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JOSEPH E. ROBERTS, Complainant v. JON JEFFREY REES and MICHAEL JOSEPH REIS, Respondents	)	CFTC Docket No. 98-R137

INITIAL DECISION

According to complainant Joseph Roberts, respondent Michael Reis (his broker at Carrington Financial) illegally promised to increase his $80,000 account to the value of $100,000. When the trades recommended by Reis did not succeed, Roberts claims, he complained to Reis's supervisor Jon Jeffrey Rees, who promised to provide commission-free trades in compensation but allegedly failed to do so. Roberts also claims that Reis churned his account. He seeks $22,170 in damages.[1] Respondents deny any wrongdoing.

The following decision reflects my evaluation of the respective credibility of the three party witnesses during a telephonic oral hearing held in April 1999. All dates are in 1996 unless otherwise noted.

Findings of Fact and Conclusions of Law

1. The parties are not in dispute regarding many basic facts, including the details of the prior trading by Roberts from May 1995 until early April 1996. During that eleven-month period, Roberts traded extremely successfully, following recommendations given him by Reis. From Roberts' initial investment of approximately $23,000, the account had almost quadrupled in value, and by April 11, 1996, the value of the account had risen to more than $80,000.

[1] Complainant apparently based his damage claim on his *net* overall loss during the history of his account, as shown in an accountant's statement used in his tax filings (exhibit to Complaint). The parties were informed prior to, and during, the oral hearing in this matter (Tr. at 4-5) that complainant's causes of action, if proven, would have entitled him to recover the full amount of his losses stemming from the particular transactions he was challenging, i.e., over $60,000 in damages if he had filed a Formal Proceeding. Were he to win in this Summary Proceeding, Roberts' potential recovery in this action would be limited to the jurisdictional limit, $30,000, even if his actual damages were greater.

2. Most of the $57,000 in profits in the Roberts account were earned on a position in wheat options that, previously nicely profitable, had suddenly risen in value in the two days before April 11 until they had quadrupled in price (Tr. at 29-32; *see also* April 9 and 11, 1996, trading statements). A small position in July soybean meal call options had risen in value substantially from April 9 to April 11, leading Reis to recommend selling all the wheat options, taking out enough cash to return to Roberts the amount of his initial investment, and to invest the remaining proceeds in 50 more July soybean meal call options (Tr. at 43-45). These options cost, in addition to the premium, a total of $10,000 in commissions (April 11, 1996, statement).

3. Roberts claims that he was reluctant to invest so much in one position, and that Reis persuaded him to do so, over his objections, by promising to make the account a $100,000 account. According to Roberts, Reis told him that Reis had taken him "this far" and that he wanted Roberts to do the trade "for" Reis, which meant out of trust for Reis. The testimony of Roberts regarding his conversations with Reis is crucial to the disposition of this case:

> MR. ROBERTS: . . .["]We're going to sell the wheat,["] he says, "Well, okay, I want you to buy the soybean meal." And he said, "I want you to buy 50." And I said, "No." Or I said, "Okay. I'll buy 5." He said, "No. No, I didn't say 5. I said 50." I said, "No, I don't want to buy that much. I'm, you know, it's too much, too big. I don't want to do that."
>
> And then Mike Reis said, "Joe, you know, do it for me. I got you this far." He said, "I'll make this [a] $100,000 account."
>
> J.O. MAILLIE: And did you believe that Mr. Reis had inside information about anything?
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> MR. ROBERTS: No, sir.
>
> J.O. MAILLIE: Did--
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> MR. ROBERTS: I mean, I just thought he was doing his homework.
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> J.O. MAILLIE: Did you know that he was expressing his opinion or did you believe that he somehow had knowledge of the future?
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> MR. ROBERTS: No, I did not believe he had knowledge of the future.
>
> J.O. MAILLIE: Did you know he could be wrong?
>
> MR. ROBERTS: Yes, sir. I knew he could be wrong.
>
> J.O. MAILLIE: Did that have something to do with your reluctance to take 50 rather than 5 at the beginning?

