

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

JOHN Y. ABOULGHAR

v.

RICHARD LEYTON MULCAHY,
R.J. O'BRIEN & ASSOCIATES, INC., and
R.M. TRADING, LLC

CFTC Docket No. 06-R044

OPINION and ORDER

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This reparations case involves a broker's alleged misstatements and omissions regarding margin rate changes and unauthorized liquidation of a customer account. The complainant, John Y. Aboulghar ("Aboulghar"), appeals from the order of dismissal issued upon respondents' unopposed motion for summary disposition. In the initial decision, the Administrative Law Judge ("ALJ") found that no genuine issue existed as to any material fact and that respondents were entitled to judgment as a matter of law. *Aboulghar v. Mulcahy*, No. 06-R044, 2007 WL 1145270 (C.F.T.C.) (Apr. 18, 2007) ("I.D.").

On appeal, Aboulghar asks the Commission to set aside the dismissal, stating that he failed to oppose respondents' motion because he was "unfamiliar [with] and unaware of the protocol governing the proceedings." App. Br. at 2. He argues that the record reveals genuine issues of material fact in dispute, and asks the Commission to remand the matter for a hearing, or alternatively, to remand and allow him to file an opposition to respondents' motion for summary disposition. On review, we find that further development of the record is necessary to determine whether respondents' nondisclosure of certain exchange margin increases may have been material to Aboulghar's decision to purchase seven gold contracts in after-hours trading on April

19, 2006, and if so, whether the nondisclosure proximately caused his losses. Accordingly, we vacate the order of dismissal and remand for additional fact-finding on these issues.

BACKGROUND

Aboulghar is a resident of California with at least one year's experience as an active trader prior to the events at issue. Respondents R.J. O'Brien & Associates, Inc. ("R.J. O'Brien"), R.M. Trading, LLC ("R.M. Trading"), and Richard L. Mulcahy ("Mulcahy") are, respectively, a futures commission merchant, an introducing broker, and the broker associated with R.M. Trading who handled Aboulghar's account.

On April 19, 2006, Aboulghar placed purchase orders for six silver, two copper and one gold futures contracts, increasing his existing positions in these metals. The day before, the New York Mercantile Exchange ("NYMEX") issued notices to members that the margin rates for copper and silver would be increased, effective at the close of business on April 19.¹ Aboulghar contends that Mulcahy did not advise him of the increases when the two spoke on April 19. After purchasing the additional contracts described above, Aboulghar's account had a closing net value of \$116,161.72, with excess margin of \$19,797.72. *See* April 19, 2006 Confirmation Statement, Motion for Summary Disposition ("Mot. Summ. Disp."), Exh. E. After pit trading closed on April 19, Aboulghar placed an after-hours order to purchase seven more gold futures contracts. After this purchase, Aboulghar held 11 silver, 11 gold, five copper, one platinum and one palladium futures contracts.

On April 20, an unusually steep decline in the price of silver futures led to a temporary halt in silver trading and drove down futures prices in other metals. By mid-session, the open trade equity balance of Aboulghar's account had declined to almost zero, which resulted in

¹ The margin rate for silver rose from \$4388 to \$5063 per contract, an increase of \$675; copper margin rose from \$4725 to \$5063, a \$338 increase.

margin calls demanding immediate payment. Partial liquidations of Aboulghar's account during the trading session proved insufficient to cure the margin deficit. His remaining positions were consequently liquidated during the last hour of trading, leaving a debit balance of \$29,408.12.

Aboulghar filed a reparations complaint on June 1, 2006, based on the forced liquidation of his account. He alleged that respondents misled him by failing to timely inform him of the margin rate increases, and asserted that he should have been told of such changes at or before the time he placed his orders. He also alleged that respondents refused to allow him sufficient time to wire money to satisfy the margin deficiency. He claimed out-of-pocket damages and lost profit opportunities.

On June 2, 2006, R.J. O'Brien filed a breach of contract action against Aboulghar in the Circuit Court of Cook County, Illinois, seeking satisfaction of the debit balance resulting from the liquidation of the account. Aboulghar's amended reparations complaint was served on respondents on July 11 by the Commission's Office of Proceedings. Respondents answered Aboulghar's reparations complaint on August 10, 2006, denying liability and disclosing the Cook County action. Both cases went forward. On December 11, the Circuit Court of Cook County issued a default judgment in R.J. O'Brien's favor in the amount of \$34,608.56 for the debit balance, legal fees, interest and costs. Mot. Summ. Disp., Exh. K.

On March 5, 2007, the ALJ scheduled a hearing on Aboulghar's reparations complaint. Prior to the hearing, respondents filed their motion for summary disposition, which the ALJ granted. In ruling on the motion, the ALJ noted that Aboulghar sought "from Respondents fiduciary responsibilities which are not inherent to the market in which he chose to trade." I.D. at *2. He also found that the Cook County proceeding had priority in time and stated he was not

free to reject the related determination of that court. I.D. at *1-*2. Finding no genuine issue as to any material fact, the ALJ dismissed the case. I.D. at *2.

