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UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

Sergei S. Laube and Galina Laube,
Complainants,

v.

Gain Capital Group, LLC d/b/a Forex.com,
Respondent.

CFTC Docket No. 13-R006

OPINION & ORDER

This reparations matter involving an allegedly improper liquidation of a customer's retail forex account by a futures commission merchant is before the Commission on review of the Judgment Officer's October 10, 2014 order awarding $35,205 in damages to complainants. For the reasons set forth below, we reverse.

BACKGROUND

Respondent Gain Capital Group, LLC ("Gain") appeals from an order in which the Judgment Officer ("JO") held that Gain's liquidation of the complainants' account for insufficient margining was in bad faith because liquidation of just one forex contract would have met the margin deficit, but instead Gain liquidated all open positions. *Laube v. Gain Capital Grp.*, [2014-2015 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,334 (JO CFTC Oct. 10, 2014).

Complainants Sergei and Galina Laube (the "Laubes") are Washington, D.C. residents who opened a joint retail forex account with Gain in 2010. *See* Respondent's Answer and Statement of Facts, filed Mar. 5, 2013, Tab No. 8 ("Answer") at Statement of Fact. Gain, which operates Forex.com, is a registered futures commission merchant ("FCM") and Retail Foreign

Exchange Dealer ("RFED"). The Laubes' forex account was self-directed by Sergei Laube; Galina Laube "d[id] not trade and ha[d] no knowledge of the account password." Answer, Ex. C. Gain did not advise the Laubes on any trades.

Gain's standard customer agreement applied to the Laubes' account. That agreement contained provisions regarding margin requirements and liquidation in the event of margin deficits. The customer agreement authorized Gain to liquidate, without notice, any or all positions in an account with insufficient margin. In pertinent part, the agreement provided:

> 5. Margin Requirements. Customer shall provide to and maintain with Forex.com Margin in such amounts, in cash or other such forms, and within such limits as Forex.com, in its sole discretion, may from time to time require. . . . *Forex.com may at any time liquidate Customer's Account in accordance with Paragraph 9* [see below]. Forex.com may withdraw funds from the Customer's account *without notice*: (x) to ensure that Posted Margin equals or exceeds Required Margin . . .
> ***
> 9. Liquidation of Accounts and Deficit Balances. In the event of: (a) an Event of Default; (b) *insufficient Margin*, or Forex.com's determination that any Collateral deposited to protect Customer's Account is inadequate, regardless of current market quotations, to secure Customer's Account; or (c) any other circumstances or developments that Forex.com, in its sole discretion, deems appropriate for its protection, *Forex.com may, in its sole discretion,* take one or more, or any portion, of the following actions: (1) satisfy any obligation Customer may have to Forex.com (either directly or by way of guarantee or suretyship) out of any of Customer's funds or property in the custody or control of Forex.com; (2) *sell or purchase any or all Contracts and any securities or other property held or carried for Customer*; and (3) cancel any or all outstanding Orders or Contracts or other transactions or commitments made by or 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 to Customer . . . and regardless of whether the ownership interest is held individually or jointly with others. . . .

Answer, Ex. A, at pp. 6-7 ¶¶ 5, 9 (emphasis added).

Further, in the "Trading Policies and Procedures" section of the customer agreement, Paragraph 6 stated in pertinent part, "if the Margin Balance should at any time equal or fall below the Minimum Margin Requirement for Customer's Account in the aggregate, Forex.com

will have the right but not the obligation to *liquidate any part of or all Open Positions in Customer's Account*." Answer, Ex. A, at p. 12 ¶ 6 (Liquidation Level) (emphasis added).

Gain liquidated all positions in the Laubes' account without notice when the account became under-margined on August 1, 2011. Trading in the Laubes' account leading up to the liquidation consisted of some trades that were executed immediately, and other trades that were to be executed only if and when a certain trading price was attained. *See* Answer at Statement of Fact and Exs. D & E. In the first trade, on April 8, 2011, Sergei Laube entered a new position by buying 100,000 U.S. Dollar / Swiss Franc ("USD/CHF") position at a rate of $0.9099 with a margin requirement of $2,000. Answer, Exs. D & E. On April 14, 2011, Sergei Laube increased his position by buying another 100,000 USD/CHF at the rate of $0.88997, bringing the aggregate margin requirement to $4,000. Answer, Ex. D. Then, on June 2 and 3, 2011, Sergei Laube placed two additional 100,000 USD/CHF "pending limit" orders to be executed if the trading price for USD/CHF reached $0.80088 or $0.82033, respectively. Answer, Exs. D & E. A pending limit buy order is for the purchase of a trading position at a price below the current trading price; the trade is executed if the named price is reached.

