U.S. COMMODITY FUTURES TRADING COMMISSION



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OFFICE OF PROCEEDINGS

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CAROL PEGREM, and NORMAN PEGREM, Complainants,

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CFTC Docket No. 97-R40

JEFF MAWHORR, and AMERICAN FUTURES GROUP, INC., Respondents.

INITIAL DECISION

Carole Pegrem and Norman Pegrem allege that Jeff Mawhorr fraudulently induced them to trade commodity options and futures through misrepresentations, misleading half-truths, material omissions, and minimization of risks. Respondents deny the allegations of wrongdoing. For the reasons set out below, it has been concluded that the Pegrems have established violations of Sections 4c(b) and 4b of the Commodity Exchange Act, and CFTC rule 33.10, and that they are entitled to an award of \$10,606, plus prejudgment interest and costs.

The findings and conclusions below are based on the parties' documentary submissions and their oral testimony, and reflect my determination that the testimony of Carole Pegrem and Norman Pegrem was generally more credible than the testimony of Jeff Mawhorr. Unless otherwise noted, dates are in 1995, and amounts are rounded to the nearest dollar.

Factual Findings

The Parties

1. Carole Pegrem and -Norman Pegrem are married and live in Philadelphia,
Pennsylvania. Carole Pegrem, 55 years old at the relevant time, has a tenth-grade
education, and since 1976 has been a full-time homemaker, raising five children. Before
1976, Carole Pegrem had worked as a nurse's aide, a catalog order taker, and a hospital
food-service worker. I found Carole Pegrem's testimony to be generally credible.
Significantly, her testimony that Mawhorr failed to disclose the mechanics and risks of
trading commodity options was substantiated by recordings of her conversations with the
American Futures Group compliance department, which established that she did not have
even a rudimentary understanding of the instruments that Mawhorr had convinced her to
buy.

Norman Pegrem, 56 years old at the relevant time, is a high school graduate.

Norman Pegrem retired in 1996, after working as a claims representative and a claims processor for the Social Security administration. I also found Norman Pegrem's testimony to be generally credible.

In early 1995, when the Pegrems opened their joint account with American Futures Group, they had a combined annual income of about \$35,000, and owned a Philadelphia row house, mortgage free, worth about \$45,000. The Pegrems had an IRA account worth about \$8,000, and an additional \$24,000 invested in bank certificates of deposit and savings accounts. The Pegrems had no experience trading stocks or derivatives. [See Pegrems' reply to respondents' Interrogatory 1, and pages 3-4 and 20-21 of transcript of first day of hearing.]

Since Carole Pegrem exclusively handled the account for the Pegrems, all references are to her.

2. American Futures Group ("AFG") was a registered futures commission merchant at the relevant time. Jeff Mawhorr, a resident of Palm Beach Gardens, Florida, was registered as an associated person with American Futures Group from August 1994 to June 1995. He is currently associated with Ceres Trading Group. [See Mawhorr's replies to complainants' interrogatories 18 and 21; paragraph 1 of reply to Order compelling Additional Production (filed August 6, 1997).] Mawhorr received 35% of the \$4,500 in commissions paid by the Pegrems. [Page 86 of transcript for first day of hearing, and pages 141-145 of transcript for second day of hearing.]

At the time that Mawhorr solicited the Pegrem account, he was the account executive for nine accounts, none of which were profitable. [See paragraph 6 of respondents' reply to Order compelling additional production (filed August 6, 1997); and complainants' submission (filed March 17, 1998).]

The Solicitation

3. Around the beginning of February 1995, Carole Pegrem heard AFG radio advertisements touting options on sugar futures. Respondents have not rebutted Pegrem's description of these commercials as barely mentioning risk, and as excitedly claiming that the sugar market was "exploding," and that money could be multiplied in just a few days. [See page 2 of factual description of Complaint; complainants' reply to respondents' interrogatory 3a; Pegrem's testimony at pages 4 and 22-23 of transcript for first day of hearing, and pages 27-30 of transcript for second day of hearing; and AFG's document production (filed September 9, 1997).]