MR. ROBERTS: No. I just didn't want to--we had made a profit. I wanted to take some out and more--just take some profit out, not just my costs out. But the $23,000 representing my cost.

J.O. MAILLIE: And so he convinced you otherwise?

MR. ROBERTS: That's correct.

J.O. MAILLIE: And--but did you know it was your decision, not his?

MR. ROBERTS: Yes, sir. I know that.

J.O. MAILLIE: Did you know you could disagree with him and say, "No, I really want to do this"?

MR. ROBERTS: Yes, sir. I knew that.

J.O. MAILLIE: I mean, did he threaten to stop giving you advice if you failed to buy that many?

MR. ROBERTS: No, sir. He did not.

J.O. MAILLIE: I mean, did he indicate any, you know, that it would irreparably harm your relationship with him or anything like that if he didn't--if you didn't take that advice?

MR. ROBERTS: No, sir. He used the profit potential as the, the carrot to induce me or to tempt me to make the trade. And I agreed to make the trade.

J.O. MAILLIE: Now, at the time when--see, when you say he promised you this money, he says, "I'll make this $100,000 account," now, you said he had just right before that he said, "I've taken you this far," something along those lines?

MR. ROBERTS: Something along those lines.

J.O. MAILLIE: And was he correct about that?

MR. ROBERTS: Yes, sir.

(Tr. at 77-80.)

4. Roberts was fully aware of the risks of trading at all times. He was also aware that Reis did not claim to "know" what the market would do, and that any recommendations made by Reis would reflect Reis's opinion, which could be wrong. However, he believes that once he had

expressed reluctance and hesitation about the trade, it became Reis's responsibility for overcoming that reluctance and for disregarding Roberts' expressed objections about taking such a sizeable position:

> J.O. MAILLIE: . . . If . . . in fact, you knew he could be wrong, if, in fact, it wasn't--what is it that you didn't know that you should have known or what is it that he caused you to believe that you shouldn't have been believing when you made that trade?
>
> MR. ROBERTS: Well, I knew that he could be wrong. My belief comment [sic] is, once I had expressed reservation going into it, he used promises and very strong persuasive profit potential to entice me to make the trade.
>
> Now, I don't disagree that I knew that he could be wrong and I knew that all the money was at risk. But once I had made a reservation about making that trade, then I think it's illegal to continue on saying, well, look--that at that point he--the [sic] responsibility shifted from me to Mike Reis, as the professional, to back off of that trade, and to start somewhere else again. When he continued on and said, "Look at all the good things that I've done for you," you know, "This is a--I can make this happen. This is a good trade. I'll make this $100,000 account. Joe, do it. I haven't been wrong this time."
>
> Then the responsibility, in my mind, shifted from me to him. And I think--
>
> J.O. MAILLIE: So at that point, at that point basically you can, at that point your theory would amount to you having license to trade and it's all at his risk then?
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> MR. ROBERTS: That's what I believe, sir.
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> J.O. MAILLIE: So in other words, once he has confidence after you've said any--after you've indicated reluctance--
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> MR. ROBERTS: Correct.
>
> J.O. MAILLIE: --then it becomes his loss not yours?
>
> MR. ROBERTS: It's his responsibility at that point to listen to my reservations. . . .

(Tr. at 98-100.) According to Roberts, the responsibility would shift at that point because Reis was "speaking as a professional" while Roberts was "speaking as an amateur" (Tr. at 114).

5. Reis denies promising to make the account worth $100,000, although he concedes he could have used that number essentially as a target (Tr. at 119-120). He disputes any implication that he improperly overrode Roberts' reluctance through promises of profits or otherwise (Tr. at 119). According to Reis, he was the one who recommended that Roberts take out his initial investment, and he appeared rather proud that he had acted to protect his customer's initial investment when some brokers do not do that (Tr. at 118-119).