Shortly after placing his pending limit orders in June 2011, Sergei Laube went on an extended vacation in Cancun, Mexico, where he remained from June 11, 2011 to September 3, 2011. Answer, Ex. C. On July 13, 2011, while Mr. Laube was still away on vacation, the pending limit order for 100,000 USD/CHF was triggered and executed at the rate of $0.82033, bringing the margin requirement of the Laubes' account to $6,000. Answer, Ex. D. On July 25, 2011, the second pending limit order was triggered, and a trade of 100,000 USD/CHF was executed at the rate of $0.80088, bringing the Laubes' aggregate margin requirement to $8,000. *Id.*

On the morning of August 1, 2011, while Mr. Laube remained on vacation, the Laubes' margin balance fell to $6,919.91. *See* Complaint, filed Nov. 6, 2012, Tab No. 1 ("Compl."). This balance was $1,080.09 short of the $8,000 margin required for the Laubes' open positions. Without notice, and in accordance with Gain's policy that it "does not make margin calls in the ordinary course of its business" to which the Laubes had agreed, Gain liquidated all positions in the Laubes' account, selling 400,000 USD/CHF at the price of $0.78167. *See* Compl. at 1; *see also* Answer, Ex. A, at p. 12 ¶ 6 (Liquidation Level). By Gain's calculation, the Laubes' account realized a loss of $37,662.95 from the liquidation. *See* Answer at Statement of Fact.

Sergei Laube complained to Gain and requested a refund of $35,362.69. Answer, Ex. C. Gain denied the request and concluded that "no credit is due in this case" because the "August 1st liquidation was performed correctly in accordance with FOREX.com's stated policies and procedures" that allowed the FCM to liquidate all positions without notice in the event of a margin deficit. Answer, Ex. D.

PROCEEDINGS BEFORE THE JUDGMENT OFFICER

The Laubes, *pro se*, filed a reparations claim with the Commission on November 6, 2012. *See* Compl. Their complaint did not cite any Commodity Exchange Act ("CEA") sections or CFTC regulations, and instead generally alleged that Gain engaged in "deceptive margin and liquidation practices[.]" *See* Compl. at 2. The Laubes present the issue as, "Why Gain Capital Trading Desk sold all 400,000 USD/CHF, instead of closing only one 100,000 USD/CHF contract, maybe [two] 100,000 USD/CHF contracts?" *Id.* at 1.

Gain filed an Answer in which it asserted that the open positions in the Laubes' account were created by Sergei Laube's self-directed trading, and the positions were properly liquidated

in accordance with Gain's margin and liquidation procedures when the account became under-margined. *See* Answer.

The JO requested written final arguments from the parties. Order, dated Jan. 9, 2014, Tab No. 17. Only the Laubes submitted closing arguments. Complainant's Closing Arguments, filed Feb. 11, 2014, Tab No. 18. The Laubes did not make any legal argument or cite authority regarding FCM liability for margin-related liquidations. Rather, they cited news articles about currency manipulation in forex markets. *See id.* Gain did not file a closing argument and stated instead that Gain "did not feel it necessary to make further filings" because "[t]he original answer contained the full extent of our arguments as well as a plea to have the case dismissed." "Phone Note" Docket entry, dated Apr. 16, 2014; Respondent's Response to JO McGuire's Email Dated April 16, 2014, filed Apr. 16, 2014, Tab No. 20.

In the Initial Decision ("ID"), the JO concluded that Gain liquidated the Laubes' account in bad faith because "the $1,080 margin deficit could have been met with the liquidation of just one forex contract[.]" ID at 9. The Judgment Officer cited *Mills v. Smith Barney*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,762, CFTC No. R81-813-82-111, 1985 WL 56343 (CFTC Oct. 1, 1985), and concluded that the Laubes had "shifted the burden to Gain to show that its determination to liquidate all four contracts was in good faith." ID at 9. Because Gain justified the total liquidation by relying only on its standard margin and liquidation policy, the Judgment Officer found that "Gain has produced no evidence justifying the liquidation of more than one contract in these circumstances, and thus has failed to show that the total liquidation was in good faith." *Id.* The Judgment Officer *sua sponte* concluded that Gain violated CEA Section 4d(a)(2), which requires that FCMs treat as customer property those funds that are used to margin domestic futures positions. The Judgment Officer ordered Gain to pay

the Laubes $35,205 for the violation, plus prejudgment interest and fees. *Id.* at 10. This appeal followed.

