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UNITED STATES OF AMERICA

Before the

COMMODITY FUTURES TRADING COMMISSION

THOMAS J. PRESTON, III, and
THOMAS J. PRESTON, JR.,

Complainants,

v.

REFCO, INC., DAVID J. BOUVIER, and
DAVID M. KAVANAGH,

Respondents.

CFTC Docket No. 96-R097

INITIAL DECISION

Appearances:

For the Complainants:

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For the Respondents:

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Before: George H. Painter, Administrative Law Judge

I. INTRODUCTION

On May 17, 1996, Thomas J. Preston, III, filed this reparations complaint, as the sole complainant, with the Office of Proceedings. The complaint alleges that, on April 11, 1996, respondent David J. Bouvier engaged in unauthorized trading, in violation of Commodity Futures Trading Commission (hereinafter "CFTC") Regulation § 166.2, by entirely liquidating complainant's commodity account, and that respondent Bouvier made fraudulent representations regarding these trades, in violation of Section 4b of the Commodity Exchange Act (hereinafter "CEA"). Complainant further alleges that respondents David M. Kavanagh and Refco, Inc., each failed to diligently supervise respondent Bouvier, in violation of CFTC Regulation § 166.3. Complainant requests an award of $97,000.00, as payment for the deficit generated in his account as a result of the alleged unauthorized trades. The Office of Proceedings notified complainant of additional information required in order for processing and upon its receipt, the complaint was then served on respondents David M. Kavanagh, David J. Bouvier, and Refco, Inc.

On July 11, 1996, respondents filed an answer with the Office of Proceedings, denying any wrongdoing, asserting that its actions were fully authorized by complainant's Customer Account Agreement (hereinafter "Customer Agreement") with Refco, Inc., due to complainant's inability to satisfy margin obligations. Respondents also filed a counterclaim for the debit balance in complainant's account in the amount of $97,305.97, in addition to interest, reasonable attorney's fees and other costs. Complainant filed an answer to the counterclaim on August 12, 1996, denying the allegations and requesting that the counterclaim be dismissed. This reparations case was then forwarded to the Proceedings Clerk and assigned to this Court for disposition.

On November 12, 1996, respondents moved for dismissal of the complaint unless Thomas J. Preston, Jr., was added as a party complainant, alleging that he remained a joint holder of the account in question on April 11, 1996. Respondents also requested leave to amend its counterclaim in order to add Thomas J. Preston, Jr., as a respondent. Thereafter, an amended complaint was filed, adding Thomas J. Preston, Jr., as a co-complainant. Respondents filed an Amended Answer and Counterclaim on February 14, 1997.

The hearing was held on July 8, 1997, in Chicago, Illinois. The parties have filed post-hearing briefs and this matter is ready for disposition.

II. FINDINGS OF FACT

The Parties

1. Complainant THOMAS JERALD PRESTON, III (hereinafter "Preston III") is a resident of the state of Illinois. (Complaint [hereinafter "Comp."] at 2.) He is employed as a commercial industrial roofing contractor. (Transcript [hereinafter "Tr."] at 11; Respondents' Exhibit [hereinafter "R-Exh."] 2.) His commodity trading history consisted of an account he had maintained at Keystone for six months before closing it in order to open an joint commodity account with respondents on October 3, 1994. (Tr. at 11; R-Exh. 1-2.)

2. Complainant THOMAS JERALD PRESTON, JR. (hereinafter "Preston Jr.") is a resident of the state of Illinois and is the father of Preston III. (Amended Comp.; Tr. at 100.) After opening a joint account with Preston III, he opened an individual account with respondents in December of 1995. (Tr. at 106; R-Exh. 1, 3.)

3. Respondent REFCO, INC., (hereinafter "Refco") is an Illinois corporation with its principal place of business in Chicago, Illinois. (Answer [hereinafter "Ans."] at 12.) Refco was registered with the CFTC as a Futures Commission Merchant (hereinafter "FCM") during the time period in question. (Ans. at 2.)

4. Respondent DAVID M. KAVANAGH (hereinafter "Kavanagh") was registered with the CFTC as an Associated Person (hereinafter "AP") with Refco during the time period in question. (Ans. at 3.) He describes himself as an independent operator and partial owner of a money management firm which is registered with the CFTC as a Commodity Pool Operator (hereinafter "CPO") and Commodity Trading Advisor (hereinafter "CTA"). (Tr. at 230, 250-51.) He clears trades through Refco by virtue of his Board of Trade registration as a floor broker and, as a result, is responsible to Refco for any debit account balances belonging to his customers. (Tr. at 232, 250.) Kavanagh's expertise is in financial futures and he spends his work day in the treasury bond area on the Chicago Board of Trade. (Tr. at 232, 235.) The "upstairs operation" of his firm serves retail customers, which included complainants, in the market for non-financial instruments. (Tr. at 231.)

5. Respondent DAVID J. BOUVIER (hereinafter "Bouvier") was registered with the CFTC as an AP with Refco during the time period in question. (Ans. at 3.) He has been employed by Kavanagh for over three years and has worked in the commodities industry for about four and a half years. (Tr. at 114, 191.) Bouvier worked in the "upstairs operation." (Tr. at 115.) He was both hired and directly supervised by Mr. John Miles. (Tr. at 115-16.)

Credibility Determinations

6. The testimony of respondents Bouvier and Kavanagh was found to be honest and straightforward. Their testimony, along with the testimony of John Miles, was consistent, corroborative, and objectively credible. In addition, respondents' testimony was deemed most reliable after viewing the record in its entirety.

7. The testimony of complainants Preston III and Preston Jr. was found to be less credible. On frequent occasions, however, both individuals gave honest testimony that detracted from their case. In particular, the testimony of Preston III with respect to events predating April 11, 1996, were deemed credible. His testimony regarding statements made by respondent Bouvier immediately preceding the liquidation was found to be unlikely in the face of conflicting testimony from respondents' three witnesses at the hearing, surrounding circumstances, and the weight of the evidence.

8. In sum, the testimony of respondents and John Miles concerning events surrounding the liquidation of complainants' account was more plausible in light of the entire record.[1]

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[1] It is unclear what deference such findings will be given upon review. Traditionally, the Commission has given great deference to the factual findings of the administrative law judge, requiring the appellant to establish clear error on the part of the judge before such findings are overturned. Secrest v. Madda Trading Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,627, at 36,696 (CFTC Sept. 14, 1989) (citations omitted). This approach is similar to the strict standard of review for trial judges, pursuant to Rule 52 of the Federal Rules of Civil Procedure. Id. This policy has its basis not only in expertise and efficiency but especially when witness credibility is the key to resolution of the case since "the presiding officer has had an opportunity to become aware of the variations in demeanor and tone of voice that bear so heavily on a listener's understanding of and belief in a witness's statement, his unique vantage point provides an added dimension to the general rationale for deference on factual matters." Id. Although accepting the ALJ's credibility determinations, however, upon review it may be decided that the ALJ committed clear error in finding that this testimony was "sufficiently reliable to serve as an adequate basis for findings of fact that must be supported by the weight of the evidence." Id.

