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UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

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| JIAN KE,<br>Complainant,<br><br>v.<br><br>INTERACTIVE BROKERS LLC,<br>Respondent. | CFTC Docket No. 11-R034<br><br>OPINION AND ORDER |

Respondent Interactive Brokers LLC ("Interactive"), a registered futures commission merchant ("FCM"), wrongfully liquidated seven positions in Complainant Jian Ke's ("Ke") self-directed electronic options account. Ke wrote ten short put options in September S&P E-mini futures at a strike price of $1,275.[1] The market then moved against him. As a result, Ke would have been obliged at the options' expiration to buy the underlying futures at above-market prices. The futures would then have been assigned to Ke's account. Just before expiration, however, Interactive liquidated seven of Ke's positions under the admittedly mistaken belief that his account contained insufficient margin to support the futures positions. The Judgment Officer ("JO") awarded Ke $40,162.50 in damages based on the "highest intermediate value" rule of *Ahlstedt v. Capital Commodity Servs., Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,131, at 45,291, No. 96-R050, 1997 WL 458096, at *4 (CFTC Aug. 12, 1997). Interactive appeals only the damages calculation. We affirm.

[1] A "writer" is "the issuer, grantor, or seller of an option contract." The purchaser of Ke's "put" options then had "the right but not the obligation to sell" a specified quantity of these S&P E-mini futures at the strike price on or prior to the expiration of the options. *See* CFTC Glossary, http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm (defining "writer," "option" and "put").

## FACTUAL BACKGROUND

The material facts are undisputed. Complainant Jian Ke, a sophisticated investor, traded in an online brokerage account with Interactive. In July 2011, Ke wrote a number of options on S&P 500 E-mini (or "ES") futures at various strike prices. Initial Decision ("ID") at 2. As of the close of trading on Thursday, August 18, 2011, the futures underlying the ten put options he had written were trading well below the strike price of $1,275. *Id.* These options were set to expire at the close of trading on the following day, Friday, August 19, 2011. *Id.* At that point, if Ke's positions had not been liquidated, he would have been obliged to purchase the futures (assuming they had not rebounded to the strike price) and they would have been assigned to his account. *Id.* at 3. On August 19, however, Interactive determined incorrectly that Ke had insufficient margin to support those futures, and it therefore liquidated seven positions to prevent the account from falling into margin deficiency. *Id.* at 3-4. Ke's account was debited $56,000. *Id.* at 4.[2]

Thirty-seven minutes after receiving notice from Interactive that it liquidated seven of his positions, Ke entered a web ticket message claiming that his account was more than adequately margined. *Id.* He followed up the same day with two more messages in which he explained and documented that his account was adequately margined. *Id.* Interactive failed to respond to those messages. *Id.* Ke then attempted to communicate with Interactive another three times from August 21, 2011, through August 24, 2011, but received only assurances that Interactive was working on the claim and boilerplate responses telling him to manage his risk. *Id.* at 4-7. On Wednesday, August 24, 2011, Ke wrote Interactive, asking:

> Should I manage my risk assuming the questioned trade [] will be undone or the trade will NOT be undone? Otherwise, it is not possible to manage the risk of the questioned trade.

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[2] The JO explained the calculation as -$160 (trade price) * 50 (contract size) * 7 (number of contracts) = -$56,000. *Id.* at 4 n.7.

*Id.* at 7. Interactive failed to answer the question. Finally, on September 1, 2011—13 days after the liquidation—Interactive responded to Ke that it was willing to settle the matter for $1,750. *Id.*

Ke rejected the offer, arguing that Interactive should "absorb[] the incorrect liquidation by removing the trade from [his] account and add[ing] 7 ES underlying as the 7 put-option shorts would have been assigned post August expiration[.]" *Id.* at 8. On September 2, Interactive countered that it would not increase its offer, and it reiterated that position on September 12. *Id.* That same day, Ke rejected Interactive's offer, stating that Interactive "offered nothing for liquidating [his] position at one of the lowest point[s] of trading." *Id.* On September 13, Interactive withdrew the offer. *Id.* at 9.

**PROCEEDINGS BEFORE THE JUDGMENT OFFICER**

Ke filed this reparations action claiming wrongful liquidation and suggesting several possible damages calculations, up to $56,000. Complaint ("Compl.") at 2-3. In its answer, Interactive admitted that it liquidated the positions "erroneously." Answer at 2. It argued, however, that Ke's damages calculations were "completely speculative." *Id.* at 8. Interactive asserted that damages should be limited to $1,750.00, which it claimed "represented the actual loss" to Ke, "calculated by taking the difference between the price the positions were liquidated at and their intrinsic value at the time." *Id.* at 3, 7 & n.1. Interactive calculated "intrinsic value" using the "difference between the strike price of the contracts ... and the price of the underlying futures contracts at liquidation." *Id.* at 7 n.1. In the alternative, Interactive argued that Ke "could have bought 7 ES September futures contracts at the close on August 19, 2011," which would have limited his losses to $3,150. *Id.* at 9-10.

