UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

AMERICAN PACIFIC COMMODITIES, INC.	:	
v.	:	CFTC Docket No. 08-R019
ADM INVESTOR SERVICES, INC., R.B. MCGOVERN & ASSOCIATES, and ROBERT BRUCE MCGOVERN	:	OPINION and ORDER

Complainant American Pacific Commodities, Inc. ("APC") appeals the Judgment Officer's initial decision dismissing its reparations claim for alleged violations of the Commodity Exchange Act ("CEA" or "Act"). The Judgment Officer found that the complainant failed to establish any of the claimed violations and denied any award for losses. *American Pacific Commodities, Inc. v ADM Investor Services Inc.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 31,368 (CFTC April 30, 2009) ("ID"). For the reasons set forth herein, we now affirm.

BACKGROUND

APC filed a reparations complaint against respondent R.B. McGovern & Associates ("R.B. McGovern") and its principal, Robert Bruce McGovern ("McGovern") in January 2008, alleging numerous violations of the Act and Commission Regulations.[1] APC was a registered introducing broker during all times relevant to the disposition of this claim, with Bruce John Paranay ("Paranay"), the sole owner, serving as president and chief executive officer of the company. R.B. McGovern was a guaranteed introducing broker and McGovern was a registered commodity trading advisor and commodity pool operator at all times relevant to the claims

[1] The complaint also alleged violations of compliance rules of the National Futures Association ("NFA"). Because NFA rules violations cannot form the basis of a reparations claim, these allegations played no role in the Commission's consideration of this case.

asserted. ADM Investor Services, Inc. ("ADM") is a registered futures commission merchant located in Chicago, Illinois and acted as the guarantor for R.B. McGovern. For convenience we refer to the parties as "McGovern" and "Paranay."

The complaint alleged that McGovern engaged in unauthorized trading, churning and "trading ahead." The complaint also alleged that McGovern breached a promise to strictly limit the losses on individual trades to $300. McGovern denied all allegations and asserted that all of complainant's claims were without merit.

McGovern regularly published a "Nightly Spread Letter" that described the steadily high performance of a model account that he traded.[2] A December 30, 2005 edition of the newsletter represented that in each year since 1999, the model account had consistently realized annual profits ranging from 2% to 126%, with an average of 60%. On January 5, 2006, Paranay opened an account on behalf of APC with an initial $20,000 deposit. He completed a corporate account application and an ADM "Commodity and Options Corporate Authorization" form, which authorized him to trade commodity futures and options on behalf of APC. Paranay's application included contradictory representations as to whether the account was intended to be discretionary. In one section, he checked the box indicating that the account was to be discretionary, but in another section indicated only he would be trading and managing the account. In the event that the account were going to be managed or traded by another person, Paranay would be required to identify that person and attach a copy of a power of attorney authorization. This authorization was never executed, and as a result McGovern considered the account to be non-discretionary. This meant that the account required prior approval for each trade. Paranay advised McGovern in writing that he wanted his personal trading account to

[2] McGovern's "model account" was a personal trading account, not a hypothetical account involving simulated trading.

mirror that of McGovern's model account. After opening the account, Paranay received trading advice directly from McGovern by telephone and email, and through McGovern's newsletter.

Paranay's trading account activity can be divided into two periods. During the period of January 18 to April 21, 2006, 21 round-turn trades were executed, 15 of which resulted in realized net losses. At the end of April, the account was down $3,826. No further trading took place until June. The second trading period lasted from June 1 to September 12, 2006, a period during which nine round-turn trades were executed and further losses were incurred. Paranay ceased trading when he concluded that his account was being traded differently from the model account. From the opening of the account until its closing on September 13, 2006 the account suffered a net loss of $5,887.