6. Rees, who was the supervisor of Reis at Carrington, testified credibly regarding Roberts' complaint to him asking for a new broker to replace Reis, which occurred somewhere around June 24 (Tr. at 134-146). Rees acknowledged that Roberts accused Reis of promising to take the account to $100,000, which shocked him (Tr. at 146). Such statements of expected profitability would have violated company policy (Tr. at 147). When Roberts complained about Reis's alleged promises to make the account more profitable, he offered an accommodation to complainant by promising him 20 commission-free trades. At this time, the account was worth something on the order of $15,000, but Rees did not recommend liquidating the options (Tr. at 142-143).

7. I believe complainant Roberts' testimony that he expressed reluctance about making the trade, and I also credit his testimony that Reis talked about trying to make the account rise to a value of $100,000. However, I do not find credible any suggestion that Reis *promised* to accomplish this goal in any fashion that would have negated Roberts' awareness of risk or that, as he suggests, overcame his reluctance to trade through improper persuasive methods. Instead, the record fully supports the notion that Reis and Roberts together decided to take a sizeable position in the account, even if Roberts entered into the transactions with some hesitation and reluctance. However, since he was trading solely on profits, he was risking none of his original capital, which Reis arranged to be returned to Roberts. Although Reis may have been optimistic about the account performance (*see, e.g.,* Tr. at 119), he was no stranger to Roberts, and any comments he made were in the context of an ongoing business relationship between the two, which was a satisfactory partnership to Roberts (Tr. at 22). Roberts himself said he believed that Reis made the recommendation in a sincere belief that the market would continue to move favorably (Tr. at 82).

8. Reis did not substitute his will for that of Roberts, overreach, or otherwise take control of the account. As Roberts admitted, Reis simply asked complainant to have confidence in him. That confidence may have been misplaced with regard to the new trade. However, while the law does not allow a broker to discount a record of trading losses while claiming to have confidence in his abilities, that rule does not require a broker to avoid gaining confidence from trading successes in making new recommendations to the same customer--so long as the broker does not act carelessly, distort facts, or let his confidence make him think he has a golden touch. In the absence of any evidence that Reis negated complainant's firm understanding of risk, Roberts cannot prevail on the suggestion that Reis "promised" him a $100,000 account simply because Reis may have expressed that as a target figure or goal.

9. In complainant's mind, the offer made by Rees meant 20 trades of an unlimited number of options, whereas in Rees's mind, the offer meant a total of 20 commission-free options

(*see generally* Tr. at 185-187). I find that complainant's construction was not reasonable under the circumstances. Roberts was unhappy that Rees failed to make further trading recommendations (Tr. at 169)--an indication that Roberts was willing to continue to accept the risks of trading even after suffering such alleged abuses at the hands of Reis (Tr. at 172).

10. Roberts decided on his own in May and October to abandon his enviable position of trading solely on his profits by redepositing a total of over $23,000 back into his account to take new options positions. Roberts has tried to explain that he made these trades because he expected profits based on his past experience, which from May 1995 through April 10, 1996, at least, truly had been profitable (Tr. at 178). These positions were also allowed to expire worthless.

11. Complainant Roberts is solely responsible for all trading decisions he made after April 11. First and foremost, he decided to allow the meal options to expire worthless when he could have salvaged thousands of dollars simply by liquidating at any time over the next several months. The steady erosion of complainant's account value, and the eventual expiration of all of his options, led to questions regarding why he never liquidated any of the declining positions to protect at least some of his money (Tr. at 40). Roberts testified that in the entire account history he never had sold any of his options at a loss and that he was never given a recommendation to do so (Tr. at 40-41; *see also* Tr. at 182). He testified as follows: "Judge, I didn't realize that I could liquidate once I had the contract. I had thought I had to let it expire." (Tr. at 55.) However, during his testimony, Roberts was confronted with several occasions prior to April 11 when he had liquidated options at a loss (Tr. at 56-60; *see, e.g.*, statements for July 5, 1995, October 6, 1995, and November 3 and 22, 1995). He had no explanation for failing to remember that he had done so (Tr. at 61), asserting he could not understand his past statements (Tr. at 60), but admitted he must have known about them at the time (Tr. at 113). Still, Roberts held fast to his claim that his failure to liquidate was the fault of respondents for recommending that he hold his positions (Tr. at 74).