The more current trend has been for the Commission to review credibility determinations, requiring that the record evidence a sufficient basis for credibility findings. A. Antoine Kacem v. Castle Commodities Corporation, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,058 (CFTC May 20, 1997). This is in direct conflict with the reasoning behind a policy of deference, since it is only the ALJ who attends a hearing and can therefore evaluate first-hand the demeanor of a witness. (continued . . .)

The Account

9. On October 3, 1994, Preston III opened a non-discretionary joint account with Preston Jr., through respondent Refco, with an initial deposit of $10,000. (Ans. at 4, 13; Tr. at 43, 57, 116-17; R-Exh. 2-3.) Respondent Bouvier was the account executive for complainants' joint commodity account throughout the life of the account. (Tr. at 21.)

10. Towards the end of 1995, Preston III had discussed with Bouvier the removal of Preston Jr. from the joint account.[2] (Tr. at 43-46, 117-18.) Preston III stated that he needed to have his father removed from the account because of a legal dispute between Preston Jr. and another man, fearing that this man who was enforcing liens against the father would seize the joint account. (Tr. at 44-46, 173-74.) Bouvier gave Preston III instructions on how to remove the father from the account. (Tr. at 45-46; 119-20.)

11. Preston Jr. sent a signed letter to Bouvier in December of 1995. (Tr. at 107-08.) This letter served to create an individual account for Preston Jr., a second account. (Tr. at 107, 118-19.)

12. Bouvier told Preston III that this letter was insufficient to remove Preston Jr. from the joint account. (Tr. at 46, 119.) Bouvier stated that a written letter was needed, signed by both parties, expressing their desire that Preston Jr. be removed from the joint account. (Tr. at 58-59,

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The Commission most recently, however, restated its policy of deference to demeanor-based determinations reflecting both the "efficacy of oral testimony as a fact-finding tool," In re Michael F. Staryk, No. 95-5, 1997 WESTLAW 778236, at *12 (CFTC Dec. 18, 1997), and the hearing as "'the best tool for reliably assessing . . . credibility'." Id. (quoting In re Abrams, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,684, at 40,255 (CFTC Apr. 29, 1993)).

[2] Preston Jr. himself never orally communicated this desire to Bouvier or sent written instructions to Bouvier expressing that he be removed from the joint account. (Tr. at 118.)

119-20.) Such a "second letter" was never signed by Preston Jr. or received by Bouvier.[3] (Tr. at 105-06, 120, 172-73.)

Prior Course of Conduct

13. Prior to the date in question, April 11, 1996, the joint account had been subject to margin calls at two points in time: a series of calls in November of 1994, and one margin call in May of 1995. (Tr. at 123-24.) These calls were met promptly. (Tr. at 123-24.)

14. Prior to the date in question, April 11, 1996, the joint account had never been in a deficit position. The morning of April 11, 1996, was the first occasion that the account had a negative value. (Tr. at 55-56.)

15. Preston III authorized a total of eight checks over the life of the account. (Tr. at 164-65; Group Exh. 1.) The majority of these checks were to increase the funds available in the account, not to meet margin obligations. (Tr. at 123-24, 164.)

16. All but one of the eight checks from Preston III were sent to New York to be deposited. (Tr. 164-65.) Refco's margin department is located in New York. (Tr. at 125, 165.) The normal procedure was that any check to fund an account, even a new account, be sent to New York. (Tr. at 165.) Checks were not sent to New York to provide complainant with a "float." (Tr. at 125)

17. The $71,000 check authorized by Preston III on April 10, 1996, was the only check deposited and cleared in Chicago, where his account was located. (Tr. at 16, 165; R-Exh. 8.) It was deposited on April 11, 1996. (Tr. at 20.) It cleared on April 12, 1996. (R-Exh. 8.) The normal procedure, the sending of checks to New York, was not followed since the funds needed

[3] Although Preston III attests that such a letter was written and sent, he does not have a copy of this document showing that this authority was given. (Tr. at 59.)

to be deposited directly into the account because of the size of the account's position and complainant's lack of funding to meet the margin call the next day. Direct deposits into the account are permitted under certain circumstances, such as existed here. (Tr. at 180.)

The Strategy

18. Preston III kept detailed and current records on the status of his accounts with Refco. (Tr. at 122-23, 196-97.) He was in contact with Bouvier, his account executive, anywhere from five to ten times a day.[4] (Tr. at 52-53, 120.)

19. The commodity account typically maintained between 50 to 100 contracts in a specific commodity. (Tr. at 122.)

20. Primarily as a result of reading You Can't Lose Trading Commodities, by Robert Wiest, Preston III engaged in scale trading as a strategy. (Tr. at 51-52, 121-22, 197-98.) In order to be successful, this strategy requires correct estimations of the bottom of the market and deep financial pockets to finance margin calls in order to hold positions from increased buying in the bottom ranges of the commodity. (Tr. at 51-52, 122, 126, 197-200.)

21. Towards the end of 1995, Preston III stated to Bouvier that he intended to set aside $200,000 in cash in order to build up his account. (Tr. at 125-26.) In January of 1996, Preston III stated to Bouvier that the $200,000 had, in fact, been set aside. But for this liquid reserve, Bouvier and Miles would not have permitted Preston III to retain such a large position. (Tr. at 125-26, 130-31, 204-05.)

22. In the days preceding April 10, 1996, Bouvier informed Preston III that the $200,000 cash set aside to sustain the account's feeder cattle positions might be needed. Bouvier discussed

[4] In contrast, Bouvier spoke to Preston Jr. about once a month. (Tr. at 182.)

the possibility of a decline in feeder cattle prices. Preston III replied that he would rather not use these funds. (Tr. at 129-130.)

<u>April 9-10, 1996</u>

23. On April 9, 1996, Preston III was aware that his account was worth more than \$150,000.[5] (Tr. at 62-63; R-Exh. 4.) At that time the account held in excess of 200 feeder cattle contracts. (Tr. at 51, 128, 202; R-Exh. 4.)

24. On April 10, 1996, Preston III bought approximately 50 feeder cattle contracts, bringing his total feeder cattle contracts to roughly 250 in size. (Tr. at 23-24, 51, 128, 132, 207; R-Exh. 5.) The feeder cattle market locked limit down during trading on this day.[6] (Tr. at 132-33; 205-06.) The value of the account, at the close of April 10, 1996, was less than \$4,000. (Tr. at 60-63, 133; R-Exh. 5.)

