UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

ROBERT WEST, Complainant, v. GAIN CAPITAL GROUP, LLC d/b/a FOREX.COM, and GLENN HENRY STEVENS, Respondents	)	CFTC Docket No. 10-R017 **OPINION AND ORDER**

Respondent Gain Capital Group, LLC (d/b/a Forex.com) ("Gain Capital"), appeals from an Initial Decision in this reparations case. That decision held that, in connection with two forex transactions, Gain Capital had recklessly failed to disclose material facts to its customer, complainant Robert West ("West"). The Order that accompanied the Initial Decision required Gain Capital to pay $10,000 in speculative profits to West. In this appeal, Gain Capital argues that the Initial Decision incorrectly concluded that Gain Capital violated Section 4b of the Commodity Exchange Act, and that it erred in awarding speculative profits. We hold that Gain Capital did not violate section 4b, and that even if it had, an award of speculative profits would not be justified. Accordingly, we reverse.[1]

[1] Although West did not file a notice of appeal, in his brief, he urges the Commission to increase the award of damages to $20,000. Because we hold that Gain Capital did not violate section 4b and was not liable for speculative profits in any event, we reject West's request.

BACKGROUND

The following background facts are undisputed. In early 2010, West entered into the market for foreign currency.[2] Using the internet, he opened a self-directed account at Forex.com, a division of Gain Capital. Evidence in the record shows that, as part of the process of opening his account online, West electronically acknowledged that he had read and understood certain Gain Capital documents, including Gain Capital's Customer Agreement, its Risk Disclosure Statement, its Secondary Risk Disclosure Statement, and its Trading Policies and Procedures. He also checked a box indicating that he had at least one year's experience trading foreign currency.

The documents on Gain Capital's website contained numerous warnings regarding the risk of trading in foreign currency. For example, the Risk Disclosure Statement (RDS) advised that "Foreign Exchange Trading . . . is highly speculative[,]" RDS at ¶ 1, and that "There are no guarantees of profit or freedom from loss in Foreign Exchange . . . Trading," *id.* at ¶ 9. The Secondary Risk Disclosure Statement warned that "Foreign Exchange Trading is highly speculative and is suitable only for those customers who (a) understand and are willing to assume the economic, legal and other risks involved, and (b) are financially able to assume losses significantly in excess of margin or deposits." The Secondary Risk Disclosure Statement also informed customers (in all capital letters) that:

> Forex is an over the counter (OTC) market, meaning that the foreign currency trading that you are entering into is not conducted on an exchange. As a market maker, Forex.com is the counterparty in these transactions and, therefore, acts as the buyer when you sell and the seller when you buy. As a result, Forex.com's interests may be in conflict with yours. . . . If Forex.com elects not to cover its own trading exposure then you should be aware that Forex.com may make more money if the market goes against you.

[2] West is a practicing physician. He also has a law degree and is a member of the Texas bar, but he does not practice law.

In addition to the risk disclosures, the documents on Gain Capital's website contained information regarding margin calls and a customer's obligation to maintain minimum margin requirements.[3] The documents advised the customer to maintain minimum margin requirements at all times, that it was the customer's responsibility to monitor his account, and that Gain Capital might liquidate all of the customer's open positions whenever the required minimum margin was not maintained. (Risk Disclosure Statement at ¶ 2.) The documents further warned that Gain Capital did not make margin calls. (Trading Policies and Procedures at ¶ 8.) But the documents also advised that Gain Capital *might* call on the customer for additional margin at any time by making a margin call when the customer's account fell below minimum margin requirements. (Customer Agreement at ¶ 5.) And Gain Capital advised that, when the customer's account was insufficient to satisfy his margin obligation, the customer "shall promptly pay *upon demand* the entire amount of such deficit." (Customer Agreement at ¶ 6, emphasis added.)