I find that Roberts' not-highly-credible failure to recall that he had previously liquidated options at a loss--not just once, but *four* times--severely undercuts his claims regarding why he did not liquidate the meal options to preserve part of his funds. Although with hindsight, one could agree with Roberts that his brokers probably should have recommended that he cut his losses, hindsight is no substitute for evidence. This was a non-discretionary account with control held by Roberts. He fired Reis when the account value was at an amount that would have allowed him to liquidate with $15,000, but not only did he not liquidate, he continued trading and deposited more funds, just like a gambler who cannot avoid making more bets to "recover" his losses. Under the circumstances, Roberts is solely responsible for failing to have learned his lesson in time to quit while he was ahead, and--which was more foolish in light of his wish that his brokers would have protected him by recommending liquidation--for redepositing the initial investment that Reis had arranged be returned to him.

12. The account was not churned. First, the control element has not been established. Roberts never granted discretionary trading authority over the account to Reis (Tr. at 60). Upon consideration of the relationship between the two, I also find that Roberts did not cede *de facto*

control over the account to Reis. In addition to the matters discussed in Finding 8, above, other factors indicate that Roberts may have reposed great trust in Reis and that he followed Reis's recommendations, but this was a trust stemming from experience. Roberts carefully followed the trading in the account, as evidenced by the numerous statements produced in his discovery answers that have handwritten notes, questions, and calculations regarding the trading. Furthermore, while Roberts was deferential and polite in demeanor in all our dealings in this case, he was by no means passive or uninvolved. He owns his own business, is bright, articulate, and fully capable of independent judgment. He himself described the relationship with Reis as a "partnership" (Tr. at 22), and there is no evidence compelling the conclusion that the partnership included Roberts merely as the provider of funds. In fact, Roberts fired Reis during June, a definite indication that he well knew who was in charge.

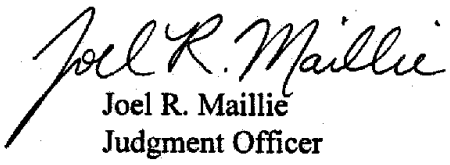
Second, even if control was a close issue, the volume of trading was not excessive *in light of the trading objectives of Roberts.* Certainly the commissions were generous: the account was charged over $46,000 in commissions in over a year (Tr. at 25), with $10,000 of that attributable to the large April 11 options purchase. However, high commission charges alone are not enough to decide that an account was churned, especially where, as here, the customer is fully aware of the amount of commissions and is satisfied that he is getting his money's worth. Clearly, before April 11, the commission charges represented an expense Roberts was willing to bear, which he himself has admitted (Tr. at 22-23). Reis and Carrington stood to make a huge commission on the April 11 transaction, but that expense was not at odds with the trading objectives of Roberts, even if he had expressed some level of reluctance originally. Roberts attempted to portray himself as a small trader who only wanted to buy 5 contracts at a time, thus suggesting that he had given in to Reis's entreaties (Tr. at 90-92). In fact, however, as demonstrated during the hearing, although the account may have started with 5-option transactions, it gradually but steadily increased until by December 1995 Roberts was trading 35-option positions (Tr. at 91-96). He said he only did that because he was trading on profits, but had no explanation why that differed for the 50-option purchase of April 11, which was also trading on profits (Tr. at 91-93).

13. Roberts has proven no wrongdoing by Rees. The failure to continue to make recommendations after the 20-option trade in the fall of 1996 did not constitute the breach of any obligation from Rees to Roberts. Roberts may have built up in his head the expectation that someone at Carrington--Rees, in his mind--could continue the prior successes experienced while initially trading with Reis, but that expectation was not engendered by any action of either respondent.

Order

No violations causing Roberts' losses having been found, the complaint is DISMISSED.

June 25, 1999



Joel R. Maillie
Judgment Officer