25. Although the margin call was not precisely calculated on April 10, 1996, after the close of the market Bouvier phoned Preston III to tell him to anticipate a margin call in the estimated range of \$130,000 to \$150,000. (Tr. at 63, 134-36.)

26. It is undisputed that when Bouvier provided this estimate Preston III replied that he did not have the funds to meet such a margin call. (Tr. at 25, 66, 135-36.) When Bouvier suggested he use the \$200,000 he had set aside, Preston III informed Bouvier that he no longer had these funds, having reinvested them in his business. When Bouvier asked what funds he did

[5] This represented an approximate \$289,000 cash value minus \$140,000 in unrealized losses from open positions. (Tr. at 129; R-Exh. 4.)
[6] The market locks limit down when the market falls 150 points in a trading session. Exchange rules prohibit further trading of feeder cattle contracts at any lower price that day. (Tr. at 132.)

have available, Preston III said he could come up with $71,000 and nothing else.[7] (Tr. at 25, 136-37, 165-66.)

27. Preston III authorized respondent Bouvier to make out a pre-signed check for $71,000 and deposit it towards the margin due, since this was all he had. (Tr. at 63-66; R-Exh. 8.)

28. Bouvier informed Preston III that the account would be in deficit if the feeder cattle market opened approximately 40-50 points lower on April 11, 1996. (Tr. at 138.)

29. Bouvier informed Preston III that if additional funds were not deposited into the account by the following morning, positions in the feeder cattle market would have to be liquidated. (Tr. at 138, 146.)

30. It is undisputed that the plan at that time, with regard to positions to be liquidated, was based on the goal of bringing the account value back into margin compliance, as required by Exchange rules.[8] (Tr. at 67-68.)

31. The $71,000 payment was not in return for a promise by Bouvier that no liquidation of the account would occur. (Tr. at 138, 148, 207-10, 212.)

<u>April 11, 1996</u>

<u>Pre-market opening</u>

32. On the morning of April 11, 1996, prior to the market opening, Bouvier spoke to Preston III four times. (Tr. at 140-41; R-Exh. 10-11.)

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[7] Preston III deposited $66,000 in his account on April 10, 1996, which were funds provided by a line of credit from Old Kent Bank. (Tr. at 64-65, R-Exh. 12.)

[8] Although testimony from Bouvier and Preston III referred to margin compliance as "required by law," it is the exchange that dictates margin rules, an area excepted from CFTC authority, pursuant to Sections 5a(12) and 8a(7) of the Commodity Exchange Act. <u>Baker v. Edward D. Jones & Co.</u>, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,167, at 24,770 (CFTC Jan. 27, 1981).

33. By this time, the Customer Equity and Account statement, containing the account activities for the previous day, was available to Bouvier.[9] (Tr. at 142-43; R-Exh. 5.) The exact final margin call of $151,325 was contained in this statement and communicated to Preston III. (Tr. at 127, 142-44; R-Exh. 5.)

34. When Bouvier asked Preston III again whether he had additional money to post, he responded that he had nothing.[10] (Tr. at 65-66, 142.) Bouvier stated that, without additional funding, liquidation was the only option. (Tr. at 142.)

35. It is undisputed that Preston III and Bouvier agreed on the morning of April 11, 1996, prior to the market opening, to lighten the account's load by selling off some of the contracts. (Tr. at 25-26, 66-67, 142.) This action was taken in order to bring back the account value into margin compliance, as required by Exchange rules.[11] (Tr. at 67-68.)

36. Preston III may have hoped, or even anticipated, that only a few positions be liquidated, but as he testified, this would have only been a viable option if the market cooperated and did not decline enough to push the account into a negative balance. Preston III did not expect respondent Refco to absorb a debit created by the account. (Tr. at 68, 98.)

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[9] This statement is customarily prepared late that night for the day's trading activity and is available the following morning when respondent Bouvier comes into work. (Tr. at 127.)
[10] Complainants' source of funds on April 11, 1996, consisted of approximately $145, 000. Preston III had $12,800 of deposits for the month of April in his interest checking account at Old Kent Bank. (Tr. at 83; R-Exh. 12.) He had approximately $237 in his personal savings account at Old Kent Bank. (Tr. at 84; R-Exh. 13.) Preston Jr. had approximately $3,000 in his checking account at Harris Bank on April 22, 1996. (Tr. at 84-85; R-Exh. 14.) Preston Jr. had approximately $6,300 in a second checking account at Villa Park Trust & Savings Bank on April 12, 1996. (Tr. at 85; R-Exh. 15.) Preston Jr. and his wife had retirement accounts with a total value of approximately $124,000, as of June 30, 1996. (Tr. at 86; R-Exh. 16.)

At the hearing, Preston Jr. testified for the first time that his house, appraised at $215,000 with a small mortgage, could have been used at the time to provide a line of credit within 10-15 minutes. (Tr. at 101.)
[11] See supra note 8.

Market opening

37. The fifth and final phone conversation between Preston III and Bouvier prior to liquidation occurred at approximately 9:05 a.m., at the feeder cattle market opening, and lasted for about 10 minutes. (Tr. at 68-69, 144-45; R-Exh. 9, 11.) Preston III and Bouvier were on the phone at the opening of the market, each watching the feeder cattle market on their respective screens. (Tr. at 28, 145, 217-18.)

38. Feeder cattle contracts dropped, opening approximately 100-150 points lower with the front month feeder cattle contracts locked limit down during their conversation. (Tr. at 27-28, 145-46.)

39. Preston III was told by Bouvier that his commodity account now had a negative liquidation value, prior to any liquidation, sales, or closing out of positions in his account. (Tr. at 70-72, 146, 218.) At this point, Preston III would have needed approximately $177,000 to maintain his account.[12] (Tr. at 89-90.)

40. Bouvier and Preston III agreed that it would be necessary to close out at least some of the contracts since he did not have the funding to hold the positions. (Tr. at 67, 146-48.) Bouvier told him that liquidation would start with the back months that were off limit and proceed from there. (Tr. at 28-29, 148.)

41. Bouvier did not make any promises not to liquidate the account or any promise to only liquidate certain positions. (Tr. at 148.)

Liquidation

42. After the phone call between Preston III and Bouvier ended, Bouvier commenced liquidation. (Tr. at 149.) Preston III ended the conversation knowing that the market was

[12] The $177,000 is composed of $80,000 in unpaid margin plus $97,000 representing the deficit position. Id.

plummeting and that Bouvier was going to close out at least some of his positions. (Tr. at 72.) Preston III went to church to pray, worried about what was going to happen. (Tr. at 30, 72-73.)

43. John Miles, Bouvier's immediate supervisor and head of the "upstairs operation," advised Bouvier and witnessed the liquidation process that Bouvier was conducting. (Tr. at 149, 219.)

44. Miles referred Bouvier to one of the floor brokers, in order to determine the best way to liquidate an account of this size. (Tr. at 139.) Bouvier was advised by the floor broker that the order should not be put out all at once but in ten and twenty lots. (Tr. at 139-40.)

