UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

SHERRY R. MIDDLETON and MARK A. MIDDLETON,	CFTC Docket No. 11-R011
Complainants,	OPINION & ORDER
v.	
INFINITY FUTURES, LLC and TRANSACT FUTURES LLC,	
Respondents.	

TransAct Futures LLC ("TransAct" or "Respondent"),[1] a registered futures commission merchant ("FCM"), appeals a judgment officer ("JO") decision in favor of Sherry and Mark Middleton (the "Middletons" or "Complainants") on their reparations claim. In the initial decision ("ID") under review, the JO concluded that Respondent engaged in unauthorized trading when it mistakenly liquidated Complainants' open positions due to a data-entry error. The JO held that Respondent's unauthorized trading violated section 4d(a)(2) of the Commodity Exchange Act ("CEA"), 7 U.S.C. § 6d(a)(2) and Commission Rule 166.2, 17 C.F.R. § 166.2, and awarded the Middletons their losses of $6,075 from the liquidation.

On appeal, TransAct asserts that the JO erred in holding that: 1) TransAct engaged in unauthorized trading; 2) the Middletons did not ratify the liquidation; 3) the Middletons were not required to actively mitigate damages; and 4) the Middletons were entitled to their requested losses. We reject all four arguments and affirm the JO's decision.

[1] As explained more fully below, Infinity Futures LLC ("Infinity"), the introducing broker of the Middletons' account and an affiliate of TransAct, was previously dismissed from these proceedings and is not a party to the present appeal.

I. FACTS

The pertinent facts are undisputed. In January 2010, the Middletons opened and deposited $80,000 in a non-discretionary customer trading account. The account was introduced by Infinity Futures, L.L.C. ("Infinity"), and cleared through Infinity's parent, TransAct, a registered FCM that conducts electronic trading focused on self-directed accounts. *Middleton v. Cagnina*, [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 32,109, at 68,544, 68,546-47, No. 11-R011, 2012 WL 368578, at *1, *3, *6 (CFTC JO Feb. 3, 2012) ("*Middleton I*").

TransAct's electronic trading system included a predetermined automatic liquidation feature intended to limit trading losses, primarily to protect the FCM. *Id.* at 68,544, *1. TransAct's system monitored all positions in each customer's account. *Id.* If daily losses in the account reached a pre-determined limit, the system would automatically liquidate all open positions. *Id.* If the account balance dropped significantly, the system would automatically re-calculate the risk assessment level to about sixty percent of the new account balance. *Id.* The daily risk assessment level could be adjusted upward or downward following consultation between the customer and an account executive. *Id.*

Mark Middleton, an experienced trader, began trading in the account in late January 2010. *Id.* at 68,544-46, *1, *3. The risk limit setting in the account was adjusted several times thereafter until May 24, 2010, when, following a disputed liquidation not at issue in this appeal, Middleton and his broker, Anthony Giacomin of Infinity, agreed via an email exchange to increase the risk setting to $47,000 or 60% of the account balance. *Id.* at 68,547 & n.7, *5 & n.7. The risk setting remained there until August 30, 2010, when a TransAct employee attempting to adjust the risk assessment level in another customer's account accidentally transposed account

numbers for that account and mistakenly reduced the daily risk assessment level for the Middletons' account from $47,000 to $6,000. *Id.* at 68,549, *9.

The Middletons only learned of this mistake months later when the erroneous risk level triggered a liquidation. *Id.* at 68,548-49, *8-9. On October 20, 2010, the Middletons entered a short position in December Euro FX futures. The market spiked up. The resulting losses breached the erroneous $6,000 risk assessment level, and TransAct automatically liquidated all open positions in the account, causing the Middletons to lose $6,075 at the time of liquidation. *Id.* at 68,549, *9.

Mr. Middleton immediately called his Infinity broker, Giacomin, for an explanation. *Id.* at 68,549-50, *10. Giacomin then called TransAct. *Id.* A TransAct agent told Giacomin that the risk assessment level of $6,000 had been triggered, causing the liquidation. *Id.* Giacomin relayed this information to Mr. Middleton, who told him that the liquidation should not have occurred, because his risk limit was far higher. *Id.* Mr. Middleton forwarded their May 24th e-mail exchange confirming the $47,000 risk setting. *Id.* Giacomin responded that he would look into it. He also told Mr. Middleton that his account, which had been temporarily locked when losses exceeded the reduced risk level, had been re-activated following the liquidation, and advised him to re-establish his positions in order to make up the loss. *Id.* Mr. Middleton refused to do so and asked to speak with Giacomin's supervisor. *Id.*; *see also* Complaint (Dec. 14, 2010) ("Compl.") at 4 (description).

