U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
www.cftc.gov

Office of Proceedings

Received
C.F.T.C.

2009 AUG 27 AM 9:39

Office of
Proceedings
Proceedings Clerk

ALFRED FURST, Complainant, v. MF GLOBAL, INCORPORATED, and PATRICK LEROY LAFFERTY, Respondents.	* * * * * * * * * *	CFTC Docket No. 08-R33

INITIAL DECISION

Introduction

This dispute arises from the liquidation of Alfred Furst's under-margined short March coffee futures position on February 29, 2008. On February 8, Furst had initiated the position, which would become under-margined on two dates: February 22 and 29. In previous margin call situations, during the six years that Furst had traded with MF Global, Furst had been able to wire funds in time to forestall liquidation. However, on February 22, Patrick Lafferty, an associated person with MF Global, had liquidated the short coffee position after he had unsuccessfully tried to contact Furst. Later on the 22nd, when Lafferty did reach Furst, the market happened to have rebounded close to the liquidation price. Given this fortuitous circumstance, Lafferty suggested, and Furst agreed, that Furst quickly wire funds so that Lafferty could offset the buy with a sell, and move the offsetting trades into MF Global's error account, which left Furst with his original short coffee position. This was the only time that a margin call in the Furst account would be resolved in this particular manner.

On the day of the disputed liquidation, February 29, Lafferty called Furst to advise him that the short coffee future was again under-margined and that his account was near deficit. Furst told Lafferty that he intended "to cover my position." Since the term "cover" is commonly used in the commodity futures industry to indicate the offset or liquidation of a short position, Lafferty automatically understood Furst's statement as an intention to offset the short position, rather than deposit additional funds. Thus, Lafferty told Furst -- in a concise, direct and possibly brusque manner -- that Furst should enter a protective stop order, *i.e.*, an order that would either keep him in the market if the market reversed, or kick him out and avoid or minimize an account deficit if the market continued to move against him. The record is not clear on exactly how Furst and Lafferty established the stop price for this order, but both sides agree that the conversation was short and abrupt and that Furst approved the stop order.

About five minutes later, Lafferty reviewed Furst's account, and called Furst to advise him that after a re-calculation he had determined that Furst should lower the stop price for the order to operate effectively as a protective debit stop. Furst approved this new stop order. Neither Furst nor Lafferty raised the notion of wiring additional funds during either conversation. The market later traded up to and through the stop price, triggering the stop. The trade execution left Furst's account with a small deficit.

Furst seeks to recover his trading loss. Furst claims that when he told Laffety that he wanted to "cover" the position, Lafferty should have deduced that Furst was willing and able to wire additional funds later in the day if necessary, and thus that Lafferty should have explicitly given Furst the opportunity to wire more funds, rather than "forcing" the stops on him. Furst also claims that Lafferty's clever resolution of the previous margin call had established a new course of dealing and operated as a waiver of MFG's contractual right to liquidate any under-margined position in its sole discretion:

> I did not have a chance to make a wire transfer in my traumatized state within the fifteen, twenty minutes before it was all over and Lafferty closed the door. Lafferty misled me by his margin or liquidation policy by not explaining or making clear to me that I could still wire the money immediately or by the end of the day and that he could fix the problem just like he fixed the problem a week before when he said "I sold out your coffee position" and then fixed it in five minutes. I feel these people are making up rules as they go along -- certainly not being consistent in their dealings. I believe they saw a big fish and decided to reel it in.
>
> Lafferty knows I'm 70 years old and our relationship over 7 years has been fine. However, his demanding actions and tactical resources make me feel like I'm being bilked.

[Factual Summary of Furst's complaint.]