GAIN'S APPEAL

On appeal, Gain does not argue that CEA Section 4d is inapplicable to retail forex. Rather, it argues that the Judgment Officer's Section 4d analysis was flawed. Gain argues that the Initial Decision should be reversed because it conflicts with longstanding interpretations of CEA Section 4d(a)(2) affording FCMs a "near-absolute right to liquidate the position of [] customers when they fail to maintain adequate margin." Respondent-Appellant Gain's Appeal to the CFTC, filed Dec. 5, 2014, Tab No. 31, at 3. Gain asserts that its liquidation was in good faith because its right to protect its own financial position and that of other customers superseded any duties it owed to the Laubes when the Laubes defaulted on their margin requirements. *Id.* at 4. Further, Gain argues that a liquidation is in bad faith only when the liquidation is to penalize the customer for a reason unrelated to the FCM's business, and that an FCM does not act in bad faith by liquidating all open positions even if lesser alternatives would meet the margin deficit. *Id.* at 4, 8. As a policy matter, Gain maintains that "forbidding firms to liquidate beyond the minimum required" would impose on FCMs "the operational cost of determining with precision the amount of liquidation that would meet the absolute minimum margin requirements[,]" a policy that is impracticable because "any further deterioration (in a falling market) will be at [the FCMs'] expense or require additional, continual risk management." *Id.* at 9. Finally, Gain argues that the Judgment Officer legally erred by shifting the burden to Gain to demonstrate that its liquidation was in good faith because the customer, not the FCM, bears the burden of proof in cases of allegedly improper liquidation. *Id.* at 10.

The Laubes did not file a brief or any other statement in Gain's appeal.

STANDARD OF REVIEW

The Commission reviews a judgment officer's initial decision *de novo*. *See, e.g.*, *In re Staryk*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,206, at 45,807, CFTC No. 95-5, 1997 WL 778236, at *7 (CFTC Dec. 18, 1997). "On review, the Commission may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, the initial decision[.]" 17 C.F.R. § 10.104(b). Further, "the Commission may, in its discretion, consider *sua sponte* any issues arising from the record and may base its determination thereon, or limit the issues to those presented in the statement of issues in the briefs, treating those issues not raised as waived." *Id.* § 12.401(f).

LEGAL FRAMEWORK

CEA Section 4d(a)(2) requires FCMs to "treat and deal with all money, securities, and property received . . . to margin, guarantee, or secure the trades or contracts of any customer . . . or accruing to such customer as the result of such trades or contracts, as belonging to such customer." 7 U.S.C. § 6d(a)(2). In general terms, Section 4d is the requirement for FCMs to segregate customer property. Section 4d applies to customer property that an FCM receives in connection with trading domestic futures and cleared swaps. CEA Section 4d(a), (f); 7 U.S.C. § 6d(a), (f).

CEA Section 4d does *not*, however, apply to retail forex transactions such as the Laubes had with Gain. *See* Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 Fed. Reg. 68506, 68515 (Nov. 14, 2013). Indeed, customers who engage in off-exchange retail forex trading have been required since October 18, 2010 to be warned about these very risks. CFTC Regulation 5.5 requires an FCM to warn its retail forex clients that:

> (3) YOUR DEPOSITS WITH THE DEALER HAVE NO REGULATORY PROTECTIONS.
>
> . . .
>
> Funds deposited by you with a futures commission merchant or retail foreign exchange dealer for trading off-exchange foreign currency transactions are not subject to the customer funds protections provided to customers trading on a contract market that is designated by the Commodity Futures Trading Commission. Your dealer may commingle your funds with its own operating funds or use them for other purposes. In the event your dealer becomes bankrupt, any funds the dealer is holding for you in addition to any amounts owed to you resulting from trading, whether or not any assets are maintained in separate deposit accounts by the dealer, may be treated as an unsecured creditor's claim.