On February 7, 2010, West opened a self-directed account with Gain Capital, and used his credit card to provide $5000 for that account. At two different times on February 8, 2010, West telephoned Gain Capital to purchase contracts on the euro. On the first occasion, he spoke to a sales representative who gave his name as "Jonathan."[4] West explained that he was a novice, and that he wanted to short the euro against the dollar. Jonathan told West that each contract represented 100,000 euros, and he further informed West that there was a one percent margin requirement for each contract, which at that moment, equaled $1367.10. West indicated

[3] Gain Capital's Customer Agreement, its Risk Disclosure Statement, its Secondary Risk Disclosure Statement, and its Trading Policies and Procedures are set forth in full at Appendix B of Gain Capital's Answer (Tab 14).

[4] Gain Capital recorded its telephone transactions with West. Transcriptions of those recordings are in the record, Tab 21, and substantial portions of the transcriptions are quoted in the Initial Decision.

that he wanted to purchase a contract, and hold it until the euro had dropped ten cents against the dollar, *i.e.*, until he had made $10,000 on the contract. After West had completed the purchase of one contract, he asked Jonathan whether he could double his position by purchasing a second contract. Jonathan explained that if West were to purchase a second contract, his margin requirement would also double. Jonathan then warned that:

> Jonathan: . . . But you most likely wouldn't want to do that because that would take you pretty close to getting out of the trade.
>
> West: I see. So if it gets up to where it's $5000, you get taken out of the trade?
>
> J: Correct.
>
> W: I see what you are saying. . . .

Later that same day, West again called Gain Capital. This time he spoke to a different sales representative who gave his name as "Matt." West informed Matt that he was a novice investor, and said that he wanted to enter into a second contract for euros. Matt sold West a second contract, but, unlike Jonathan, Matt did not advise West of the risk of the purchase.

Over the next six weeks, West periodically monitored the value of the euro on Yahoo.com, but he never examined his account on Gain Capital's website.[5] West next contacted Gain Capital on March 21, 2010, at which time he learned that on February 9, the day after he had placed his orders, the value of the euro spiked almost two cents, resulting in a loss of $2344, and Gain Capital unilaterally liquidated his account ($2656 remained in his account).[6] West spoke to a Gain Capital employee, "Eric," who advised West that he had been "way over-

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[5] Gain Capital's Customer Agreement advised that the prices on its website might deviate from the prices listed on other websites. Customer Agreement at ¶ 4.1.

[6] West's initial margin for his two contracts totaled $2736.10. Gain Capital liquidated his account when the price of the Euro had increased 1.172 cents, at which time West's total margin obligation (initial margin plus mark-to-market margin) equaled $5080.10, more than he had in his account. Although Gain Capital sold West's contracts, his account remained open.

leveraged" on his trades because he was using more than half of his account for the initial margin on his contracts. West filed a complaint with his credit card company, and Gain Capital ultimately agreed to reverse the $5000 charge that West had placed on his credit card to fund his Gain Capital account. As a result of this refund, West suffered no loss, but received no profit, from his dealings with Gain Capital.

On May 25, 2010, West filed his Reparations Complaint Form with the Commission.[7] The gist of his complaint was that he had been given assurances that, because he had used his credit card to fund his account, "any and all margin requirements would be deducted from the card." Reparations Complaint at 3. He contended that the failure to advise him that he did not have sufficient funds in his account, or that his account was going to be liquidated, constituted breach of contract, negligence, organized criminal enterprise, or fraud. He sought a refund of the $5000 he deposited in his account,[8] as well as $20,000 in profits he contended he would have received if his account had not been liquidated and if he held the contracts until the euro had dropped ten cents in value.

In its Answer, Gain Capital responded that it had not violated any contractual obligation when it closed out West's positions because its Customer Agreement made clear that Gain Capital could liquidate a customer's positions any time that there were not sufficient funds in the customer's account to satisfy margin requirements. It contended that it had no fiduciary duty to make margin calls because its Customer Agreement specifically stated that it did not make such calls. It also stated that it had not engaged in any fraud because its sales representatives had

[7] In his Complaint, West named Gain Capital, and also named its CEO, Glenn Harry Stevens. The Initial Decision held that Stevens was not liable because West had failed to show an adequate connection between Stevens and West's losses. West has not challenged that holding in this appeal.