DISCUSSION

On appeal, Aboulghar argues that material facts remain in dispute precluding summary disposition. Respondents ask us to affirm the decision below, arguing that the standards for summary disposition were met. Commission Rule 12.310, 17 C.F.R. § 12.310, provides that summary disposition shall be granted if there exists no genuine issue as to any material fact; there is no necessity for further facts to be developed; and the moving party is entitled to a decision as a matter of law. The Commission's summary disposition rule is patterned on the summary judgment provisions of Fed. R. Civ. P. 56, and the Commission is guided by federal case law in applying its rule.

A grant of summary disposition is reviewed *de novo*. *Twiss v. Kury*, 25 F.3d 1551, 1554 (11th Cir. 1994). At the summary disposition stage:

“the judge’s function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial.” All reasonable doubts about the facts should be resolved in favor of the non-moving party. If reasonable minds could differ on any inferences arising from undisputed facts, summary judgment should be denied. “When more than one inference reasonably can be drawn, it is for the trier of fact to determine the proper one.”

Id. at 1555 (citations omitted).

Aboulghar identifies three issues of disputed fact that he argues existed on the record before the ALJ. First, he asserts that respondents concealed their advance notice of upcoming margin increases, “allowing orders to be filled which they knew would result in an account margin in excess of the new requirements, devastating [his] account.” App. Br. at 6; *see also id.* at 2. Second, he contends that respondents failed to allow him “to satisfy the margin call before liquidating his positions despite statements to the contrary.” *Id.* at 2. Third, he claims that on

April 20, Mulcahy falsely represented that NYMEX “instructed [him] to liquidate Complainant’s positions and not to allow Complainant to wire funds to cover the new margin requirements.” *Id.* at 6.

In the proceedings below respondents insisted that “[c]omplainant was apprised of all relevant facts regarding his account, including the margin increases imposed by NYMEX.” Memorandum in Support of Motion for Summary Disposition (“Memorandum”) at 16. In support of their position Respondents referred only, however, to their numerous contacts with Aboulghar on April 20 regarding margin *calls*; they made no mention of contacting Aboulghar about the margin *rate increases* that took effect when trading closed on April 19. We therefore treat their nondisclosure of the rate increases as undisputed. The issue before us then is not a disputed fact as to whether notice was given, but the legal question of whether a duty to disclose existed.

“[T]here is a duty to disclose all material facts to a customer.” *Sharp v. FGL Commodity Servs.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,970 at 37,541 (CFTC Dec. 12, 1990). “A statement or omitted fact is material if it is substantially likely that a reasonable investor would consider the matter important in making an investment decision.” *Sudol v. Shearson Loeb Rhoades, Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,748 at 31,119 (CFTC Sept. 30, 1985). “It is by now ‘universally agreed’ that the question of whether a fact is material is an objective one.” *Id.* (citation omitted).

An exchange margin rate increase is not automatically material information. The impact of a margin rate increase with regard to a particular account will depend on “the size of the increase, the number of futures contracts affected by the change, the account’s gains or losses on other positions, the establishment of new positions, and other factors.” *Aboelghar v. R.J.*

O'Brien Assocs., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 31,571 at 64,160 (CFTC May 17, 2010).

The margin increases on silver and copper that went into effect on April 19 did not cause or threaten Aboulghar's account to incur a margin deficit when he purchased the additional silver, copper and gold contracts prior to the close of trading that day, despite his arguments otherwise. As noted above, Aboulghar's account retained excess margin of \$19,797.72 when the rate increases took effect at close of business, which represented approximately 17 percent of his account liquidating value of \$116,161.72. Aboulghar argues also, however, that he would not have bought the additional seven after-hours gold contracts had he been aware of the silver and copper margin rate increases. Drawing all inferences in Aboulghar's favor, as we must in reviewing an order of summary disposition, we conclude that the increased cost of carrying the silver and copper positions may have mattered to a reasonable investor in Aboulghar's shoes in deciding whether to purchase the additional gold contracts.² The gold contracts, in combination with the rate increases, may have caused Aboulghar's account to become undermargined. It is substantially likely that a reasonable investor would think it important that a contemplated transaction would result in an immediate margin deficit. Because the record does not clearly establish the impact on Aboulghar's account of the margin increases, together with the gold purchases, further fact-finding on this issue is necessary. *Cf. Human v. Alaron Trading Corp.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,806 (CFTC Oct. 18, 1996) (concurring opinion) (50 percent margin increase material to futures customer who added 20 contracts to an already undermargined account).

² While the margin rate increases did not cause or threaten a margin deficit at the close of trading on April 19, they undoubtedly reduced the amount of excess margin available to support additional positions.