45. During the liquidation, Bouvier telephoned Preston III at his office twice, once at 9:58 a.m. and again at 10:08 a.m., but Preston was not there. (Tr. at 150-52; R-Exh. 9, 11.) Bouvier left a message with his mother, saying that he had called. (Tr. at 73-74, 150-52.)

46. Once the liquidation commenced, respondents did not wait for the market to improve, incapable of being able to forecast the market. (Tr. at 221-22.)

47. Liquidation of the entire account was completed by 11:00 a.m. (Tr. at 221; R-Exh. 6.) The positions in feeder cattle contracts that were closed out on this day generated a loss of approximately $487,000. (Tr. at 155; R-Exh. 6). These losses, netted out with the balance of the commodity account, rendered a negative account value of $97,305.97. (Tr. at 155, 222; R-Exh. 6.)

<u>Post Liquidation</u>

48. Complainant eventually spoke to respondent Bouvier at 11:10 a.m., when Preston III returned Bouvier's call. (Tr. at 74, 151; R-Exh. 10-11.) Bouvier told Preston III that his entire

account had been liquidated. Preston III did not voice any complaints regarding the complete liquidation of his account. (Tr. at 151-52.)

49. During the four phone calls that took place later that afternoon between Bouvier and Preston III, complainant did not voice any complaints regarding the complete liquidation of his account. (Tr. at 153-54; R-Exh. 9-11.) The topic of these conversations was the debit amount in the account. (Tr. at 153-54.) Preston III acknowledged responsibility for the debt owed. (Tr. at 91.)

50. Respondent Bouvier telephoned Preston III on April 12, 1996. Preston III did not voice any complaints regarding the liquidation of his account the previous day. He acknowledged the debt and his responsibility for the debt, understanding that this was a chance he had taken. He ensured Bouvier that he was a good and honest person and would pay the debt. Preston III also asked Bouvier about repayment arrangements. Bouvier arranged a meeting for the following Monday with himself, Preston III, and respondent Kavanagh. (Tr. at 90-91, 158-60.)

51. Miles spoke with Preston III on April 12, 1996, as well. Preston III inquired as to what to expect from Kavanagh in terms of debt repayment. Preston III did not voice any complaints regarding the complete liquidation of his account on April 11, 1996. (Tr. at 223-25.)

52. Complainant Preston III met with Bouvier and Kavanagh on April 15, 1996. (Tr. at 36, 160, 238). Complainant reiterated that he would satisfy his debt and agreed to sign a promissory note, although he did not sign one at that time. (Tr. at 91-92, 160, 239.) Preston III mentioned his other financial obligations and requested that respondents grant him time and maintain secrecy with respect to this debt owed. (Tr. at 160-61.) He did not voice any complaints regarding the complete liquidation of his account on April 11, 1996. (Tr. at 240.)

53. During phone calls between Bouvier and Preston III following the April 15, 1996, meeting, Preston III continued to take responsibility for the debt. Preston III did not voice any complaints regarding the complete liquidation of his account on April 11, 1996. (Tr. at 162.)

54. Preston III discussed his scale trading strategy with Bouvier during one of these calls, asking Bouvier what had gone wrong. (Tr. at 162-63.) Although Bouvier agreed with Preston III that the strategy had worked up to a certain time, Bouvier stated that the problem occurred because Preston III had taken too heavy a position in feeder cattle. (Tr. at 163.) Preston III responded by acknowledging that he had gotten greedy. (Tr. at 163.)

55. During the single phone call between Preston III and Kavanagh following the April 15, 1996, meeting, Preston III spoke about a possible plan to pay off the debt. (Tr. at 241-42.) Prior to the filing of this lawsuit on May 17, 1996, Preston III never voiced to Kavanagh any allegations concerning respondents' misconduct with respect to the liquidation of his account on April 11, 1996. (Tr. at 244.)

Present Debt Status

56. Following the April 15, 1996, meeting, respondents sent Preston III a draft promissory note to sign. (Tr. at 41, 161.) Preston III told Bouvier that he wanted to have his attorney review it before he signed. (Tr. at 161, 239.)

57. The promissory note drafted was never signed. (Tr. at 41, 244.) Preston III explained to Bouvier that he could not afford the repayment terms and asked Bouvier what the consequences of default would be and if there were any other options available.[13] (Tr. at 41-42.)

[13] Payment terms were $30,000 down on December 1, 1996, and $5,000 increments every month until the debt was repaid. (Tr. at 243.)

Bouvier told Preston III that Kavanagh was not going to make any more concessions and that Preston III should sign the note at once. (Tr. at 42.)

58. Refco has held back respondent Kavanagh's future commissions earnings in order to satisfy the debt. Kavanagh has also been responsible for payment of attorneys' fees related to the counterclaim proceeding. (Tr. at 235-36, 251.)

59. Preston III has yet to pay any portion of the debt. (Tr. at 93-94, 162.)

Preston Jr., the father

60. Bouvier, the account executive, "rarely, if ever" spoke to Preston Jr. (Tr. at 182.) From the start of the joint account, statements had always been sent solely in the name of Preston III. (Tr. at 173.)

61. Preston Jr. was considered by respondents to be a "silent partner" since he was not active in the account. (Tr. at 181-82; 196.)

62. Preston Jr. was never served with a margin call. (Tr. at 105, 181-82, 196.)

63. Following the liquidation, Preston Jr. was never contacted by respondents with respect to the debt owed on the joint account. (Tr. at 173, 181, 246-47.)

64. Respondents never asked Preston Jr. to sign any promissory note regarding the debit created by the account's liquidation. (Tr. at 105, 173.)

III. DISCUSSION

CLAIM #1: Unauthorized Trading by Respondent Bouvier

The focus of complainants' arguments in the case at bar is that respondent Bouvier did not have the authority, on April 11, 1996, for the entire liquidation of the commodity account and is therefore in violation of Regulation § 166.2. Quite simply, complainants allege that they neither gave permission for the entire liquidation nor received notice prior to the entire liquidation. Complainants assert, therefore, that they are not liable for the $97,305.97 debit value thereby created. Complainants are correct in their assertion that they have an absolute right to avoid liability based on trades that they did not authorize. Sherwood v. Madda, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,728, at 23,018 (CFTC Jan. 5, 1979). However, this Court does not find that the trades in question were unauthorized.

As explicitly laid out in the Customer Agreement, signed by complainants Preston III and Preston Jr. on October 4, 1994, the actions taken by respondents on April 11, 1996, were in accord with their contractual rights regarding the liquidation of accounts.[14] So long as one of the many independent conditions was met, respondents were free to liquidate an account in its entirety and without notice to complainants.[15] The account had satisfied two conditions, arguably three, each independently warranting liquidation.

