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MAJORIE A. MINOR, Complainant, v. ALARON TRADING GROUP, and TIMOTHY CHARLES HANNAGAN, Respondents.	*	CFTC Docket No. 99-R098

INITIAL DECISION

Minor seeks to recover the $25,568 that she lost in her discretionary account with Alaron. Minor's principal allegation is that respondents determined that Minor was unsuitable to trade futures and options when they provided a supplemental risk disclosure statement that stated that in light of her lack of futures trading experience, "futures/options trading might be too risky of a strategy." In contrast, respondents assert that they routinely provided the additional risk disclosure to novice traders and that they never determined that Minor was unsuitable to trade commodity options or futures. Minor also claims that Hannagan fraudulently convinced her to give him discretionary trading authority, that Hannagan fraudulently convinced her to invest additional funds from a home equity loan, from her brother and from a securities account after she attempted to close the account, and that Hannagan generally encouraged Minor to follow an "inappropriate, imprudent" trading

strategy. Respondents deny these alleged violations. The findings and conclusions below are based on the parties' documentary submissions and oral testimony, and reflect the determination that Minor's recollection of conversations with Hannagan was simply too spotty, vague and unconvincing to support her allegations of fraud and fiduciary violations. In contrast, although Hannagan conceded that he could not recall each conversation in detail, to the extent that he could recall his dealings with Minor his testimony was generally plausible and convincing. Therefore, for the reasons set out below, it has been concluded that Minor has failed to establish any violations by respondents.

Factual Findings

Background

1. Marjorie A. Minor, a resident of Wauwatosa, Wisconsin, is a registered massage therapist who owns and operates Aquarian Bodywork. Minor has a Bachelors degree in comparative literature from the University of Wisconsin-Milwaukee. On her account application, signed May 15, 1998, Minor indicated that she was 53 years old and self-employed as a message therapist, that she had traded stocks and stock options for three years and traded options on futures for three years, and that her annual income was between $50,000 and $100,000. Minor's testimony indicates that she is intelligent and well-spoken. At the hearing, Minor disclosed for the first time in this proceeding that sometime in 1997 or 1998 an optometrist who specialized in learning disabilities had diagnosed that Minor "had trouble processing material verbally." [Emphasis added; pages 158-159 of hearing transcript.] However, Minor has produced no supporting evidence concerning this disability, and more

importantly has produced no evidence that Hannagan knew about, or took advantage of this disability. [See pages 126-128, 131-140, 158-163 of hearing transcript.]

2. Lynn Smith, Minor's boyfriend, advised Minor to open the Alaron account, helped her fill out the account-opening documents, and had discretionary trading authority for Minor's Alaron account until March 17, 1997, when Minor and Smith broke up. Smith had traded for his own Alaron account before Minor opened her account. Smith's principal contact at Alaron for both accounts was Timothy Hannagan. [See pages 30-31, and 171-173 of hearing transcript.] Neither side called Smith as a witness.

3. Alaron Trading Group is a registered futures commission merchant located in Chicago, Illinois. Timothy Charles Hannagan has been a registered associated person with Alaron since June 1995, and has been a registered associated person since 1983.

The account-opening

4. In April of 1996, Smith convinced Minor to open an account with Alaron and to give him discretionary trading authority account. According to Minor, she wanted "to supplement her income and put something aside for retirement." [Page 161 of transcript.] All that Minor could recall about Smith's trading strategy was that he told her that he would use a similar, but "less aggressive," version of the strategy that he was using in his own account. [Pages 173-175 of transcript.]

On April 15,1996, Minor signed and executed the following Alaron account-opening documents: a customer contract;[1] an acknowledgement that she had read and understood a

[1] Paragraph 5 of the customer contract provided that the customer would reimbursement Alaron's attorneys fees and expenses if Alaron prevailed in a lawsuit, but did not provide for recovery by the customer in the event that the customer prevailed.

standard futures risk disclosure statement and options risk disclosure statement; and a third-party controller statement and limited power of attorney that gave discretionary trading authority to Lynn Smith.

According to Alaron, although Minor indicated on the account application that she had traded options on futures, it determined to provide an "additional risk disclosure" because she also indicated that she had never traded futures, which involve potentially greater financial exposure than options. Hannagan credibly asserted that, on April 19, 1996, he read the additional risk disclosure to Minor over the phone. Minor does not recall this conversation. According to Hannagan, he recited verbatim a written additional disclosure statement which stated in pertinent part:

> In light of the financial and/or personal information provided by you on your account opening application, it might be interpreted that:
>
> (1) The amount of funds you have committed . . . might be overly substantial in relation to your annual income and/or net worth.
>
> (2) Based on your personal information and investment experience (or apparent lack thereof), futures/options trading might be too risky of a strategy.
>
> Based on these criteria, Alaron is providing you with the following Additional Risk Disclosure Information.
>
> Futures and Options trading is generally considered to be a risky form of investment. If you have pursued conservative forms of investment in the past, you may wish to study futures and options further before considering an investment. You must realize that you can sustain a total loss of all funds . . . .
>
> We ask that you acknowledge, by your signature below, that the funds you have committed are purely risk capital, and that such investment will not jeopardize your style of living, nor will it detract from your future retirement program. . . .