In reply, respondents seek dismissal of the claim and an award of the debit balance. Respondents assert that Lafferty acted consistently with Furst's instruction to "cover" -- *i.e.,* liquidate -- the short position, by advising him to place a stop loss order, and that Lafferty merely required Furst to lower his buy stop level to a more prudent "debit stop," *i.e.*, a stop order that would be triggered when Furst's margin deposits were nearly or completely depleted. By doing so, Lafferty kept Furst "in the game" as long as possible without adding additional funds and without risking a large debit. Respondents further assert that Lafferty never told Furst that he could not send additional margin deposits, and assert that, once Furst had stated his intention to "cover," Lafferty was not required to explicitly remind Furst that, in the alternative, he could change his instruction and meet the margin call by depositing additional funds. Finally, respondents assert that MF Global did not waive its contractual right to restrict trading in Furst's account or to liquidate under-margined positions, and otherwise deny any violations in connection with the liquidation.

As explained below, after carefully reviewing the parties' documentary submissions,[1] I have concluded that Furst has failed to show any violations by Lafferty or MF Global, and that MF Global has shown that it is entitled to recovery of the debit balance.

Factual findings

The parties

1. Alfred Furst, a resident of Kutztown, Pennsylvania, indicated in his account application in November 2001 that he was born in 1938, that he was a self-employed realtor with an annual income of $85,000 and a net worth in excess of $40,000, and that he had 12 years experience trading futures.

2. MF Global, Incorporated ("MFG"), located in Chicago, Illinois, is a registered futures commission merchant. Patrick Lafferty was at the relevant time registered as an associated person with MFG.

The customer agreement

3. Furst opened his self-directed, discount account at Man Financial, Incorporated, a predecessor of MF Global, in November 2001 by entering into a customer agreement and completing an application and related account opening documents, including a CFTC rule 1.55 risk disclosure statement, and a supplemental Man Financial risk disclosure letter.

In Paragraphs 3 and 5 of the customer agreement, Furst agreed: that he was responsible at all times to maintain, without demand from MFG, adequate margin deposits in his account;

[1] The evidentiary record includes Furst's complaint (with attachments), addendum to complaint, annotated response to answer, and "summation;" and respondents' answer (with exhibits) and "final submission" (with exhibits).

that MFG could demand immediate payment to meet a margin call; and that MFG could liquidate his account, in its sole discretion without prior notice, if his account was under-margined or in deficit. In Paragraph 14, Furst agreed that MFG had the right to restrict trading in his account. In Paragraph 10, Furst agreed that: "Neither [MFG's] failure to insist upon strict compliance with the [customer agreement] or with any of the terms hereof, nor any continued course of conduct on [MFG's] part, shall constitute or be considered a waiver by [MFG] of any of [MFG's] rights or privileges hereunder."

The term "cover"

4. The term "cover" is commonly used in the commodity futures industry to indicate the close-out or offset of a short position. *See, e.g.*, CFTC *Glossary*; *Dictionary of Futures and Options* (Probus Dictionary 1994); *Commodity Trading Manual* (Board of Trade of the City of Chicago 1989); and *The Futures Market Dictionary* (New York Institute of Finance 1986). Thus, when Furst told Lafferty that he would "cover" his short Cocoa position, Lafferty would automatically understand that as an unambiguous instruction to meet the margin call and to avoid an account deficit by offsetting the short position, rather than by depositing additional funds. [2]

Unfortunately, Furst would later reveal that he had intended to use the term "cover" as it is understood in poker – to match an opponent's stake in a wager – in order to express a willingness to wire funds to MF Global later in the day:

> To cover my position is like when you are in a card game with friends, and you are down to your last chip, but you believe you have a winning hand and cover (whatever the bet). If I lose, I will pay you later in the day or tomorrow.

[Furst's annotated reply to respondent's answer.]

---

[2] In this connection, the *American Heritage Dictionary of the English Language* lists 20 distinct definitions for the transitive verb "cover," for which a wide variety of idiomatic meanings has developed in several fields including stock trading, poker, equine husbandry, insurance, journalism, baseball, basketball, and popular music.

Previous margin calls

5. Before the disputed liquidation on February 29, 2008, Furst had largely avoided margin calls, and for the few margin calls that he did face he had successfully avoided liquidation by wiring additional funds to MFG. According to Furst:

> I have had numerous trades since opening my account. I have had one or two margin calls by mail and one wire transfer, and paid them in a timely manner.

[Factual summary of Furst's complaint.]

6. On February 8, 2008, Furst initiated a short March coffee future, at 145.75. This is the contract that would be the subject of this dispute.

