believed that the short position had been liquidated because his order to cancel the market order had not been accepted. Kohan did not mention the two margin calls or the three requests to transfer funds to his account. At 2:46 p.m., Padgurski e-mailed an explanation that the cancellation order had been "upheld," but that respondents had entered their own market order to liquidate the position because it had become severely under-margined.
- 21. The e-mail exchange continued through Monday, November 1, and Tuesday, November 2. The e-mails by both sides were, in places, strident in tone and inartfully worded. For example, Kohan exasperated respondents when he blithely declared "[W]hether [I] wire you funds from my bank to cover a [margin] or have my wife transfer funds [I] do not see the difference," and then remarkably claimed that he had "religiously" complied with their restrictions on inter-account transfer requests. [Kohan e-mail, sent November 1, at 2:20 p.m.] Similarly, O'Neil confounded Kohan when he repeatedly stated "We were not aware of any outstanding transfer requests." However, a careful reading shows that while this

particular phrase may have been awkward and off-putting, it did not effectively obscure O'Neil's intended message, which was that it was Kohan's failure to provide promptly Linda Kohan's signed authorization that had precluded Xpresstrade from crediting his account, and thus had compelled Xpresstrade to liquidate the severely under-margined position. First, by e-mail sent at 1:57 p.m., on November 1, O'Neil explained:

When you began to transfer funds back and forth between your account and that of your wife, I demanded that you begin to fax such requests to us and that each request be signed by the owner of the account from which the funds were to transferred. . . . I do not understand how, at the critical moment on Friday October 29 your wife and you failed to make the needed request, and all of a sudden without warning, you expected Xpresstrade to automatically make the transfer on your behalf.

Then, at 8:11 the next morning, O'Neil reiterated:

You knew our policy well, Mr. Kohan, which was that we would only transfer funds with a signed authorization in hand from the owner of the account. The policy was in place because of your excessive, suspicious transfers in the past, which appeared to us here to be completely without justification and illegitimate. You knew the policy, you didn't abide by it on Friday, and your account was liquidated.

[See Kohan e-mail sent November 1, at 11:22 a.m.; O'Neil e-mail sent November 1, at 1:57 p.m.; Kohan e-mail sent November 1, at 2:20 p.m.; Kohan e-mail sent November 1, at 3:57 p.m.; O'Neil e-mail sent November 1, at 4:00 p.m.; O'Neil e-mail sent November 1, at 5:20 p.m.; and O'Neil e-mail sent November 2, at 8:11 a.m.]

22. Kohan also had opportunities to re-enter the market, at the liquidation price, or better, on Monday, November 1, when the December Nasdaq traded between 263.40 and 268.20, and on Tuesday, November 2, when the December

Nasdaq traded between 262.70 and 268.30. In any event, after November 2, the Nasdaq rallied, and the December Nasdaq steadily rose, hitting a high of 333.80 on December 16. Thus, even if respondents had not liquidated Kohan's short Nasdaq position, or if Kohan had re-initiated the short position on October 29, or November 1 or 2, he would have realized much larger losses. [See price history of December 1999 IMM Nasdaq 100 index future (generated from CME data base by CFTC Division of Economic Analysis and produced at the request of the undersigned, and attached as Appendix).]

Conclusions

Section 4d of the Commodity Exchange Act imposes the duty on an FCM to protect and safeguard its customer's segregated funds to which it is entrusted. Thus, an FCM must treat and deal with the customer's money as belonging to the customer. See Lee v. Lind-Waldock & Co., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,173 at 50,159 (CFTC 2000); and Slone v. Dean Witter Reynolds, Inc., [1994-96 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,283 at 42,433 (CFTC 1995). Consistent with this duty, once respondents had detected the unauthorized inter-account transfers, they informed Kohan that they would not remove funds from Linda Kohan's account until the owner of that account, Linda Kohan, had provided her authorization. The weight of the evidence shows that although respondents had accommodated Kohan by permitting inter-account transfers in non-margin call situations, respondents had consistently conditioned the transfer of funds from Linda Kohan's account on receipt of her written authorization.

Under Section 4d, an FCM must also follow a customer's instructions regarding the customer's money and property. However, when a customer fails to meet a margin call, the FCM's "duty to protect the financial position of its other customers and its right to protect its own financial position supercedes any duties it owes to the defaulting customer." Lee, supra. In these circumstances, an FCM may make a "good-faith business judgement" about the necessary steps to protect its financial interests, including forced liquidation of the defaulting customer's account. Baker v. Edward D. Jones & Co., [1980-82 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,167 at 24,772 (CFTC 1981). Here, where respondents had issued two margin calls on Kohan's rapidly deteriorating Nasdaq contract, and Kohan had not promptly taken the necessary steps to provide the required funds, respondents were free to liquidate the account without taking any additional steps, as long as they had not misrepresented their margin policy. In this connection, Kohan argues that he reasonably expected respondents to credit his account because he had assured them that Linda Kohan's authorization was forthcoming and respondents' e-mail had acknowledged that his request would "be processed as soon as possible."⁷ However, this argument must fail in light of the fact that the e-mail reply was obviously just a boiler-plate confirmation and the fact that respondents had consistently demanded Linda Kohan's signed authorization before crediting Shawn Kohan's account. The record makes clear that it was principally a series of

⁷ Kohan argues that respondents sent him "two e-mails confirming that the transfers were going to take place and leading us to believe that everything was being handled by them. In the meantime putting an order on the acct. to liquidate my position. This is a clear case of willful negligence and lack of responsibility." [Fourth page of factual description to complaint.]

decisions by Kohan that triggered the forced liquidation and resulting loss: It was Kohan who chose not to purchase a fax machine for his home so that Linda Kohan could promptly fax her written authorization during trading hours in Chicago; who selected the dubious two-account wash-trading strategy; who, after the long leg had been liquidated on October 28, held the deteriorating short leg without immediately adding more funds to his account; and who did not mention the transfer request during the phone conversation with respondents before the market open on October 29. Finally, even if Kohan had somehow shown that respondents had recklessly liquidated his position, he could not have shown any damages proximately caused by such a violation because his losses would have been much greater if he had remained in the market. In these circumstances, Kohan is not entitled to any award.

ORDER

Shawn Kohan has failed to show any violations by respondents.

Accordingly, the complaint in this matter is DISMISSED.

Dated April 11, 2001.

Philip V. McGuire, Judgment Officer