Respondents argued below that it was the historic drop in silver prices on April 20 that caused Aboulghar's losses, not the margin rate increases. *See generally* Memorandum in Support of Mot. Summ. Disp. Aboulghar's silver positions lost \$110,000 in market value during the first hour of open outcry trading on April 20. It is possible that the market drop was the supervening – or the only – cause of Aboulghar's losses, with the margin deficit associated with the market decline dwarfing any margin deficit associated with establishing the additional gold positions. Those issues of causation and damages, however, were not addressed by the ALJ and are beyond our reach in reviewing the instant order granting summary disposition.

Aboulghar's contention that respondents refused to allow him a reasonable amount of time to satisfy the margin calls on April 20, however, lacks any basis. Telephone records submitted by respondents indicate a number of calls to Aboulghar on April 20, and Aboulghar does not dispute speaking with respondents during the trading day. Respondents' insistence on immediate payment in extreme market circumstances is consistent with Commission precedent recognizing

the special status of margin in the [Commodity Exchange] Act's regulatory scheme and . . . our desire that futures commission merchants have adequate means to assure their own financial integrity and thereby contribute to the financial integrity of the entire marketplace. Particularly in those market situations where a prompt response is required, a futures commission merchant is free to exercise its power to demand the deposit of additional funds by its customer and to liquidate an account without hesitation if the demand is not met. The exercise of those powers is available as a matter of business judgment

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Baker v. Edward D. Jones & Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH)

¶ 21,167 at 24,772 (CFTC Jan. 27, 1981).

Assuming the truth of Aboulghar's final contention, that Mulcahy falsely represented that he was instructed by NYMEX personnel to liquidate Aboulghar's positions and not allow

Aboulghar to wire funds to cover new margin requirements, we conclude it is not material to the outcome of this case. The parties agree on the essence of Mulcahy's conversations with Aboulghar on April 20: the account was undermargined, the market was collapsing, a limited window of time existed to provide additional margin and if the account remained in margin deficit as the market neared its close, the account would be liquidated. That is what was communicated, that is what happened, and details regarding the origin of the demand are not material.

Any kind of margin trading involves inherent risks, and the risk of loss in trading futures can be substantial. Under Commission Rule 1.55, 17 C.F.R. § 1.55, these risks are required to be disclosed to customers before an account is opened. In relevant part, the disclosure mandated by the rule provides that “[t]he risk of loss in trading commodity futures contracts can be substantial If the market moves against your position, you may be called upon by your broker to deposit a substantial amount of additional margin funds, on short notice, in order to maintain your position.” *Id.* at 1.55(b). Accordingly, customers are placed on notice, at the time of account opening, regarding the risk of margin trading, including the risk of liquidation when a margin call is unmet.³

Finally, we address the ALJ's statement that “the Circuit Court proceeding had priority in time.” *I.D.* at *1. Aboulghar filed his reparations complaint on June 1, 2006, one day before respondents filed their action in the Circuit Court of Cook County. Commission Rule 12.24 bars

³ On February 13, 2008, Aboulghar filed with the Commission a Supplemental Appellate Brief in which he asserts that trade executions reported for his account do not match NYMEX prices for the times in question. We treat the supplemental brief as a motion pursuant to Commission Rule 12.405, 17 C.F.R. § 12.405, to adduce additional evidence. On review, we find that the discrepancies stem from the time difference between respondents' Central time zone locations – R.J. O'Brien in Chicago and R.M. Trading in Oklahoma – and NYMEX's Eastern time zone location in New York. When the time zone difference is taken into account, the prices reported to Aboulghar are consistent with NYMEX prices. *Supp. Br. Exhs. A, B; Exh. C* at 64, 107. Accordingly, Aboulghar's Supplemental Brief lacks relevance and plays no role in our disposition of his appeal.

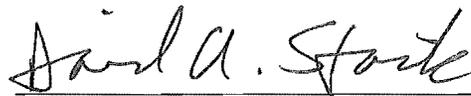
reparations claims if a civil court action based on the same facts is pending “at the time the reparation complaint is filed.” 17 C.F.R. § 12.24(a)(1). The Cook County action was not pending on June 1, 2006, and thus was not a parallel proceeding barring the reparations complaint within the meaning of Commission Rule 12.24. Given our decision today, we need not, and do not, address the parties’ arguments regarding the application of principles of *res judicata* and collateral estoppel. Because the case was brought properly in the reparations forum, we are not bound by the circuit court’s decision.

CONCLUSION

Based on the foregoing, we vacate the order of dismissal and remand this matter to the ALJ to develop the record on the issue of how the above-discussed silver and copper margin increases, combined with the after-hours purchase of the seven gold contracts, affected Aboulghar’s account. The ALJ shall determine whether the nondisclosure of the margin rate increases constituted a material omission. If so, the ALJ shall determine whether such omission proximately caused any of the losses Aboulghar suffered on April 20. Respondents may renew their causation arguments and other defenses on remand. Aboulghar’s other arguments on appeal are rejected as lacking merit and shall not form the basis for relief.

IT IS SO ORDERED.

By the Commission (Chairman GENSLER and Commissioners SOMMERS, CHILTON and O’MALIA) (Commissioner DUNN not participating).



David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: September 2, 2010