On February 22, the account was under-margined and approaching deficit during a big move against Furst's short coffee position. Lafferty could not reach Furst and liquidated the short position with a buy at 159.70.

Furst was upset when Lafferty did reach him and advise him about the liquidation, because never before had he been liquidated without prior notice:

> Lafferty called and said, "I sold out your coffee position." I said "What! After seven years of dealings and you treat me like this. Not even a call for margin money?"

[*Id.*]

Shortly afterwards, the market rebounded back to the same price that Lafferty had earlier liquidated. Lafferty called Furst and told him that if Furst wired funds that day, Lafferty could offset the liquidating trade and leave Furst with his original position:

> Five minutes later, he calls and says: "I can fix this. But wire me money today."

[*Id.*]

After Furst agreed to wire additional funds, Lafferty offset the 159.70 buy with a 159.75 sale, and moved the offsetting two trades into MFG's error account. This left Furst with his original short position. Later that afternoon, MFG received Furst's wire, and Furst was off margin call.

This outcome resourcefully engineered by Lafferty no doubt pleased Furst. However, Furst never informed Lafferty that he actually expected him to perform similar feats to resolve future margin deficits, and Lafferty never suggested to Furst that he would or could resolve all future margin calls in a similar manner.

Disputed liquidation

7. On February 29, 2008, the market moved sharply against Furst's short March coffee futures position. Lafferty contacted Furst and issued a margin call. Furst told Lafferty simply that he would "cover" the position. Lafferty told Furst that he should place a protective buy stop order, which Furst authorized. About five minutes later, Lafferty determined that the buy stop level would leave Furst with a substantial deficit in the account, and re-calculated the necessary prudent price for the buy stop for it to function properly as a debit stop. Lafferty called Furst and told him that the buy stop had to be placed at 168.60 or lower in order to avoid a debit balance. Furst agreed. According to Furst:

> Five minutes later he calls and says, "No, your stop will be 168.60." Bang went the receiver. Before I could assimilate all this, I was traumatized with the effects I've heard.

[*Id.*] [3]

[3] Furst and Lafferty dispute exactly who set the stop price for the first stop order: Furst points to Lafferty, who points to Furst. Nonetheless, Furst and Lafferty agree that for the second stop order it was Lafferty who had re-calculated the debit stop price. Since this second stop order is the liquidation order that was executed, it is not necessary to resolve the parties' dispute about who set the price for the first stop order. In this connection, Lafferty has stated that he routinely recorded conversations with customers, but that he discovered, in the course of preparing

The market later traded up to and through that price, triggering the stop. As a result of "slippage," the trade was executed at 169.20. This left Furst's account with a $219.93 deficit. According to Furst:

> Lafferty called and said the stop was hit and that I still owe $169.20 [*sic*] plus interest if not paid on time. It is to be noted the first stop of 171.10 he assigned to me was never hit.

[*Id.*]

Subsequently, Furst complained to MFG that Lafferty had put him under "extreme pressure" to approve the stop-loss orders, and Lafferty advised Furst that he should find a new broker, because they could no longer work effectively together.

Conclusions

Initial and maintenance margin provide a means for futures commission merchants to assure their financial integrity and contribute to the financial integrity of the entire marketplace. For this reason, the Commission has consistently upheld the right of a broker to liquidate a customer account when the account is under-margined, or when the broker otherwise deems liquidation necessary to protect itself or the customer, based upon its own good-faith business judgment. *Baker v. Edward D. Jones & Co.*, Comm. Fut. L. Rep. (CCH) ¶ 21,167 (CFTC 1981); *see also Gelderman v. Lane Processing, Inc.*, 527 F2d 571 (8th Cir. 1975). In *Baker,* the Commission stated that "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." Id. Thus, if a customer indicates that he will not be depositing additional funds to meet a margin

for this case, that his recording system had not been working for a while, and thus that the recordings of his two conversations with Furst were inaudible. *See Gilbert v. Lind-Waldock,* Comm. Fut. L. Rep. ¶ 26,720 (CFTC 1996) (adverse inferences not drawn for respondent's failure to retain tape-recordings which respondent was not mandated to retain).

call, the futures commission merchant may choose to liquidate immediately via a market order or to set a prudent price for a protective stop order. Accordingly, in order to establish wrongdoing by Lafferty and MF Global, Furst must show by a preponderance of the evidence either that Lafferty disregarded his instructions, that Lafferty misled him about MF Global's margin policy, or that Lafferty otherwise acted in bad faith when he advised Furst to place a protective stop order.