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[14] The Customer Agreement contains the following:

> **5. LIQUIDATION OF ACCOUNTS**. In the event of . . . (d) insufficient margin, or Refco's determination that any collateral deposited to protect one or more accounts of Customer is inadequate, regardless of current market quotations, to secure the account, or (e) any other circumstances or developments that Refco deems to require action necessary for its protection, Refco is hereby authorized, according to its judgment and in its sole discretion, to take one or more or any portion of the following actions: . . . (2) sell any or all futures contracts, commodities, or securities held or carried for Customer or purchase any or all futures contracts, commodities or securities held or carried as a short position for Customer; and (3) cancel any or all outstanding orders, contracts, or any other commitments made on behalf of Customer. Any of the above actions may be taken without demand for margin or additional margin, without prior notice of sale or purchase or other notice or advertisement to Customer . . . . Customer at all times shall be liable for the payment of any debit balance upon demand by Refco, and shall be liable for any deficiency remaining in Customer's account(s) in the event of the liquidation thereof . . . .

(R-Exh. 1) (emphasis added.)

[15] See Modern Settings, Inc. et al. v. Prudential-Bache Securities, Inc., et al., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,074, at 38,022 (CA-2 May 6, 1991) ("Liquidation provisions in securities broker-customer contracts have been upheld by courts where sufficient equality of bargaining power exists, as between a sophisticated, experienced investor and a broker, and where the liquidation provisions are commercially

First, the account was undermargined, in accordance with subpart (d) of paragraph 5. Complainant Preston III was not able to meet either the margin call estimated by respondent Bouvier on the afternoon of April 10, 1996, or the margin call precisely calculated on the morning of April 11, 1996. Regardless of documentation that complainants have shown or testimony they have provided as to funds available at that time, the fact of the matter is that on the afternoon of April 10, 1996, and on the morning of April 11, 1996, it is undisputed that Preston III expressed to Bouvier his inability to meet the margin demands on both occasions.[16] The Commission has noted that with respect to establishing a Section 4b violation, even more pertinent than an undermargined account at the time of liquidation is notice to the customer of this fact through the making of a margin call. John H. Faro v. Interlink Trading, Inc., et al., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,537, at 43,374 (CFTC Nov. 16, 1995). It is uncontroverted that respondent Bouvier notified complainant Preston III about the margin call on more than one occasion.

Inability to meet margins is de facto grounds for liquidation, reinforced by the fact that "[n]othing in the Commodity Exchange Act or Commission regulations dictates that an FCM must retain an account when the customer is unable to continue to maintain the position." Roberts v. Ray E. Friedman & Co., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,063, at 32,131 (CFTC May 15, 1986).[17] In that case, the customer expressed his inability to finance his position if the market continued to move against him, as both parties anticipated. Id.

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reasonable.") (citations omitted); See also Capital Options Investments, Inc. v. Goldberg Brothers Commodities, Inc., 958 F.2d 186 (7th Cir. 1992); Prudential-Bache Securities, Inc. v. Stricklin, 890 F.2d 704 (4th Cir. 1989); Geldermann & Co., Inv. v. Lane Processing, Inc., 527 F.2d 571 (8th Cir. 1975).

[16] Even assuming, arguendo, that he was financially able to meet margin demands, he did not do so.

[17] See Mills v. Smith Barney, Harris Upham & Co., Inc., et al., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,691, at 33,789-90 (Initial Decision on Remand June 12, 1987).

It undisputed that Preston III was well aware that the account was undermargined. Preston III's total contribution to the margin call was $76,000, only about one-half the amount due. In addition, he made it clear on both occasions that no additional funds were forthcoming.

In light of the Customer Agreement that put complainant "on notice that payment was due in response to margin calls and that the result of a failure to promptly respond could result in the liquidation of the positions in his account without prior demand or notice," and that complainant was aware of the margin deficit, and that complainant "failed to take reasonable steps to satisfy his obligations," liquidation was not improper "in order to avoid further losses of both parties." Nacht v. Merrill Lynch, Pierce, Fenner & Smith, Inc., et al., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,366, at 42,706 (Initial Decision on Remand Apr. 17, 1995).[18]

Margin policy has a special status in the federal regulatory scheme in that the CEA exempts margin rules from CFTC authority, reflecting a desire to protect the FCM and the marketplace. Baker v. Edward D. Jones & Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,167, at 24,772 (CFTC Jan. 27, 1981).[19] The margin rights of the FCM and the liquidation recourse of the FCM ensure that it is that particular customer who bears the risk in the futures market and not the FCM or other customers.[20] Comtrade, Inc., et al. v. Cargill Investor

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[18] See Jerry J. Hornstein v. Prudential-Bache Securities, Inc., and Jerry P. Gettinger, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,476 (Initial Decision June 9, 1989); Amin A. and Yasmin G. Mohammed v. Jack Carl/312 Futures, Index Futures Group, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,229, at 38,665 (Initial Decision Jan. 27, 1992) ("Nothing in the Act or regulations requires a futures commission merchant to obtain the consent of a customer to liquidate positions on an undermargined account. As a good business practice, a futures commission merchant should make a diligent effort to notify a customer that additional margin money must be deposited to avoid liquidation. The customer has an unequivocal duty to monitor his own account, and to deposit additional margin money when a margin call arises.")

[19] See Moss, et al. v. J.C. Bradford & Co., et al., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,146, at 41,802-05 (N.C. Mar. 14, 1994) (reciting history of federal regulation of futures trading, its goal of providing maximum protection to commodities merchants and exchanges, and permitting liquidation of under-margined accounts without prior demand or notice).

[20] See J.W. Macara, Inc. v. Peregrine Financial Group, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,777, at 44,201-02 (Initial Decision Aug. 15, 1996).

Services, Inc., et al., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,734, at 44,037 (Initial Decision July 15, 1996).

A second, and even more compelling reason for liquidation was the fact that the account was in a deficit position as of the opening of the market on April 11, 1996. Preston III himself conceded that a negative liquidation value in an account would trigger liquidation, in accord with the Customer Agreement, as it represented collateral inadequate to secure the account.[21] (Tr. at 80.)

In addition, the disclosure by Preston III on April 10, 1996, for the first time of the nonexistence of the $200,000 set aside, that complainant had previously represented to Bouvier as existing, could itself have warranted liquidation pursuant to subsection (e) of paragraph 5 as "any other circumstances or developments that Refco deems to require action necessary for its protection." (R-Exh. 1.) As both parties agree, the fact that complainant engaged in scale trading as a strategy risked the need for sizable financial resources. This conclusion is reinforced by testimony of both respondent Bouvier and Mr. Miles regarding the importance they placed on that representation in permitting complainants to continue holding such a large position.

In light of the aforementioned, there is no probative evidence to support an allegation by complainants that the forced liquidation of the account on April 11, 1996, constituted unauthorized trading.