Giacomin then e-mailed TransAct risk manager and principal Mark Gordy. Giacomin asked Gordy for the history of loss limit changes in the account and told him that the last change Giacomin had was to $47,000 on May 24. *Middleton I*, [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 68,550, 2012 WL 368578, at *10. Gordy admitted to Giacomin that there had

been a typographical error in setting the risk level for another customer's account, resulting in the Middletons' account level being reduced instead. *Id.* Giacomin exclaimed: "Crap," and asked "[w]hat should we do?" *Id.* Gordy more or less responded that they should do nothing, telling Giacomin that the Middletons' account had already been "unlocked immediately and [Mr. Middleton] had plenty of time to re-establish the price at the price or better. He chose not to." *Id.*[2] In phone conversations later that day, Giacomin and his supervisor, Infinity principal James Cagnina, repeatedly urged Mr. Middleton to re-establish his positions and offered a commission credit, but Mr. Middleton continued to refuse. *Id.*; *see also* Compl. at 4.

II. PRIOR PROCEEDINGS

Having heard nothing further from Giacomin or Cagnina, the Middletons filed a reparations complaint in December 2010, alleging that Infinity and its employees/associated persons/principals, Giacomin and Cagnina, liquidated their positions on October 20, 2010, without authorization. Compl.[3] TransAct was not named as a party at that time.

1. The Judgment Officer's First Decision

Following discovery and submissions by the parties, the JO issued an initial decision. *Middleton I*, [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 32,109, 2012 WL 368578. He determined that Infinity, but not Cagnina or Giacomin, violated Section 4b(a) of the CEA, 7 U.S.C. § 6b(a), because Infinity was required but failed to provide timely and adequate disclosure of a material fact—the fact of and reasons for TransAct's reduction of the Middletons' account risk setting. *Id.* at 68,550-51, *11. The JO further determined that purported waivers in

[2] Giacomin only disclosed the cause of the error during discovery in the Middletons' reparations proceeding, more than one year later. *Middleton I*, [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 68,545, 2012 WL 368578, at *2.

[3] The Middletons also alleged that there was an unauthorized liquidation of their positions in May 2010. Compl. at 4. The JO dismissed this allegation as to all respondents. *Middleton I*, [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 68,551, 2012 WL 368578, at *12. The Middletons did not appeal that dismissal, and it is now final.

the customer agreement did not overcome Infinity's duty to disclose the risk setting change and the reasons for it. *Id.* He rejected Infinity's ratification and mitigation arguments on the grounds that Infinity's failure to disclose material facts in advising Mr. Middleton to re-establish his positions precluded those defenses. *Id.* at 68,551 n.8, *12 n.8. The JO awarded the Middletons $6,075, their claimed losses from the liquidation. *Id.* at 68,551, *12.

2. The Commission's Remand Order

Infinity appealed to the Commission. We reversed and dismissed the complaint as to Infinity on the grounds that there was no evidence it knew of TransAct's error at the time of the liquidation and no basis to impute TransAct's actions to Infinity. *Middleton v. Cagnina* [2013-2014 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 32,955, No. 11-R011, 2014 WL 495628 (CFTC Jan. 2, 2014) ("*Middleton II*"). However, we remanded to the JO to: 1) give the Middletons the opportunity to present evidence that would support a finding that TransAct was an agent of Infinity; and/or 2) determine whether the applicable statute of limitations and tolling doctrines would permit a reparation action against TransAct. *Id.* at 75,471, *1.

3. The Judgment Officer's Second Decision

After the remand, the Middletons moved to amend their complaint to add TransAct as a respondent. The JO provisionally granted the motion, subject to further submissions by the parties on the timeliness of the amended complaint and whether TransAct violated CEA section 4d(a) and Rule 166.2. *Middleton v. Infinity Futures LLC, et al.*, No. 11-R011, slip op. at 2 (CFTC Dec. 12, 2014) ("*Middleton III*").[4]

Following those submissions, the JO issued another initial decision holding that TransAct committed unauthorized trading in violation of Section 4d(a)(2) and Rule 166.2 when it

[4] This decision is not reported in CCH or Westlaw.

liquidated the Middletons' account based on an erroneous risk limit level. *Id.*, slip op. at 12. The JO did not address anew the ratification and mitigation arguments or arguments as to the proper calculation of damages. He awarded the Middletons their losses at the time of liquidation, $6,075, plus interest and filing costs. *Id.*, slip op. at 3, 13.[5]

III. STANDARD OF REVIEW

The Commission reviews the facts and law *de novo*. *Ahlstedt v. Capital Commodity Servs., Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,131, at 45,290, No. 96-R050, 1997 WL 458096, at *3 n.12 (CFTC Aug. 12, 1997); *Chu v. Peregrine Fin. Grp., Inc.*, [2013-2014 Transfer Binder] Comm. Fut. L. Rep. ¶ 32,806, at 73,760, No. 07-R029, 2013 WL 4785177, at *4 (CFTC Sept. 5, 2013).