Pegrem called the number provided in the AFG ads, and was referred to Mawhorr. Pegrem credibly testified that Mawhorr's solicitation mirrored the advertisements by barely mentioning and downplaying risk, and by claiming that his other clients had "always" "made money" and were currently "making money" in the sugar market that was supposedly "exploding." When Pegrem indicated that her investment funds were earmarked for retirement, Mawhorr conceded that it was theoretically possible to lose money, but undermined this disclosure by stating that he would be recommending options which he indicated were much less risky than futures, by promising that he would closely watch her account and advise her what to trade and when to get in and get out, and by emphasizing that his clients had always made money. Pegrem then said that she was interested, and Mawhorr sent her an account-opening package. [See pages 5-8, 18-20, 25-26, and 44-47 of transcript for first day of hearing, and pages 11-50 and 69-75 of transcript for second day of hearing.]

- 4. On February 6, Mawhorr called Pegrem who told him that she had not yet read the account-opening documents. Mawhorr replied that they were not important, and told her where to fill out and sign the various account-opening documents. Pegrem told Mawhorr that she had \$5,000 available to invest, but preferred to start with just \$2,500, and included a check for \$2,500 with the signed account-opening documents. [See page 23 of transcript for first day of hearing, and pages 11-15, 75-84, and 122 of transcript for second day of hearing.]
- 5. On February 8, Mawhorr called Pegrem and told her that he had "talked to the company," and been instructed that "It's not fair [to his other customers] for you to put up only \$2,500 when other customers have invested at least \$5,000." On February 9, 1995,

Pegrem deposited an additional \$2,500. [See pages 22-23 and 50-51 of transcript for first day of hearing, and pages 52-53 of transcript for second day of hearing.]

6. The tape recordings of Pegrem's first two conversations with the AFG compliance department establish that she did not remotely understand the mechanics of trading options. During the first compliance review on February 9, 1995 conversation, Pegrem interrupted the AFG compliance employee, Ms. Jones, when Jones started to explain the break-even price and the expiration date: "Hold on a minute. This is my first time, and I didn't quite understand. What did you say about breaking even." Jones did not explain what she was discussing, but transferred Pegrem back to Mawhorr. When Pegrem was transferred back to Jones she answered affirmatively when Jones discussed the terms of the trade. (Neither Pegrem nor Mawhorr described this conversation.) During the compliance review for the second trade on February 17, Pegrem asked Jones to "go a little slower this time, so I can get all you're saying... I want to try to understand this better this time so I don't have to get back to Jeff." [Tape cassette produced as exhibit to Answer; see page 108 of transcript for second day of hearing.]

The Sugar Trades

7. Also on February 9, Pegrem authorized the purchase of five July sugar 13-cent calls. Pegrem paid \$3,808 in total premiums and paid \$825 in commissions and fees.

On February 14, Mawhorr called Pegrem, and she accepted his advice to sell the 13-cent sugar calls for a modest profit and to invest an additional \$2,150. On February 15, the 13-cent sugar calls were sold. The confirmation statement reported the gross trading profit ("net premium collected") of \$1,344, but not the actual net profit of \$519 (\$1,344 net

premium collected, less the \$825 paid in commissions). [See pages 26-28 of transcript for first day of hearing.]

8. On February 16, Mawhorr faxed a letter that stated: "The last time the sugar stocks/use ratio was this low was back in 1980-81. As you view the enclosed graph you will see that during that time sugar traded over 40 cents per pound." On February 17, Mawhorr called Pegrem and "excitedly"-urged her to buy more sugar options by claiming that the market was "rising" and "moving, — moving," and that his other clients were "doubling and tripling their investments."

During this conversation, Pegrem informed Mawhorr that she could not understand the account statements. Mawhorr replied that he did not have time to explain the statements, but assured Pegrem that she would eventually understand as she went along. [See pages 9-11, and 28-31 of transcript for first day of hearing, and pages 64-69 of transcript for second day of hearing.] Pegrem then agreed to deposit an additional \$2,875, and on February 23, Pegrem accepted Mawhorr's advice to buy 10 July 14-cent sugar calls. The order was filled at 57 cents. The 14-cent sugar calls thereafter would steadily decline.

9. On March 8, the 14-cent sugar calls opened at 39 cents, down 18 cents from Pegrem's purchase price.

Also on March 8, Mawhorr called Pegrem and urged her to increase her sugar positions, representing that the sugar market was "moving fast," that she would "miss the boat" and "miss out" on profits, unless she decided to buy more sugar options "now." Mawhorr otherwise did not indicate that Pegrem's sugar positions actually had declined. [See pages 11-12 of transcript of first day of hearing, and paragraph 7 of the Answer.] Pegrem then

accepted Mawhorr's advice to buy five July 13.5-cent sugar calls. This order was filled on March 9, at 42 cents.

