LIGO WILLOW

U.S. COMMODITY FUTURES TRADING COMMISSION

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FRED MUELLER, Complainant,

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CFTC Docket No. 98-R57

R. J. O'BRIEN ASSOCIATES, INCORPORATED, PACIFIC RIM ASSET MANAGEMENT INC., and CHARLES HATSUTARO FUJIKAWA, Respondents.

INITIAL DECISION

Fred Mueller's claim arises from the market crash of October 1997. Mueller alleges that respondents mishandled the execution of a stop order to sell one S & P 500 Index put option, and seeks \$6,000 in damages. Respondents deny that the order was mishandled. After a careful review of the parties' documentary submissions, it is concluded that Mueller has failed to show any violations by respondents or their floor broker agent.

The findings and conclusions below are based on the parties' documentary submissions. Unless otherwise noted, the facts are not in dispute, all times are central time, and amounts are rounded to the nearest dollar.

Factual Findings

- 1. On his account application, Fred Mueller, a resident of Wilsonville,
 Oregon, stated that he is a "developer" with an annual income between \$100,000
 and \$250,000 and a net worth between \$500,000 and \$1,000,000. Charles
 Fujikawa, who acted as Mueller's account executive, is a registered associated
 person with Pacific Rim Asset Management, an introducing broker located in
 Portland, Oregon and guaranteed by R.J. O'Brien Associates, a futures commission
 merchant located in Chicago, Illinois. Pacific Rim has direct dial access to R.J.
 O'Brien's S&P desk at the Chicago Mercantile Exchange. Timothy Rudnick was the
 floor manager for R.J. O'Brien's S&P trading desk at the relevant time. [¶9 Rudnick
 affidavit, produced July 8, 1998).]
- 2. On October 27, 1997, the Dow Jones Industrial Average dropped 554 points, the worst one-day drop in history. [See, e.g., pages A1 and C1 of the Wall Street Journal (October 28, 1997).] The corresponding dramatic market decline in the S&P futures contract continued during the Globex trading session on the evening of October 27. [¶8, Rudnick affidavit.]
- 3. At the close on October 27, Mueller held a profitable long December S&P 750 put option, which was protected by an open sell-stop order at 6.50.
- 4. On October 28, after opening limit-down at 8:15 a.m., the first trade in the S&P 500 futures trading pit occurred at 8:27 a.m. At all times relevant to the execution of Mueller's orders, the S&P 500 futures contract was trading in a fast

market.¹ Also, the S&P 500 options market experienced corresponding volatility, and the December 750 S&P put option opened at 17.00. [¶10, Rudnick affidavit; and CME tine and sales report for October 28, 1997 (produced July 8, 1998).]

On October 28, R.J. O'Brien would receive a higher than average number of S&P orders: 663 S&P futures and options orders on October 28, in contrast to the average of 518 S&P futures and options orders.² Throughout the morning, the volume of orders was so great that runners, including RJO"s runners, were often lined up approximately five to seven persons deep attempting to enter orders into the chaotic S&P options pits, and S&P options floor brokers were often prohibited from accepting additional orders for execution. [¶¶4, 5 and 11, Rudnick affidavit.] Despite the hectic conditions, throughout the day, each order received by an RJO phone clerk was taken by a runner to the options trading pit in less than a minute of receipt of the order, and introducing brokers or account executives with access to RJO's S&P floor desk to place trades were not hindered by problems such as busy phone lines. [¶¶7 and 10, Rudnick affidavit.]³

¹ CBT rule 320.16 provides in pertinent part: Whenever price fluctuations in the pit(s) are rapid and the volume of business is large, the pit reporter . . . shall cause the "FAST" symbol to be used in conjunction with all exchange quotation displays and records. . . . In the even that a dispute arises concerning the execution of an order, the fact that the market was designated "FAST" shall constitute evidence that market conditions were rapid and volatile. A "FAST" market designation does not nullify or reduce the obligations of the floor broker to execute orders with due diligence according to the terms of the order.

² Average for the fourth quarter of 1997.

³ In addition to Timothy Rudnick, the floor manager for the S&P trading desk, the R.J. O'Brien S&P trading desk was fully staffed with 4 phone clerks and 2 runners. [¶6 Rudnick affidavit.]

5. At approximately 8:05 a.m., in an effort to capture profits in the steadily declining S&P market, Mueller cancelled the 6.50 stop, and replaced it with a stop order at 15.50. The S&P continued to decline. Between 8:31 and 8:55 a.m., the December 750 S&P put rose from 17.00 to 23.00. At approximately 9:05 a.m., Mueller cancelled the resting 15.50 stop order and replaced it with an stop order to sell at 20.00. Pacific Rim transmitted the order to the trading floor within one minute.

At 9:14 a.m., the market crashed through the stop price, converting the order to a market order. However, the order would not be reported as filled until 10:01 a.m., at 8.00 points.⁴ Notwithstanding the 45-minute interval between placing the order and reporting the fill, the trade realized a net profit of about \$4,000.

- 6. At 2:45 p.m., Fujikawa told Mueller that "something seems wrong" about the fill, and that he was requesting a time and sales report from the CME. At 4:45 p.m., Fujikawa told Mueller that he had not yet received time and sales report. Fujikawa also told Mueller that he believed that R.J. O'Brien would "probably have to eat the difference" because of the apparent delay in the fill. [Complaint.]
- 7. On October 30, Pacific Rim obtained the price-change register. Stewart Rudnick represented that it was his opinion that the order "should have filled at 15 instead of 8," and that "a fast market excuse wouldn't hold up." Later that day, Fujikawa told Mueller that R.J O'Brien would "probably give you somewhere

⁴ The price-change register reported trades between 17.00 and 10.00 points between 9:14 and 9:34 a.m.; a trade at 7.00 points at 9:36 a.m., and a trade at 8.00 points at 10:01 a.m.

between 9 and 12." [Complaint.] During a third conversation that day, Fujikawa told Mueller that Rudnick had interviewed the executing floor broker, Harris Klein of LFG, who had informed Rudnick that Mueller's' order had not been misplaced, and that Mueller's' order had been executed in the order that it had been received, and in accordance with industry custom practice. Fujikawa then told Mueller that R.J. O'Brien would not be adjusting the fill. [¶¶6 and 11, Rudnick's affidavit; and respondents' reply to May 21 Order (filed July 8, 1998.).]

Conclusion

Mueller alleges that his order should have been the executed in less time and at a better price. However, Mueller has produced no evidence of any intentionally fraudulent or reckless conduct by respondents or their floor broker agent in connection with the execution of his order. The fact that his fill was not reported for forty-five minutes and that he received one of the worst fills during the first hour of trading may have been unwelcome, but is insufficient by itself to establish a violation or to shift the burden of proof to respondents where Mueller knew that the market was chaotic and volatile and where Mueller was attempting to maximize his profit by twice canceling and replacing his order in the midst of the chaotic and volatile market conditions.

ORDER

No violations having been established, the complaint is DISMISSED.

Dated October 20, 1998.

Philip V. McGuire, Judgment Officer