IV. DISCUSSION

1. Unauthorized Trading in Violation of Section 4d(a)(2) and Rule 166.2

TransAct maintains that the JO erred in determining that the liquidation was unauthorized because: a) liquidations for failure to meet legitimate margin calls are considered authorized; and b) TransAct's customer agreement authorized the liquidations and/or waived any liability TransAct would otherwise have. Appeal Brief to the December 12, 2014 Initial Decision on Remand in Perfection of TransAct's December 19, 2014 Notice of Appeal, Appellate Arguments of TransAct Futures (Jan. 16, 2015) ("TransAct Br.") at 7-14. We disagree.

Generally, to show that a trade was authorized, the FCM must show either: 1) a written power of attorney authorizing a person or entity to conduct discretionary trading; or 2) specific authorization of the transaction by the customer in advance of its execution. *Hussain v. Saul*

[5] The JO also found that the Middletons' complaint as to TransAct was timely. *Middleton III*, slip op. at 4-11. TransAct did not challenge this determination, which is therefore final and not at issue in this appeal.

Stone & Co., [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,460, at 54,991, No. 98-R153, 2003 WL 1908052, at *7 (CFTC Apr. 22, 2003). Although a forced liquidation may constitute unauthorized trading, we have held that an FCM can avoid liability by showing the liquidation was done for failure to meet a legitimate margin call. *See, e.g.*, *Slone v. Dean Witter Reynolds, Inc.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,283, at 42,433-34, No. 93-R125, 1994 WL 702358, at *4-5 (CFTC Dec. 16, 1994); *Ahlstedt*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 45,290, 1997 WL 458096, at *4; *Faro v. Interlink Trading, Inc.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,537, at 43,373-74, No. 93-R134, 1995 WL 684097, at *8 (CFTC Nov. 16, 1995); *Hussain*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 54,991, 2003 WL 1908052, at *8; *Lee v. Lind-Waldock & Co.*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,173, at 50,159, No. 99-R018, 2000 WL 862615, at *4 (CFTC June 29, 2000). These cases reconcile the prohibition against unauthorized trading with the need for FCMs to exercise judgment in demanding margin and, as necessary, liquidating customer positions in order to avoid excessive losses that endanger other customers and the FCM itself.[6]

While none of these decisions squarely address the scenario here—a concededly erroneous liquidation—they all turn on whether the margin call was based on the FCM's exercise of reasoned judgment. *Slone*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) at

[6] Some of our earlier decisions such as *Baker v. Edward D. Jones & Co.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,167, at 24,771-72, No. R76-4, 1981 WL 26078, at *4 (CFTC Jan. 27, 1981), and *Roberts v. Ray E. Friedman & Co.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,063, at 32,131, No. 82-R813, 1986 WL 66208, at *2 (CFTC May 15, 1986), do not suggest a contrary outcome here. These older decisions excuse an FCM from unauthorized trading liability for forced liquidation when such FCM does not mislead its customers and makes good faith business judgments regarding margin calls and forced liquidations. *Baker*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 24,771, 1981 WL 26078, at *4 (referring to FCMs' "legitimate business judgments"). Respondent's failure to exercise any reasoned judgment precludes reliance on *Baker* or *Roberts*.

42,433, 1994 WL 702358, at *4; *Hussain*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 54,991, 2003 WL 1908052, at *7-8; *Lee*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 50,159, 2000 WL 862615, at *4. Here, TransAct exercised no judgment in reducing the Middletons' risk limit. The reduction was an admitted mistake. *Middleton I*, [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 68,549, 2012 WL 368578, at *9; TransAct Br. at 2-3. Under these circumstances, this liquidation was not a response to a "legitimate" margin call in the sense that we have previously recognized as a defense to a claim of unauthorized trading.

Separately, TransAct argues that section 7 of its customer agreement with the Middletons authorized the liquidation and/or waived any liability it might otherwise have. We disagree. Section 7 authorizes TransAct to liquidate positions in its "sole discretion." TransAct Br. at 9-11; *see also* Respondents' Statement of Case, Answer, and Affirmation Defenses (Mar. 28, 2011), Ex. 1 (Customer Agreement) at § 7. But TransAct did not liquidate the Middletons' positions in the exercise of "discretion." It did so due to a clerical error. TransAct also cites to an unidentified provision in the agreement that purportedly absolves it of liability for losses caused by problems with its automated trading system. TransAct Br. at 11. TransAct does not state what provision of the agreement does this, and we therefore do not credit the assertion. Moreover, the functioning of the automated trading system is not at issue here. Finally, the customer agreement itself provides that customer transactions are subject to "exchange rules and law," including "all applicable government acts and statutes and to rules and regulations thereunder," which include the prohibitions on unauthorized trading. Customer Agreement § 2.