The JO held that Interactive's unauthorized liquidation was a "reckless breach" of Sections 4c(b) and 4d(a) of the Commodity Exchange Act ("CEA") and Commission Rules 33.10(a) and 166.2. ID at 10. He calculated Ke's damages based on the Commission's decision in *Ahlstedt.* In *Ahlstedt*, we held that damages for wrongful liquidation are "calculated using either (1) the value of the futures position at the time of conversion or (2) its highest intermediate value between notice of the conversion and a reasonable time thereafter during which the futures position could have been replaced had that been desired, whichever is higher." [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 45,291, 1997 WL 458096, at *4 (internal quotation marks and citation omitted). The JO held that August 31, 2011, was "the outer limit of a reasonable period" after the wrongful liquidation, based on the facts that 1) after the liquidation, Ke immediately protested that his account had been adequately margined to support the puts; 2) Interactive failed to timely respond; 3) Interactive made Ke wait indefinitely; 4) Interactive, without elaboration, additionally directed Ke to manage the risk of the closed out position; and 5) Interactive failed for over thirteen days, until September 1, 2011, to acknowledge its own error or to offer to settle the matter. ID at 11. The JO reasoned that if Ke had carried the position and liquidated at the highest intermediate value, his loss would have been reduced to $15,837.50. *Id.* at 10, 12.[3] He therefore awarded Ke $40,162.50, the difference between the $56,000 loss at the wrongful liquidation and the hypothetical $15,837.50 loss Ke would have suffered had he liquidated the position at the highest intermediate value. *Id.* at 12.

[3] The JO initially cited CME price data provided by the CFTC Office of the Chief Economist, which stated a highest intermediate value of $1,229.80. *Id.* at 9 n.9. However, he appears to have made his calculation based on a price of $1,229.75, the intermediate high provided by Ke based on data compiled from "wsj.com market data center." Compl. at 3, 7 (Table 1). As explained *infra* note 7, we rely on the data Ke submitted.

## INTERACTIVE'S APPEAL

Interactive challenges the JO's damage award, offering two alternatives means of calculating Ke's damages. Neither is consistent with our precedent or has any other basis in law, and we reject them.

## DISCUSSION

A claimant in reparations is entitled to "actual damages proximately caused" by a respondent's unlawful act. 7 U.S.C. § 18(a)(1)(A). The calculation "should focus on the out-of-pocket loss to the complainant." *Stiller v. Shearson, Loeb Rhoads, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,780, at 27,155, No. R 79-359-80-45, 1983 WL 29739, at *2 (CFTC July 11, 1983). In cases of wrongful liquidation, our method of calculation is well established. As the JO did here, we apply the highest intermediate value rule set forth in *Ahlstedt*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 45,291, 1997 WL 458096 at *4.[4] Under the rule, damages are "the difference between the contracts' liquidation prices and the highest intermediate prices reached by the identical contracts during a reasonable period after the wrongful sale," during which the claimant could have reentered the market had he or she wished to do so. *Severance v. First Options of Chicago, Inc.*, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,132, at 57,518, No. 02-R078, 2005 WL 2171179, at *9 (CFTC Sept. 7, 2005) (quoting *Katara v. D.E. Jones Commodities, Inc.*, 835 F.2d 966, 972 (2d Cir. 1987)); *see also Ahlstedt*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 45,291, 1997 WL 458096, at *4.

The *Ahlstedt* rule reflects a claimant's duty to mitigate damages. *Severance*, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 57,518, 2005 WL 2171179, at *9 (quoting

[4] The rule itself long predates our adoption of it in *Ahlstedt*. *See, e.g.*, *Gallagher v. Jones*, 129 U.S. 193, 200 (1889).

*Katara*, 835 F.2d at 972). It compensates the customer for opportunity lost as a result of the unlawful act, *Schultz v. CFTC*, 716 F.2d 136, 140 (2d Cir. 1983), but not for "lost profits beyond the point at which [the customer] had a fair opportunity to repurchase," *Kinsey v. Cendant Corp.*, 588 F. Supp. 2d 516, 520 (S.D.N.Y. 2008), although the claimant need not actually do so, *Ahlstedt*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 45,291, 1997 WL 458096, at *4.[5]

In this case, Ke's positions held an aggregate value of -$56,000 when Interactive wrongfully liquidated them. It is undisputed that if Ke had wished to reestablish those positions, a "reasonable period" by which to do so ran through August 31. By that date, Ke could no longer have written the same options he had previously because the expiration date had passed. But, as Interactive notes, he could have reestablished the position "exact[ly]" by purchasing the underlying futures. Answer at 9; Respondent Interactive's Appeal Brief ("Appeal Br.") at 5. Accordingly, the relevant time of highest intermediate value is the high point reached by the underlying futures through August 31, 2011. *See Rauser v. LTV Electrosystems, Inc.*, 437 F.2d 800, 804 (7th Cir. 1971) (for expired options, calculating the highest intermediate value based on price of the underlying). By August 31, the price of the futures had run up considerably, peaking at $1229.75, equivalent to an aggregate value of -$15,837.50 for the original positions. In practical terms, Interactive's wrongful liquidation deprived Ke of the benefit of that $40,162.50 run up between -$56,000 (liquidation) and -$15,837.50 (highest intermediate value). Thus, under *Ahlstedt* and as the JO determined, Interactive proximately caused Ke $40,162.50 in damages.