[8] At the time West filed his Reparations Complaint, Gain Capital had yet to agree to the refund of his $5000 deposit.

informed West of the consequences of failing to maintain sufficient funds in his account to meet margin requirements, and had made no misrepresentations regarding the transactions.

On June 9, 2011, the Judgment Officer conducted a telephone hearing regarding West's complaint. West was the only witness. West argued that he never authorized the liquidation of his account, and that Gain Capital had an obligation to notify him before it completed the liquidation. He made no mention of the disclosures that he was provided when he opened his account. (In fact, in response to a question from the Judgment Officer, West stated that he had not read any of the disclosure documents.) He provided no evidence that he had ever been assured that margin requirements would automatically be deducted from his credit card account. Counsel for Gain Capital noted that, when West opened his account, he represented that he read and understood the Customer Agreement. As part of this representation, he agreed that he had either traded foreign currency for at least six months, or had traded on Gain Capital's Demo Trading System. Also, he had checked a box on his application indicating that he had at least one year's experience trading foreign currency. Counsel further noted that the Customer Agreement informed West that Gain Capital did not make margin calls. Counsel also explained that, even though West made two separate purchases from Gain Capital, because both of those purchases involved the same currency pair (*i.e.*, euro/dollar), Gain Capital regarded this as one position. Thus, when West no longer had sufficient funds in his account to satisfy his margin requirement, Gain Capital liquidated West's entire position.

On November 25, 2011, the Judgment Officer issued the Initial Decision. The Initial Decision contains lengthy factual findings, including extensive quotes from West's telephone conversations with Gain Capital's sales representatives. The Initial Decision concluded that

Gain Capital committed fraud by omission, thereby violating section 4b(a)(2)(A) of the CEA.[9] In particular, the Initial Decision held that, at the time when West purchased his second contract, West made it clear to Gain Capital's sales agent (Matt) that he did not understand the risks of purchasing a second contract. According to the Initial Decision, this triggered Gain Capital's obligation to disclose to West that, if he purchased a second contract, he would be over-leveraged, and that, if his account did not contain enough to satisfy margin requirements, Gain Capital would liquidate his entire position. The Initial Decision concluded that, by failing to disclose this information to West, Gain Capital recklessly violated section 4b(a)(2)(A) of the CEA.

The Judgment Officer then awarded West half of the $20,000 in speculative profits that he sought. The Initial Decision noted that, in an action such as this one, damages are normally limited to out-of-pocket losses, and Gain Capital had already compensated West for those losses by agreeing to a full refund of the $5000 in credit card charges. Nonetheless, the Initial Decision awarded West $10,000 in lost profits from the first contract he purchased because, it concluded, West would have realized that amount if he had received adequate disclosures, had not purchased a second contract, and had held his contract until the euro dropped ten cents in value. (The euro did drop ten cents in value approximately three months after Gain Capital liquidated West's account.) The Initial Decision found that West would have held his position until the euro had dropped ten cents because, after West purchased his contracts, he did not access his account for six weeks "indicat[ing] that West was committed to a long-term strategy of waiting for the exit price to be hit." ID at 19. The Initial Decision concluded that West was not entitled to any lost profits from his second contract because "he never expressed to Matt an intention to

[9] Section 4b(a)(2)(A) of the CEA, 7 U.S.C. § 6b(a)(2)(A), makes it unlawful "for any person, in connection with any order to make . . . any contract of sale of any commodity for future delivery, . . . to cheat or defraud or attempt to cheat or defraud the other person."

deposit addition[al] funds, and since he has otherwise not shown with a reasonable degree of certainty that he would have realized a profit on the second lot." *Id.*

DISCUSSION

On appeal, Gain Capital has raised two issues: it argues that it did not commit fraud when West purchased his second contract, and that, even if it did commit fraud, the award of lost profits was not appropriate. In his brief, West argued that he should have been awarded damages of $10,000 for both of his contracts – a total award of $20,000. We review these issues *de novo*. *Scheufler v. Gerald, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27, 294 at 46, 340; *Ahlstedt v. Capitol Commodity Servs., Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,131 at 45,290 n.12.