[Exhibit 2 to answer, boldface in original deleted; *see* pages 6-31, 43-53,118-122,129-131, and 173-181 of hearing transcript.]

Trading by Smith (May 1996 through March 1997)

5. Smith traded Minor's account from May 8, 1996 to March 10, 1997.[2] During this time, Smith spoke daily and extensively with Hannagan. As a result, Hannagan was quite familiar with Smith's trading strategy. [*See* pages 74-78,106-107, 114-116,140-142, and 163-166 of hearing transcript.]

6. Smith exclusively traded grain contracts. However, as indicated by the account statements, Smith appeared to modify his trading strategy in November 1996 and again in late January 1997.[3]

First, Smith started with a strategy of taking a position and letting it ride for several weeks. In May 1996, Minor deposited $7,500, and Smith purchased September wheat options that expired on August 24, 1996, for a total *loss* of $6,978. In September 1996, Minor deposited $25,000, and Smith bought 10 November soybean futures and initiated a November soybean option spread. In October 1996, Smith offset the futures and long options leg, and let the short leg expire. This November soybean trade realized an aggregate net *loss* of $2,365.

Second, from late November 1996 to early January 1997, Smith made a series of day-trades and short-term trades: four short-term soybean futures trades that realized an aggregate

[2] During this time, Minor deposited a total of $27,500, and withdrew a total of $6,000, for an aggregate net deposit of $21,500. Also during this time, Minor received confirmation statements, monthly account statements, and annual tax forms that reported Smith's trading results.

[3] Since Smith did not testify, and Minor could neither explain the trading strategy nor recall discussions with Smith about the trading strategy, the principal evidence concerning Smith's trading activities consists of the account statements.

net *profit* of $8,829; one wheat futures trade that realized a $2,096 *loss*; and one soybean option day-trade that realized a $4,753 *loss*.

Third, from January 31 to March 10, 1997, Smith traded soybeans much more aggressively, typically by trading large positions that he built up over several days. For example, he bought March puts on February 6, 7, 10 and 11, until he had bought a total of 45 puts.

7. Trading by Smith in 1996 and 1997 would realize an aggregate net profit of $6,820.[4]

Trading by Hannagan (March 18, 1997 to June 19, 1998)

8. On March 17, 1997, Minor and Smith had falling out, and Minor called Hannagan to revoke Smith's power of attorney and to close the account. Hannagan instructed her to send a written notice confirming the revocation. Hannagan also told her that, since he was familiar with Smith's trading strategy and was familiar with the grain markets, he would continue to trade the account similarly to Smith for her if she wanted. Minor asserts that he told her that he was an "expert" in the grain markets, but Minor otherwise could recall little about this conversation. After thinking about Hannagan's suggestion for about an hour, Minor called him back and indicated that she was willing to continue trading. Minor could recall little else about this conversation, and could recall little about her subsequent conversations with Minor from March through November 1997. In contrast, Hannagan

[4] Smith's trading realized an aggregate net *loss* of $9,426 in 1996. Smith's trading realized an aggregate net *profit* of $16,246 in 1997: (1) in January and February 1997, Smith's trading realized an aggregate net *profit* of $14,038; (2) the one trade by Smith in March realized a *loss* of $10,753; (3) and three open trades initiated by Smith in March and liquidated by Hannagan in early April 1997 realized an aggregate *profit* of $12,961. *See* 1996 tax form 1099, and January through April 1997 monthly account statements.

credibly testified that, although Hannagan had discretionary trading authority, he discussed every trade with Minor and obtained her approval for each trade. Hannagan's testimony was supported by the account statements, order tickets and phone records which indicate that Minor called Hannagan nearly everyday that an order was placed. [See pages 40-42, 56-64, 107-110,113-117, 122-123, 142-148, 206-212 of hearing transcript.]

9. As indicated by the account statements, Hannagan continued to trade grain futures and options contracts and did not appear to deviate from Smith's 1997 trading strategy.[5] Unfortunately, Hannagan's trading was not successful and wiped out Smith's early 1997 profits. As a result, the account liquidation value declined from $27,136 on March 18, 1997, to $71 on December 1, 1997.