2. Ratification

TransAct next claims that the JO erred in rejecting its claim that the Middletons ratified the liquidation. TransAct Br. at 14-25. The record provides no support for this claim. A customer may be found to have ratified a trade under either of two scenarios. The first is where

it is "clear from all the circumstances presented that the intent of the customer was to adopt, as his own and for all time, the trades executed for his account without authorization." *Adams v. Black Diamond Futures & Trading, Inc.*, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,492, at 59,403, No. 04-R052, 2007 WL 1110753, at *4 (CFTC Apr. 11, 2007) (citation omitted). In order for the customer to adopt the trades in question, he or she must know both of the trades in question and that he or she had a right to avoid financial responsibility for them. *Yrag Traders, LLC v. Liberty Trading Grp.*, [2014-2015 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,363, at 76,935, No. 12-R033, 2014 WL 7028077, at *3 (CFTC Dec. 11, 2014). The second scenario in which ratification may be found is when a customer acquiesces to unauthorized trading by knowingly failing to object. *Sherwood v. Madda Trading Co.*, [1977-1980 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 20,728, at 23,020 n.19, No. 77-2, 1979 WL 11487, at *4 n.19 (CFTC Jan. 5, 1979); *Modern Settings, Inc. v. Prudential-Bache Sec., Inc.*, 709 F. Supp. 70, 76 (S.D.N.Y. 1989), *aff'd in part and rev'd in part*, 936 F.2d 640 (2d Cir. 1991). Nothing in the record indicates that the Middletons adopted the liquidation or acquiesced in it. On the contrary, Mr. Middleton objected at every turn. Accordingly, this argument is rejected.

3. Mitigation

TransAct also argues that the Middletons did not mitigate their damages because they failed to re-establish their positions. TransAct Br. at 25-31. But there is no duty under these circumstances for a customer to re-enter the market. *See Ahlstedt*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 45,291, 1997 WL 458096, at *4 (citing *Schultz v. CFTC*, 716 F.2d 136, 140 (2nd Cir. 1983) (citing *Letson v. Dean Witter Reynolds*, 532 F. Supp. 500, 503 (N.D. Cal. 1982))). Accordingly, this argument is rejected as well.

4. Calculation of Damages

Finally, TransAct claims that the JO erred in awarding the Middletons their out-of-pocket losses based on the difference between the purchase price of their positions and the liquidation price. According to TransAct, the JO should have assessed the damages "at the intermediate price reached between the contract's liquidation and the price during a reasonable time after the liquidation." TransAct Br. at 33.

TransAct alludes to the "highest intermediate value" rule for calculating unauthorized trading damages. Under this rule, recovery is limited "to the additional amount required to repurchase the same contracts in the market within a reasonable time after liquidation." *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) (citation omitted).[7] This is "measured by 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." *Id.*; *accord Ahlstedt*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 45,291, 1997 WL 458096, at *4. This rule, however, applies only to long positions. Where, as here, the wrongful liquidation is of a *short* position, the general "highest intermediate value" rule is inverted and "the lowest intermediate price is used." *Stiller v. Shearson Loeb Rhoades, Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,663, at 30,808 n.3, No. R 79-359-80-45, 1985 Westlaw 56303, at *1 n.3 (CFTC June 27, 1985).

TransAct states that after the wrongful liquidation at 1.3973, the market moved higher, peaking six minutes later at 1.3982, which it argues was a reasonable time period after liquidation for purposes of computing damages. On these facts, TransAct argues that the Middletons' damages are zero because if they had reentered the market at that highest

[7] As discussed above, the customer need not actually do so.

intermediate value, they would have come out ahead of where they would have absent the wrongful liquidation. TransAct Br. at 33-34. Because this was a wrongful liquidation of a short position rather than a long position, however, the "highest intermediate value" rule does not apply. Accordingly, we reject TransAct's argument on damages.[8]

V. CONCLUSION

For the reasons stated above, we AFFIRM the JO's decision.

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: July 29, 2016

[8] We decline to consider *sua sponte* any arguments for reduced damages that TransAct failed to assert on appeal. *See Myron v. Chicoine*, 678 F.2d 727, 731-32 (7th Cir. 1982).