On this record, Furst has not shown that Lafferty disregarded his instructions, deceived him about MF Global's margin policy, or acted in bad faith. The customer agreement provided that Furst was responsible for maintaining, without demand from MF Global, adequate margin deposits in his account. The agreement also provided: that MF Global could demand immediate payment to meet a margin call; that MF Global could liquidate his account, in its sole discretion without prior notice, if his account was under-margined or in deficit; and that MF Global could restrict trading in his account if it deemed him in default of the agreement. The agreement also provided that any deviation from "strict compliance" with these or other contractual provisions would not constitute a waiver by MF Global of any of its contractual rights or privileges. In Furst's case, in the six-plus years before February 2008 he had faced very few margin calls, and in those rare instances the circumstances had permitted Furst to forestall liquidation by depositing additional funds.

The circumstances on February 22, 2008 were different and unique. On that date, Lafferty could not reach Furst when the account became under-margined and in danger of deficit, and thus liquidated the position without prior notice. That in itself was not unique, but what next happened was. Soon afterwards, the market fortuitously reversed back to the liquidation price. Thus, when Lafferty did reach Furst, he was able to advise Furst that he could reinstate the position at about the same price if he wired more funds, which Furst did. Nothing in the record shows that Lafferty promised Furst that he could resolve all margin deficit situations in this manner, or that Furst ever informed Lafferty that he expected him to "fix" all future margin deficit situations in a similar manner. Thus, Furst was merely imputing to respondents his own mistaken expectation of a similar fix for all future margin calls, and could not reasonably shift to respondents his responsibility to maintain adequate margin and to provide adequate margin on demand. *See* Grist v. Shearson Lehman Brothers, Inc., Comm. Fut. L. Rep. (CCH) ¶ 24,962 (CFTC 1990); *and* Avis v. Shearson Hayden Stone, Inc., Comm. Fut. L. Rep. (CCH) ¶ 21,379 at page 25,831 n.7 (CFTC 1982).

On February 28, Lafferty advised Furst that the same short coffee position again had become under-margined and that his account was in danger of deficit. Lafferty's manner made it clear that a rising coffee market and a looming account deficit dictated that Furst must decide on-the-spot how to meet the margin call. This merely conveyed objective reality, and did not constitute arbitrary and unreasonable pressure.

When Furst replied simply to Lafferty that he would "cover" his short coffee position, Furst may have subjectively intended this statement to convey a willingness to wire more funds. However, Lafferty reasonably interpreted that statement as it has customarily been used in the futures industry: an unambiguous instruction to meet a margin call by offset rather than wiring more funds. Once Furst gave this instruction, Lafferty was not required to explicitly remind Furst that he could, in the alternative, wire more funds to meet the margin call, particularly since Furst had extensive experience and had previously met margin calls with deposits. Rather, consistent with Furst's instruction, Lafferty calculated the prudent price for a protective debit stop order that would keep Furst "in the game" as long as possible without adding additional funds and without risking a large debit. In these circumstances, Furst's claim that Lafferty misled him about MF Global's margin policy, and unreasonably "forced" Furst to authorize the protective debit stop order is without merit.

ORDER

Complainant has failed to establish any violations by respondents causing damages. Accordingly, the complaint in this matter is dismissed.

Respondents have established that MF Global is entitled to recover the debit balance of \$219.93. Accordingly, Alfred Furst is ordered to pay to MF Global \$219.93, plus interest on that amount at 0.44% compounded annually from February 29, 2008, to the date of payment, plus \$75 for the cost of the filing fee for the answer.

Dated August 27, 2009.

Philip V. McGuire,
Judgment Officer