10. As of December 1, 1997, Minor's account was long three July soybean call options, which had a purchase cost of $6,881. Minor then authorized the purchase of two more July soybean calls on December 29, 1997, three more calls on December 30, and four more calls on December 31, for a purchase cost of $10,050. The total cost for the twelve July soybean calls was $16,931.

In December 1997 and January 1998, Minor would make a series of deposits totaling $10,670 to pay for the Purchases in December.

Minor could recall little about the specific conversations concerning the individual orders and deposits, but asserts that at some point Hannagan dissuaded her from investing in stocks by calling them "old lady" investments and that he assured her that the soybean trades were "a once-in-a-lifetime" opportunity based on the effect of El Niño on the soybean crop.

[5] After Hannagan began trading for her account, Minor began using Alaron's "Infoline" quote system and Alaron's "Hotlines" research system.

However, by January 31, 1998, the soybean calls had lost over half of their value, and had a liquidation value of $7,350. The liquidation value of the soybean calls declined to $6,300 on February 28, and $2,400 on March 31. The calls would expire worthless in June 1998. Minor testified that throughout the first six months of 1998 Hannagan gave accurate updates on the declining options, and that he advised her to hold the options because he expected a rebound. No other trades were made in the account. [See pages 90-95,104-105,111-112,123-124,149-154, 168-170, 181-220, and 228-232 of transcript.]

Deposits and withdrawals during Hannagan's tenure

11. During the time that Hannagan traded the account, Minor withdrew a total of $11,583, and deposited a total of $10,670, for an aggregate net deposit of $914.

Minor first made a series of withdrawals: $5,799 on August 4; $1,799 on September 3; $1,600 on September 18; and $2,400 on October 20, 1997. Minor next made a series of deposits to pay for the additional, purchase of June soybean calls: $600 on December 9; $3,700 on December 15; $2,190 on December 30, 1997; and $4,180 on January 2, 1998.[6]

Conclusions

The Commission has consistently declined to read into the antifraud provisions of the Commodity Exchange Act a requirement that commodity professionals must determine a

[6] Minor has not established that the withdrawn funds were depleted before she made the later deposits. Five months before she would make the first deposit during Hannagan's tenure – in May and June of 1997 – Minor executed the home equity loan paperwork. Just before she would begin depositing additional funds in the Alaron account – in November 1997 – Minor withdrew over $41,000 from her securities account. And soon after her last deposit into the Alaron account – on January 13, 1998 – Minor executed the paperwork for the loan from her brother. However, Minor has not established that the home equity loan, the securities account or the personal loan were the actual source, or the only possible source, for the deposits between December 9, 1997, and January 2, 1998.

prospective customer's suitability to trade futures or options. As a result, a customer who has made a knowing and meaningful election to undertake the risks of futures or options trading cannot recover losses by claiming that her account executive should have specifically warned her that she was unsuitable for such a risk. *Phacelli v. ContiCommodity Services, Inc.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,250 (CFTC 1986); and *Hannay v. First Commodity Corp.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,859 (CFTC 1986). Here, Alaron had provided the additional disclosure because Minor was a novice futures trader. Minor's novice status alone did not render her either unable to understand the risk disclosures or unprepared to undertake the risks of futures and options trading. Thus, in the absence of a claim of any misrepresentations by respondents during the account-opening, her suitability claim must fail.

Beyond the simple fact that she lost money, Minor has produced no evidence in support of her assertion that Hannagan's trading strategy was inherently "inappropriate and imprudent." Moreover, the account statements show that Hannagan did not deviate from Smith's trading strategy, and thus did not breach his promise to follow Smith's strategy. Thus, Minor's complaint about Hannagan's trading strategy must also fail. *See Syndicate Systems, Inc. v. Merrill Lynch, Pierce, Fenner & Smith,* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,289 (CFTC 1986) (complainant has the burden to establish that respondent's trading strategy lacked a reasonable basis).

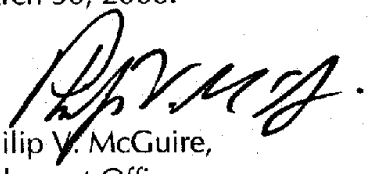
Finally, Minor's sketchy and vague recollections that Hannagan told her that he was an "expert" grain trader and that the soybean trade was a "once-in-a-lifetime" opportunity are, by themselves, insufficient to support findings that Hannagan provided a false, fraudulent or deceptively unbalanced mix of information about the relative risks and rewards of trading

with him, especially where she had received ample notice by early December 1997 that Hannagan's trading had been unsuccessful.

ORDER

No violations having been established, the complaint is DISMISSED.

Dated March 30, 2000.



Philip V. McGuire,
Judgment Officer