In early 2008, Paranay filed a reparations claim seeking to recover his losses. The parties engaged in discovery and participated in a telephone hearing before the Judgment Officer, who issued an initial decision in McGovern's favor on April 30, 2009. The Judgment Officer found that neither Paranay's nor McGovern's oral testimony about the events in question was particularly compelling, as neither party could specifically recall important details of conversations. The Judgment Officer nevertheless held that "overall, McGovern's testimony seemed more forthright, focused, and plausible." ID, ¶ 31,368 at 62,910.

The Judgment Officer rejected Paranay's unauthorized trading allegations. He found that McGovern credibly asserted that he discussed each of the trades with Paranay before executing them, and that Paranay recommended modifications to some of the trades that McGovern suggested. *Id.* at 62,911. The Judgment Officer's demeanor-based credibility findings were supported by documentary evidence in the form of an itemized phone bill and the parties' affidavits, indicating that for most trades executed for the account, McGovern had spoken with

Paranay the day before, the day of, or the day after the date an order was placed. *Id.* at 62,911-12.

Also important to the Judgment Officer's determination was the fact that Paranay documented only one objection he made during the life of the account – via e-mail – concerning any deviation by McGovern from Paranay's trading instructions to mirror the model account. When Paranay complained, McGovern cancelled the trades in question, credited the account for the losses resulting from these trades, and re-credited all commissions and fees paid respecting the challenged trades. *Id.* at 62,912.

The Judgment Officer rejected Paranay's claim that McGovern failed to honor a promise to limit losses on several spread trades to $300. The Judgment Officer held that the basis for the allegation—a statement in McGovern's newsletter that he was establishing a $300 "mental stop" on new positions executed for his model account – did not amount to an enforceable promise to limit Paranay's losses to that amount. *Id.* at 62,912-13. Holding that Paranay failed to establish any of his claims, the Judgment Officer dismissed his complaint. This appeal followed.

DISCUSSION

On appeal, Paranay argues that the Judgment Officer erred in failing to find that McGovern engaged in "frontrunning/trading ahead" and unauthorized trading. He also challenges procedural rulings made by the Judgment Officer prior to the hearing as well as the Judgment Officer's conduct during the hearing. Respondents did not file an answering brief.

Commission adjudicatory decisions must be supported by the "weight of the evidence," *i.e.*, the preponderance of the evidence. *Scheufler v. Gerald, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. ¶ 46,339 at 46340 (CFTC March 26, 1998). In determining which way the evidence preponderates in a given case, the Commission conducts an "independent assessment of

the factual record." *Id.* (internal citations omitted). Additionally, we apply a deferential standard of review to a presiding officer's findings regarding witness credibility based on observations of witness demeanor. *In re Global Telecom, Inc.*, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. ¶ 30,143 at 57, 562 (CFTC Oct. 4, 2005). This is especially important in a case such as this, where much of the evidence under consideration is oral testimony that relies upon the parties' recollections of telephone conversations where neither party kept notes.

The alleged activity that Paranay labels as frontrunning or trading ahead is viewed more appropriately as misrepresentation or failure to follow trading instructions.[3] Paranay argues that on numerous occasions, McGovern liquidated positions in his model trading account while advising Paranay to hold them, despite Paranay's instructions and expectation that his and McGovern's accounts would be traded in identical fashion. App. Br. at 2-3. He argues also that the Judgment Officer failed to take into account two oral complaints he made regarding allegedly unauthorized trading, and noted only the emailed complaint. App. Br. at 6-7.

Our review of the record reveals no reason to reweigh the evidence, as Paranay asks us to do. In particular, we find no clear error that would warrant overturning the Judgment Officer's credibility determinations. More importantly, the evidence demonstrates that Paranay's account actually performed better than McGovern's model account during the first phase of trading.[4] Therefore, as the Judgment Officer concluded, even if there were deviations between the model account and the complainant's account, the deviations worked to the complainant's benefit.