During this conversation, Pegrem again told Mawhorr that she could not understand the statements. Pegrem replied that he did not have a copy of her statement, and asked her to fax a copy of the statement. Although Pegrem faxed a copy, Mawhorr did not call her, and later claimed that he never received the fax. [See pages 12-14, 19, 26-28, and 31 of transcript for first day of hearing, and pages 54-64 and pages 156-157 of transcript for second day of hearing.]

10. Mawhorr and Pegrem spoke on March 10, 14 and 21. On March 14, Pegrem deposited another \$3,185 to cover the cost of the 13.5-cent sugar calls. [See pages 34-37 of transcript for first day of hearing, and page 85 of transcript for second day of hearing.]

By March 21, the 14-cent sugar calls had declined to 22 cents, and the 13.5-cent sugar calls had declined to 29 cents.

- 11. On March 30, Pegrem accepted Mawhorr's advice to liquidate the 13.5-cent and 14-cent sugar options. The confirmation statement reported the trading loss or net premium paid for each trade: a \$224 trading loss for the 13.5-cent sugar calls, and a \$3,472 loss for the 14-cent calls. However, these figures did not reflect the cost of the commissions and fees, which increased the actual loss for the 13.5-cent calls to \$1,049, and increased the actual net loss of the 14-cent calls to \$5,122. Pegrem credibly testified that Mawhorr did not report these actual losses. [See pages 33-39 of hearing transcript.]
- 12. As of March 30, the account had a \$532 cash balance; and the three sugar option trades had realized aggregate net losses of \$5,552.

The Yen Option and the Corn Futures Trades

- 13. Also on March 30, Pegrem accepted Mawhorr's advice to buy nine June Yen puts. These options quickly lost their value: dropping about two-thirds by April 3, losing almost all of their value by April 4, and expiring worthless on June 10, for a loss of \$4,523. [See pages 14-15 of transcript for first day of hearing.]
- 14. As of April 28, the yen option had lost \$2,700 (on a \$3,038 premium). On April 28, Pegrem asked Mawhorr how things were going. Mawhorr did not mention the previous losses on the sugar trades or the nearly worthless Yen options, and told her "You've got money in the account. Why don't you let it work for you?" Pegrem then accepted Mawhorr's advice to initiate a short corn futures position, which would be liquidated for a \$431 loss on May 1. [Pages 15-18 and 42-43 of transcript for first day of hearing.]
- 15. In early May, Mawhorr reported the loss on the corn trade. When Pegrem asked Mawhorr how much money she had in the account, she was surprised when he informed her that she had lost all but \$104 of her total investment of \$10,710. Thus, Pegrem lost \$10,606.

CONCLUSIONS

The record supports violations of Sections 4b and 4c(b) of the Commodity Exchange Act, and CFTC rule 33.10 by Jeff Mawhorr and American Futures Group, as well as AFG's liability for Mawhorr's violations under Section 2(a)(1)(A) of the Act. American Futures Group's radio commercials presented a deceptive message that downplayed the significant risk of loss and exaggerated the likelihood of profits by barely mentioning risk and excitedly claiming that the sugar market was "exploding," and that money could be multiplied in just a few days. Mawhorr fraudulently induced Pegrem to open the account by failing to explain

adequately the mechanics of trading options, and by minimizing the risks with false statements such as that all of his clients were making money. Mawhorr perpetuated this initial fraud by evading her questions about the account statements, and by inducing her to invest additional funds and to purchase additional contracts by misrepresenting market conditions and the status of open positions. The deliberate nature of Mawhorr's violations is underscored by the patent nature of Pegrem's inability to understand the mechanics of trading options or to understand the account statements.

ORDER

Violations having been established, Jeff Mawhorr and American Futures Group are ORDERED to pay to Carole Pegrem and Norman Pegrem reparations of \$10,606, plus interest on that amount at 5.407%, compounded annually from February 6, 1995, to the date of payment, plus \$125 in costs for the filing fee. Liability is joint and several.

In addition, pursuant to CFTC rule 12.30, American Futures Group is ORDERED to pay to Carole Pegrem and Norman Pegrem \$478 in attorneys fees and costs. See Order Imposing Costs (July 25, 1997), and Pegrems' statement of attorney's fees and costs (September 10, 1997).

Dated April 30, 1998.

Philip V McGuire, Judgment Officer