Prior Course of Conduct

Complainants also attempt to establish a claim of unauthorized trading by arguing that the prior course of conduct established between respondent Bouvier and complainant Preston III served to altered the legal rights and obligations of complainants with respect to the events of

[21] Paragraph 5, subsection (d) of the Customer Agreement. (R-Exh. 1.)

April 11, 1996. Specifically, complainants argue that respondent Bouvier in the past had consistently granted complainants additional time in meeting margin calls, a process referred to as "floating."[22] This conduct, complainants argue, thereby altered the rights of complainants in meeting future financial obligations to respondents. This argument fails on two counts.[23]

Of greatest significance is the fact that there is no evidence to establish a course of conduct between respondents and complainants with respect to "floating" instances when the account had a deficit value, as it did for the first time on April 11, 1996.

Second, in trying to establish a prior course of conduct with respect to respondents' treatment of margin calls, the account had been subject to only two series of prior margin calls, hardly enough to establish a course of conduct.[24] Even assuming, arguendo, that this did constitute a course of dealing, it would be limited to respondents' treatment of margin call situations, which was not the situation on April 11, 1996, shortly after the market opened.

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[22] Complainants allege that this was done by respondent Bouvier through the delayed depositing of checks for their commodity account in Chicago by sending them for deposit to respondent Refco in New York.

[23] Even assuming, arguendo, that a prior course of conduct had been established by complainants, a non-waiver clause in the customer agreement would serve to emasculate its affect. J.W. Macara, Inc. v. Peregrine Financial Group, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,777, at 44,202 (Initial Decision Aug. 15, 1996). The customer agreement cited in that case had a non-waiver clause that expressly stated that a determination not to issue a margin call in one instance would not constitute future waivers. Id. Even more encompassing is the provision contained in respondents' Customer Agreement in the case at bar:

> **17. NO WAIVER OR AMENDMENT.** No provision of this agreement may be waived or amended unless the waiver or amendment is in writing and signed by an authorized officer of Refco. No waiver or amendment of this agreement shall be implied from any course of dealing between the parties or from any failure by Refco or its agents to assert its right under this agreement on any occasion or series of occasions. No oral agreements or instructions to the contrary shall be recognized or enforceable.

(R-Exh. 1) (emphasis added.) Although this provision has not been addressed by either party in this case, it should put to rest complainants' attempt at asserting a course of conduct claim.

[24] As noted in J.W. Macara, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 44,202, with respect to establishing a course of conduct, two instances of permitting a customer account to maintain undermargined futures positions "falls woefully short of establishing a course of dealing manifesting a mutual agreement" in contradiction to contractual agreements.

Affirmative Defense of Ratification

As noted by respondents, a complainant is prohibited from recovering on a claim of unauthorized trading, pursuant to Regulation § 166.2, if the trades are subsequently "ratified" by complainant. See Sherwood v. Madda, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,728, at 23,020 (CFTC Jan. 5, 1979); Comtrade, Inc., et al. v. Cargill Investor Services, Inc., et al., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,734, at 44,036-37 (Initial Decision July 15, 1996). This Court has determined that the liquidation of complainants' account did not constitute unauthorized trading. However, even if respondent Bouvier had been found to have engaged in authorized trading, respondent would have succeeded in defending himself through the application of the ratification doctrine.[25]

It is undisputed that Preston III was told by Bouvier about the complete liquidation of the account shortly after it was completed. The testimony of respondent Bouvier, respondent Kavanagh, and Mr. Miles is explicit with respect to Preston III's consistent failure to complain of respondents' conduct with respect to the April 11, 1996, liquidation of his account. Preston III was in contact with these individuals on April 11, 12, and 15, as well as subsequent dates. Complainant Preston III's testimony not only fails to directly contradict this testimony but reinforces respondents' testimony that, following April 11, 1996, Preston III continued to take responsibility for the debit account value, continued to make promises of repayment, and acknowledged fault for what had happened as a result of his greed.

[25] Complainants ratified the trades when Preston III knowingly adopting the alleged "wrongful" liquidation trades as his own. See Comtrade (citing Baker v. Dain Bosworth, Inc., et al., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,752, at 31,132 (CFTC Sept. 30, 1985)). Preston III was given notice of the trades and he failed to satisfy his duty to complain to respondents at the "first reasonable opportunity." See Comtrade (citing Sherwood v. Madda, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,728, at 23,018-19 (CFTC Jan. 5, 1979).

CLAIM #2: Fraudulent Representations by Respondent Bouvier

Complainants have failed to show that respondent Bouvier was guilty of making fraudulent representations regarding the alleged unauthorized trades, in violation of Section 4b of the CEA. In this case, complainants allege in their complaint that respondent Bouvier not only failed to notify Preston III of the account's total liquidation, but represented to him that only a partial liquidation would take place. Preston III relied on this alleged representation and, therefore, refrained from having complainant Preston Jr. deposit additional funds in the account, which would have otherwise been done but for the representation made. This claim fails for multiple reasons.

"To be actionable, a misstatement of fact must involve a fact that is material." Sudol v. Shearson Loeb Rhoades Inc., et al., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,748, at 31,118 (CFTC Sept. 30, 1985).[26] There is no probative evidence in the record to show that respondent Bouvier ever promised complainant Preston III that only a partial liquidation would occur, no matter what the negative value of the account was. To the contrary, this Court finds that both parties' accounts of the liquidation plans were to bring the account back into regulatory compliance. Despite what Preston III may have desired or even anticipated, the actions of the market on the morning of April 11, 1996, resulted in an increasing negative account balance. Unfortunately, this mandated the complete liquidation of complainants' account. The $71,000 deposit authorized by Preston III on April 10, 1996, was not in exchange for a promise not to liquidate, but was only partial payment of the outstanding margin call.

[26] Whether or not a misstatement of fact or omission is material is an objective determination based on whether a reasonable investor would attach significance to it in making his decision. Id. at 31,118-19 (citations omitted).

Even if complainants had established that a material misrepresentation was made by respondent Bouvier, namely that only a partial liquidation of the account was to ensue, complainants would still fail in their claim. Complainants must also prove justifiable reliance, which establishes a causal connection between the misrepresentation or omission and complainants' losses. Jakobsen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,812, at 31,392 (CFTC Nov. 21, 1985). Although complainants allege that but for this alleged representation, they would have deposited the necessary funds to maintain the account and avoid liquidation, they have failed to establish that the $177,000 funds necessary on the morning of April 11, 1996, were available for immediate deposit.[27] In essence, complainants have failed to establish that they could or would have acted any differently.[28]

Even more importantly, Preston III represented to Bouvier, on April 10, 1996, that he had no other funds available and repeated this representation to Bouvier on the morning of April 11, 1996. Preston III had an undisputed obligation to meet the margin call and his admitted inability to do so is inconsistent with his present contention that he would have satisfied the account deficit, on April 11, 1996, had he known that complete liquidation was imminent. This Court, therefore, binds Preston III to the representations he himself made to respondent Bouvier on April 10 and 11, 1996.