17 C.F.R. § 5.5(b)(3).

On the other hand, there is a requirement for FCMs and RFEDs to have prior authorization to trade in a retail forex customer's account. *See id.* § 5.17. Under Regulation 5.17, no FCM or RFED "may directly or indirectly effect a retail forex transaction for the account of any customer unless before the transaction the customer . . . specifically authorized the [FCM or RFED] to effect the transaction." 17 C.F.R. § 5.17.

In the futures context, where Regulation 166.2, 17 C.F.R. § 166.2, codifies the requirement of prior authorization to trade, Commission and court precedent have long held that when an FCM determines that a customer is under-margined, the FCM's duty to protect the financial position of the FCM's other customers and right to protect the FCM's own financial position can supersede any duties the FCM owes to the under-margined customer. *See, e.g.*, *Lee v. Lind-Waldock & Co.*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,173, at 50,159, CFTC No. 99-R108, 2000 WL 862615, at *4 (CFTC June 29, 2000); *see also Capital Options Inv. v. Goldberg Bros. Commodities*, 958 F.2d 186, 190 (7th Cir. 1992) ("Margins are accorded a special status in the regulatory scheme of the Commodity Exchange Act so that futures commission agents are able to assure their own financial integrity, which, in turn, contributes to the financial integrity of the entire marketplace."). A futures customer who claims

his positions were improperly liquidated must show by a preponderance of the evidence either that the FCM misled him about its margin policy or that the FCM liquidated the positions in bad faith. *Baker v. Edward D. Jones & Co.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,167, at 24,771-72, CFTC No. R 76-4, 1981 WL 26078, at *4 (CFTC Jan. 27, 1981).

Moreover, in the futures context, the Commission has summarily affirmed cases involving FCM liquidations, including total liquidations, under contractual provisions that authorize total liquidation without notice in the event of a margin deficit. *See, e.g.*, *Cost v. Goscenski*, [2009-2011 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 31,332, CFTC No. 07-R059, 2009 WL 613634 (JO CFTC Mar. 5, 2009), *summarily aff'd*, 2013 WL 1398995 (CFTC Apr. 4, 2013); *see also Glass v. Rosenthal Collins Grp.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep (CCH) ¶ 27,455, CFTC No. 98-R124, 1998 WL 770585 (JO CFTC Nov. 5, 1998), *summarily aff'd*, 1999 WL 343406 (CFTC May 28, 1999).

Similarly, in the context of contract law, federal courts recognize that a contractual provision authorizing an FCM to liquidate a customer's account, without notice, upon occurrence of a margin deficit, is enforceable and not unconscionable. *Geldermann & Co. v. Lane Processing, Inc.*, 527 F.2d 571, 578 (8th Cir. 1975). This is so because commodities trading generally is "not a long-term investment to be made and thus thought about at infrequent intervals." *See generally id.* Self-directed trading requires "daily, and at times constant, attention." *Id.* It is "incumbent" upon a customer who self-directs his trades "to furnish the required margins as needed according to the terms of his trading contract even without notice[.]" *Id.*

A Seventh Circuit decision holds that the existence of "less drastic alternative[s]" does not establish bad faith when considering a customer's tort and breach-of-contract claims against

an FCM for trading losses resulting from liquidation without notice. *Capital Options Inv.*, 958 F.2d at 191. In *Capital Options Inv.*, the Seventh Circuit held that an FCM is not obligated to use a "less drastic alternative" and does not breach a duty of good faith by liquidating all open positions when the parties have contractually agreed that total liquidation to meet a margin deficit may be done at the FCM's discretion. *Id.* (Imposing a "less drastic alternative" standard on FCMs would "strip them of their right to raise margins when they perceived a potentially volatile market.").

We have found no Commission authority establishing that it violates the CEA or Commission regulations if an FCM or RFED foregoes less drastic alternatives and completely liquidates a retail forex customer's account in the event of a margin default, particularly where a contractual provision authorizes a total liquidation without notice, and where monies held to margin retail forex positions have no regulatory protections under the CEA and Commission regulations.

ANALYSIS

Here, although the Laubes suffered significant trading losses from liquidation of their account, Gain's decision to liquidate the Laubes' retail forex positions did not violate the CEA or the Commission's regulations because CEA Section 4d is inapplicable to retail forex transactions and the evidence that Gain acted in bad faith is insufficient.