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[5] A requirement to reenter the market might force the customer to do so at an unfavorable time, leaving him or her worse off and frustrating the rule's purpose to make the complainant whole. *Schultz*, 716 F.2d at 140.

Interactive proposes two alternatives, both of which contradict the *Ahlstedt* rule. First, Interactive argues that the Commission should award Ke $3,150, which is the difference between the $56,000 loss at liquidation and a hypothetical $52,850 loss they assert Ke would have suffered if he held the positions to expiration at the close on August 19. Appeal Br. at 3-4. Interactive argues it "was not the proximate cause of Complainant's [initial] $56,000 in trading losses," *id.* at 2-4 (de-capitalizing words in heading B(I)), because it had no role in establishing the position, and Ke "was going to take a substantial trading loss on this position ***regardless*** of whether [Interactive] liquidated the position," *id.* at 3. On this reasoning, Ke's true damages would be $3,150. *Id.* at 4.[6]

We see no factual or legal basis for this claim. Interactive's calculation overlooks that Ke was entitled at expiration to seven of the underlying ES September futures, but he did not receive them due to the wrongful liquidation. Answer at 1 (admitting these facts). At that point, Ke might or might not have continued to hold the futures. But we will not speculate about what Ke might have done if Interactive had not deprived him of the opportunity to decide. *Haft v. Dart Grp. Corp.*, 877 F. Supp. 896, 902 (D. Del. 1995) ("The injury that the plaintiff suffers is the deprivation of his range of elective action."); *Kinsey*, 588 F. Supp. 2d at 522 (rejecting similar argument because while the plaintiff "was contractually required to exercise the options by April 1, 2002, he was not so obligated to sell them by that date"). The question is not what hypothetically might have occurred if not for the liquidation, but what out-of-pocket losses the

[6] Interactive, in a footnote to its Appeal Brief, also notes that the $56,000 liquidation loss does not include $6,940.06 of premium credits Ke received for selling the contracts in the first place. Appeal Br. at 2-3 & n.1. However, Interactive goes on to note that "Complainant's -$56,000 trading loss and his $6,940.06 premium received should not be used to calculate damages at all." *Id.* Thus Interactive does not appeal the exclusion of the premiums from the damages calculation. Even if it did, Interactive does not demonstrate that the premium is connected either as a legal or factual manner to Ke's out-of-pocket damages from the wrongful liquidation itself.

liquidation did inflict, as limited by the duty to mitigate. *Severance*, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 57,518, 2005 WL 2171179, at *9 (quoting *Katara*, 835 F.2d at 972); *Schultz*, 716 F.2d at 140; *Kinsey*, 588 F. Supp. 2d at 521; *Stiller*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 27,155, 1983 WL 29739, at *2.

Alternatively, Interactive argues that damages should be limited to $15,820, which it states is the "price" Ke would have paid to reestablish his position by buying the underlying futures on August 31.[7] This formulation, however, has no relationship to Ke's out-of-pocket loss, and we reject it. For the reasons given above, damages here do not equal the price Ke would have had to pay to reestablish the position after he absorbed the initial $56,000 loss. Ke's damages equal the loss Ke did suffer when, because of Interactive's unlawful act, he lost the benefit of the underlying contract's recovery through the highest intermediate value. *See supra* at 5-6 (discussing damages standards); *Schultz*, 716 F.2d at 140; *Haft*, 877 F. Supp. at 902.[8]

## CONCLUSION

For these reasons, we affirm the Initial Decision of the Judgment Officer.

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[7] $15,820 is calculated using the CME data rather than the Wall Street Journal data supplied by Ke and used by the JO. *See supra* note 3 (noting the discrepancy). Interactive explains that: "1275 (assignment price) – 1229.80 (price to re-establish position) = 45.2 (Difference In Price)" and "45.2 * 7 (# of contracts) * 50 (multiplier) = $15,820." Appeal Br. at 5. Using $1229.75 is actually a bit more favorable to Interactive, because the run-up it caused Ke to miss is slightly smaller than if $1229.80 were used. The JO relied on $1229.75 and, since Ke supplied it and neither party objects, we do not disturb the JO's calculations based upon it.

[8] For this reason, we disagree slightly with the JO's characterization of the correct award of $40,162.50. The JO reasoned that if Interactive had not wrongfully liquidated the position, "Ke's account would not have been debited $56,000" and, had that not happened, the "best that Ke could have done" through August 31 would have been to hold the position until it reached the highest intermediate value. ID at 12. The issue under *Ahlstedt*, however, is not what might have happened if Interactive had not committed the violation. The issue is how much of the claimant's actual out-of-pocket loss he or she would have mitigated by *reentering* the market at the time of the highest intermediate value.

IT IS SO ORDERED.

By the Commission (Chairman MASSAD and Commissioners BOWEN, and GIANCARLO).

Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: September 26, 2016