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[27] By complainants own documents, the sum of immediately reducible funds was approximately $145,000. See supra note 10. In addition, Preston III testified that funds coming from Preston Jr. would have been available Friday, April 12, 1996. (Tr. at 34.)

[28] Complainants also must show that respondent made the misrepresentation intentionally or with reckless disregard, Hammond v. Smith Barney, Harris Upham & Co., Inc., et al., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617, at 36,659 (CFTC March 1, 1990), and that their losses are proximately caused by respondent's misconduct, Peterson v. Thomson McKinnon Securities, Inc., et al., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,390, at 33,050 (CFTC Dec. 2, 1986).

CLAIM #3: Failure to Adequately Supervise

This court finds complainants' claims, that respondent Kavanagh and respondent Refco were each in violation of Regulation § 166.3, for failure to adequately supervise respondent Bouvier, to be without merit. Failure to supervise is an independent violation that does not require proof of another violation. In re Paragon Futures Ass'n, et al., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266, at 38,849-50 (CFTC April 1, 1992) (citing In re Big Red Commodity Corp., et al., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,623, at 30,667 (CFTC June 7, 1985)); In re First National Trading Corp., et al., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,142, at 41,786 (CFTC July 20, 1994).

In a reparations case, the complainant must "show (1) either that respondent had knowledge of wrongdoing and failed to take reasonable steps to correct the problem, or that respondent failed to discharge specific responsibilities of supervision; and (2) that respondent's failure was the proximate cause of complainant's damages." Bunch v. First Commodity Corp. of Boston, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,352, at 39,169 (CFTC Aug. 5, 1992). Complainants have failed to establish prong number one of this test.

First, no wrongdoing has been found to have occurred. Second, there is no probative evidence that respondent Kavanagh failed to discharge his responsibilities of supervision. Kavanagh hired Mr. John Miles for the express purpose of overseeing the "upstairs operation" which provided market services for non-financial instruments, such as feeder cattle contracts, to commercial and retail customers.[29] (Tr. at 232-33.) Kavanagh's expertise was in financial futures and he did not consider himself sufficiently knowledgeable to run the non-financial trading aspect of the business. (Tr. at 234-35.) In contrast, Miles had substantial experience to qualify for this

[29] The "upstairs operation" consisted of two people: Miles and respondent Bouvier. (Tr. at 177.)

position, having worked as an AP of Refco since 1983 and having worked in the commodities field since the late 1970's.[30] (Tr. at 190, 233.) Miles was the direct supervisor of Bouvier, who was stationed directly next to him. (Tr. at 116, 232-34.)

As the testimony of respondent Bouvier and Miles has established, Bouvier apprised Miles of the status of the account well before liquidation occurred. Specifically, on April 10, 1996, Bouvier notified Miles that Preston III no longer had the $200,000 cash reserves he had represented earlier as being set side and that complainant only had $71,000 available to meet the margin call estimated at that time to be between $130,000 and $150,000. In light of these developments, it was Miles who advised Bouvier that liquidation of complainants' account would be necessary to bring the account into regulatory compliance. (Tr. at 209-12.)

The following morning, respondent Bouvier communicated to Miles that complainant had again confirmed, earlier that morning, that no additional funds were available to meet the margin call. (Tr. at 214-15.) Miles advised Bouvier to consult with Refco's feeder cattle expert on the exchange floor in order to determine the most prudent way to liquidate complainants' large position since the feeder cattle market is not that active. (Tr. at 215.) Miles monitored the opening of the feeder cattle market, alongside Bouvier, and witnessed the entire liquidation process conducted by Bouvier. (Tr. at 217-19.)

As for respondent Refco, complainants have failed to proffer <u>any</u> evidence to establish that Refco was in violation of Regulation § 166.3 for failure to adequately supervise respondent Bouvier. There is no evidence that the FCM in this case either failed to maintain an adequate supervisory system or failed to diligently enforce the existing system with respect to respondent Bouvier. <u>In re GNP Commodities Inc., et al.,</u> [1990-1992 Transfer Binder] Comm. Fut. L. Rep.

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[30] At the time in question, Miles supervised between 90-100 accounts. (Tr. at 191.)

(CCH) ¶ 25,360, at 39,220 (CFTC Aug. 11, 1992). Respondents testified that Refco had a compliance department, staffed by Refco personnel, that was directly accessible to Miles on site. (Tr. at 192.) Refco also provided an operations manual for Miles and respondent Bouvier. (Tr. at 193.)

ADDITIONAL ISSUES

1. Joint Account Status

Preston III and Preston Jr. opened a joint account on October 3, 1994. Respondent Bouvier testified that in order to remove Preston Jr. from the joint account, written paperwork was required "stating please remove Tom Preston, Jr., from this account and signed by both of the parties so that we know that it's an agreement between both parties since it is a joint account." (Tr. at 119-20.) Despite Bouvier's belief that the written consent of both parties is required, neither the Customer Agreement nor Account Application mandates such procedures. Moreover, this Court has failed to find any language in the contracts which addresses the proper procedure for removal of a joint owner from a joint account.[31]

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[31] This Court has paid particular attention to the following paragraphs which are the only sections even remotely addressing this issue:

> **1. AUTHORIZATION**. Customer authorizes Refco to purchase and sell futures contracts for Customer's account in accordance with Customer's oral or written instruction. Customer hereby waives any defense that any such instructions were not in writing as may be required by any law, rule, or regulation. The authority hereby conferred shall remain in force until written notice of its revocation signed by Customer, or by any one of the Customers in the case of a joint account, is received by Refco at its main office. Each Customer having an interest in a joint account shall have the authority to issue such instructions and generally to deal with Refco as fully and completely as if the other person had no interest therein. Refco shall be under no duty or obligation to inquire into the purpose or propriety of any instruction given by any Customer in the case of a joint account and shall be under no obligation to see the application of any funds delivered to any Customer upon his order.
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> . . . .

It has been determined that when the language of an agreement, such as contained in a Customer Agreement, is ambiguous, the Commission will rely on " 'the general maxim that a contract should be construed most strongly against the drafter'." Clarke v. Shearson Lehman/American Express, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,746, at 31,111 (CFTC Sept. 16, 1985) (quoting United States v. Seckinger, 397 U.S. 203, 210 (1970)). In that case, the Commission held that even though the Customer Agreement stated that termination of an account "may" be terminated by written notice, such language was ambiguous and did not preclude use of other forms of notice to achieve termination. Id. The Commission held that when the complainant orally communicated to respondent that his account be closed out, a termination of the account was effectuated. Id. at 31,112.