Finally, Paranay alleged that McGovern breached a promise to limit losses on trades to $300. Such a promise, if made, would be a prohibited guarantee of trading outcomes. Paranay,

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[3] A broker engages in prohibited trading ahead when the broker intentionally buys or sells for the broker's own account while holding an executable customer order on the same side of the market. *In re Mehmedovic*, 2004 WL 1888323 (C.F.T.C. Aug. 24, 2004).

[4] No comparison of account outcomes is available for the second phase of trading.

however, relies upon a statement in McGovern's February 10, 2006 "Nightly Spread Letter" as evidence of the promise. The newsletter advised readers that McGovern had experienced unexpected losses in the model account, and concluded that "I feel I can no longer accept losses on any particular spread trade of more than $300 plus commissions." This statement facially is neither a prohibited promise to limit losses (to Paranay or anyone else) nor a specific undertaking to perform a particular act or service for complainant. The Judgment Officer determined that the use of this language in the newsletter simply informed McGovern's readers that he was adjusting his trading strategy to try to limit losses to that amount, and that the statement did not amount to a promise to strictly limit losses. ID, ¶ 31,368 at 62,912-13.

Further undercutting Paranay's argument, the Judgment Officer found that Paranay failed to assert that he ever informed McGovern that he expected losses to be limited to no more than $300 per spread, *id.* at 62,912, a finding that Paranay does not contest on appeal. Paranay also testified that he understood that no one could make a guarantee that losses would be limited to a particular amount. Tr. at 34. Accordingly, the Judgment Officer found that it would be unreasonable to conflate McGovern's newsletter into a promise to strictly limit losses to the $300 amount where McGovern was never informed that the complainant would be acting in reliance upon that statement. *Compare Avis v. Shearson Hayden Stone, Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,379 (CFTC Apr. 13, 1982) (salesman's express promise to undertake additional duty obligated him to carry it out in a professional manner).[5]

[5] Among the several allegations made by the complainant is that McGovern engaged in prohibited churning. A claim for churning is established where the complainant shows, by a preponderance of the evidence, that a party controlled the level and frequency of trading in the account, chose an overall volume of trading that was excessive in light of the trading objectives, and acted with either intent to defraud, or in reckless disregard of his interests. *Symon v. Fullet*, Comm. Fut. L. Rep. [1996-1998 Transfer Binder] ¶ 27,121 (CFTC Aug. 7, 1997). While the Judgment Officer does not explicitly address churning, and Paranay does not raise this issue on appeal, we note that the Judgment Officer found credible McGovern's assertions that he treated the account as being non-discretionary because Paranay never executed a power of attorney, that Paranay suggested some trades and that Paranay objected to only one trade. We defer to these findings, which are supported by the circumstantial evidence that McGovern

We have reviewed Paranay's other arguments, including his assertions of error and bias with regard to the Judgment Officer's conduct of discovery and other prehearing proceedings, and his conduct of the hearing. We find that these arguments lack merit and reject them without extended discussion. Our review of the record and Paranay's brief establishes that the Judgment Officer's findings and conclusions are supported by the weight of the evidence, and we therefore adopt them.

CONCLUSION

For the foregoing reasons, the Initial Decision of the Judgment Officer is AFFIRMED.

IT IS SO ORDERED.[6]

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

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

Dated: February 18, 2011

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regularly consulted Paranay before entering trades, and which establish that Paranay, not McGovern, controlled the account. Accordingly, we conclude that the weight of the evidence does not establish a claim for churning.

[6] Under Sections 6(c) and 14(e) of the Act (7 U.S.C. §§ 9 and 18(e)), a party may appeal a reparation order of the Commission to the United States Court of Appeals for only the circuit in which a hearing was held; if no hearing is held, the appeal may be filed in any circuit in which the appellee is located. The statute states that such an appeal must be filed within 15 days after notice of the Commission order, and that any appeal is not effective unless, within 30 days of the effect of the order, the appealing party files with the clerk of the court a bond equal to double the amount of the reparation award.