The Judgment Officer *sua sponte* applied CEA Section 4d to the Laubes' claim, and cited *Mills*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,762, 1985 WL 56343. However, *Mills* does not support the proposition that an FCM acts in bad faith unless it liquidates the smallest position that would cover a margin deficit. Rather, that case stands for the more general proposition that the "rights given to customers by section 4d of the Act" are not

"absolutely waived" by a customer agreement that allows an FCM "unfettered discretion to liquidate a customer's account without notice." *Id.* at 31,186 n.2, 1985 WL 56343, at *10 n.2. In *Mills*, the Commission remanded for further findings where it appeared an FCM liquidated an account notwithstanding receiving assurance from the customer that a check to cover the margin deficit was in the mail. *Id.* at 31,186, 1985 WL 56343, at *10. Yet even circumstances like that are not necessarily conclusive proof of bad faith. *See, e.g.*, *Geldermann & Co.*, 527 F.2d at 578 ("Due to the availability of wire transfers, one hour is not unreasonable in usual circumstances as a time limitation for giving commission merchants the proper assurance that sufficient financial reserves will be maintained.").

While it is true that customer rights are not "absolutely waived" by a contract that allows an FCM unfettered discretion to liquidate a customer's account without notice, *Mills*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 31,186 n.2, 1985 WL 56343, at *10 n.2, the Judgment Officer's *sua sponte* application of CEA Section 4d to the Laubes' claim was error as a matter of law because that section does not apply to money held by an FCM or RFED to margin retail forex transactions. *See* 17 C.F.R. § 5.5(b)(3).

Further, under the circumstances of this case, Gain appears to have acted within its contractual rights to liquidate all open positions in the Laubes' account without notice when their account became under-margined. The only evidence of Gain's alleged bad faith was that liquidation of fewer than all open positions in the Laubes' account could have met the margin deficit. Yet Gain did not misrepresent its liquidation policies, and as a matter of law, did not violate any duty of good faith by foregoing a "less drastic alternative." *See Capital Options Inv.*, 958 F.2d at 191. The Commission has long recognized, albeit in the more highly regulated futures context, that FCMs must have "adequate means to assure their own financial integrity

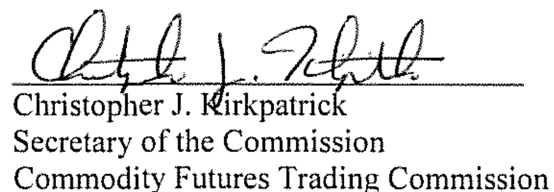
and thereby contribute to the financial integrity of the entire marketplace." *Baker*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 24,772, 1981 WL 26078, at *4. Gain Capital liquidated the Laubes' open positions for business reasons in accordance with the terms of its customer agreement, and these facts do not indicate bad faith based on Commission precedent in other, more regulated contexts. *Id.* at 24,772 n.10, 1981 WL 26078, at *4 n.10. Thus, based on the facts of record here, we decline to hold that Gain's actions constituted bad faith in the retail forex context.

We are careful to note that our decision today does not foreclose the possibility that an FCM or RFED could be found to have liquidated in bad faith in other cases, where the facts so indicate. Further, the mere existence of a contractual provision authorizing liquidation without notice does not waive a retail forex customer's right to be dealt with in good faith. We conclude today only that the facts of this case, without more, do not indicate that Gain acted in bad faith.

For these reasons, the October 10, 2014, order is hereby reversed.

IT IS SO ORDERED.[1]

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



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

Dated: January 6, 2017

[1] Under Sections 6(c)(11)(B) and 14(e) of the Commodity Exchange Act, 7 U.S.C. §§ 9(11)(B) and 18(e), a party may appeal a reparation order of the Commission to the United States Court of Appeals for only the circuit in which a hearing was held; if no hearing was held, the appeal may be filed in any circuit in which the appellee is located. The Commission has ruled that telephonic hearings are "held" in Washington, D.C., although parties may speak from several different locations. *Dubois v. Alaron Trading Corp.*, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,406, at 51,026 n.16, CFTC No. 95-R152, 2000 WL 1593877, at *5 n.16 (CFTC Oct. 26, 2000). The statute also states that such an appeal must be filed within 15 days after notice of the order and that any appeal is not effective unless, within 30 days of the date of the Commission order, the appealing party files with the court a bond equal to double the amount of any reparation award. CEA Sections 6(c)(11)(B), 14(e), 7 U.S.C. §§ 9(11)(B), 18(e).