The Commission in Clarke relied on the Restatement of Agency by noting:

> [e]ven though the authority of an agent has been created by a sealed instrument, his authority is revoked or renounced by written or spoken words or other conduct which, reasonably interpreted, indicates that the principal no longer consents to have the agent act for him or that the agent no longer consents so to act. An agreement that the authority is to be revoked only in a particular manner is ineffective; despite such an agreement any form of manifestation made known to the other party is effective.

Id. at 31,112 n.4 (quoting Restatement (Second) of Agency § 119 cmt. a) (emphasis added). As established above, in the absence of unambiguous language in the Customer Agreement requiring

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> **20. TERMINATION.** This agreement shall continue in effect until terminated and may be terminated by Customer at any time when Customer has no positions and no liabilities held by or owed to Refco or at any time whatsoever by Refco . . . .

(R-Exh. 1) (emphasis added).

written notification from a joint account owner in order to be taken of the account, oral communication of this desire, in the case at bar, was sufficient.[32]

Pursuant to the Customer Agreement, each joint account holder is treated as the agent for each of the others: "[e]ach Customer having an interest in a joint account shall have the authority to issue such instructions and generally to deal with Refco as fully and completely as if the other person had no interest therein." (R-Exh. 1.)[33] Considering the aforementioned, in addition to respondents testimony that Preston Jr. was considered and treated as a silent partner from the very start, an oral communication from Preston III expressing Preston Jr.'s desire seemed entirely reasonable.

Preston Jr., by his own account, did not personally communicate to Bouvier, either orally or in writing, his desire to be taken off the joint account.[34] It is uncontested, however, that Preston III orally communicated such a desire to Bouvier. Moreover, the desire to remove Preston Jr. from the joint account was made explicitly clear to Bouvier. This Court finds Bouvier's testimony that Preston III just dropped the matter of removing the father from the joint account as unlikely in light of the fact that Bouvier testified that he explained to Preston III not only what was necessary to remove the father from the joint account but also that the letter Bouvier had received from the father was insufficient. (Tr. at 174.)

In light of the entire record and notions of fairness, including the fact that respondents never called Preston Jr. for margins, never contacted Preston Jr. about the debt created from the liquidation, and never asked Preston Jr. to sign the promissory note, this Court finds that Preston

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[32] See Kurowski v. International Futures Strategists, et al., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,820, at 36,859-60 (Initial Decision March 28, 1990).
[33] Paragraph 1, Customer Agreement.
[34] It is undisputed that Preston Jr. only sent one signed letter, regarding opening of an individual account, in December of 1995.

Jr. was effectively taken of the joint account in December of 1995, when Preston III communicated this desire to respondent Bouvier and when Preston Jr. opened up an individual account with Refco.

2. Failure of Respondents to Retain Tapes

This Court refrains from faulting respondents for not retaining tapes of phone conversations between respondent Bouvier and Preston III. Respondents did not have these tapes available to meet Complainants' Discovery Requests filed on September 12, 1996. Respondents' policy was to maintain tapes of trading activity for two to three days. (Tr. at 157-58, 165-66.) In light of the findings that, in the weeks following the events of April 11, 1996, complainant Preston III failed to voice any complaints to respondents with respect to the entire liquidation of his account and that complainant acknowledged his debt and promised to repay it, this Court would be remiss in inferring fault. There was no reason for respondents to preserve these tapes.

3. Post-Liquidation Market Performance

The performance of the market after the liquidation on April 11, 1996, is irrelevant. The fact that complainants would have had no deficit at the market close on April 11, 1996, does not impact the appropriateness of the decision made by respondents that morning any more than a market closing locked limit down would support a claim by respondents for additional reimbursement based on hypothetical losses avoided by an earlier liquidation.[35] If anything, the performance of the feeder cattle market on April 10, 1996, and on the morning of April 11, 1996, is more probative of the reasonableness of respondents decision to liquidate when it did.

[35] Complainants' account would not have had a debit value at the close of April 11, 1996, if no liquidation had been performed. (Tr. at 76, 155-56.) Complainants' account would have had a debit value of $120,000 if the feeder cattle market had closed limit down on April 11, 1996. (Tr. at 77-78, 156.)

4. Attorney's Fees

Respondents have requested an award for attorney's fees. Although this Court is entitled to award attorney's fees in a reparations case, it may only do so where it has determined that the losing party has engaged in " 'bad faith' " during the proceeding. Sherwood v. Madda Trading Co., et al., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,728, at 23,025 (CFTC Jan. 5, 1979).[36] Since there is no evidence in this case to suggest the aforementioned, this Court declines respondents' request for an award of attorney's fees.

IV. CONCLUSIONS OF LAW

In accordance with the Customer Agreement, respondents were well within their contractual rights to liquidate complainants' commodity account in its entirety on April 11, 1996, due to complainant's notification of and failure to meet a margin call of $151,000 on two occasions, complainant's representation that no additional funds were forthcoming, and the deficit value in complainant's account. Respondents were not required to obtain the permission or provide notification of the ensuing liquidation.

Respondent Bouvier was not in violation of Regulation § 166.2 or Section 4b of the CEA in liquidating complainants' account. Liquidation of the joint commodity account held by complainants did not constitute unauthorized trading.

There is no probative evidence which shows that respondent Kavanagh failed to supervise respondent Bouvier, in violation of Regulation § 166.3.

There is no probative evidence which shows that respondent Refco failed to supervise respondent Bouvier, in violation of Regulation § 166.3.

[36] (discussing when attorney's fees are to be awarded in a reparations case.)

In light of the entire record with respect to respondents treatment of Preston Jr., ownership status of the account in question on the date of April 11, 1996, was a commodity account in the name of Preston III only.

ORDER

Complainants have failed to show by a preponderance of the evidence that they suffered monetary damages by reason of unlawful conduct on the part of respondents. The complaint is **DISMISSED** with prejudice.

Respondent Refco has shown by a preponderance of the evidence that the commodity account belonging to complainant Thomas J. Preston, III, had a debit value of $97,305.97. Complainant Preston III, is hereby **ORDERED** to pay $97,305.97 in damages to respondents. Interest accrued on this amount, at a rate of 5.468%, shall be calculated from April 11, 1996, the date the account was liquidated, to the date of its payment in full.[37]

Attorney's fees and costs are hereby **DENIED**.

Dated this 31st of December, 1997

George H. Painter
Administrative Law Judge

Attorney-Advisor:
Martha A. Mensoian

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[37] See Newman v. Bache Halsey Stuart Shield, Inc., et al., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,432 (CFTC Nov. 19, 1984) (interest rate based on the most recent treasury bill auction); Katz v. Shearson Hayden Stone, Inc., et al., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,878 (CFTC Oct. 20, 1983) (prejudgment interest on counterclaims).