The Judgment Officer concluded that Gain Capital engaged in fraudulent conduct in violation of section 4b of the CEA because its sales representative recklessly failed to disclose material information to West. According to the Initial Decision, West should have been told at the time he purchased his second contract, that, by purchasing that contract, he would be over-leveraged.[10] As discussed below, we disagree.

1. We have held that, to establish fraud by omission, it is necessary to show 1) that the respondent failed to disclose certain information; 2) that a reasonable investor would consider the omitted information to be material to his investment decisions; and 3) that the respondent must have been aware that, by failing to disclose the information, the investor would have been misled. *In the Matter of: IAG Capital Mgmt., LLC,* Comm. Fut. L. Rep. (CCH) ¶ 32,124 at 68,775 (2012). Gain Capital's conduct does not satisfy the third element of fraud by omission. The Initial Decision held that Gain Capital acted recklessly (*i.e.*, satisfied the third element)

[10] This was not West's theory of his case – he alleged that Gain Capital erred by liquidating his account without his permission.

because West told Matt that he (West) was a novice. "In these circumstances, Matt was well aware of West's reliance and was thus obligated to provide complete, accurate and meaningful disclosure of information material to a customer in West's place." ID at 17. But to establish a fraud by omission, Commission cases require more: there must be a showing that Gain Capital was aware that, absent these disclosures, West would be *misled.*

For example, in *CFTC v. R.J. Fitzgerald & Co.*, 310 F.3d 1321 (11th Cir. 2002), the defendants informed potential customers in both a television commercial and a sales seminar that defendants had identified business opportunities that could generate 200 to 300 percent in profits. The court held that the defendants had engaged in a fraudulent omission because, "[g]iven the extremely rosy picture for profit potential painted in the Seminar and in the Commercial, a reasonable investor *surely* would want to know – before committing money to a broker – that 95% or more of [its] investors lost money." *Id.* at 1332 (emphasis in original). Thus, because the defendants had touted their profits, it was fraudulent for them to fail to disclose that the vast majority of their customers lost money.

Similarly, in *IAG Capital Mgmt.*, *supra*, the respondents told investors in a commodity pool that their money would be used exclusively for trading, on the investors' behalf, in commodity interests. The Commission held that the respondents had committed fraud by omission because they failed to tell investors that, in fact, the respondents commingled investment funds with their personal accounts and used those funds for their personal purposes. Comm. Fut. L. Rep. (CCH) at 68,775 (2012). That is, respondents' scienter was established by the untrue statements that they made, and that they subsequently failed to correct.

Although West did inform Gain Capital's sales representatives that he was a novice investor in foreign exchange, the Initial Decision does not identify evidence that is sufficient to demonstrate that Gain Capital had the scienter necessary to establish fraud by omission. That is, the Initial Decision does not find that Gain Capital was aware that West believed (incorrectly) that Gain Capital made margin calls.[11] Examples of such evidence might consist of misleading statements or half-truths, if any misimpression created by the statements could have been corrected by the omitted information.[12] However, the mere fact that Gain Capital failed to provide West with information that might have been helpful to him does not, without more, constitute fraud.[13] Thus, the Initial Decision erred in holding that Gain Capital violated section 4b of the CEA.

2. Nor is there evidence to support West's theories of his case. In his complaint, he alleged that Gain Capital had an obligation to provide him with a margin call, and that Gain Capital should not have liquidated his account without his permission. In fact, there is no obligation on a company such as Gain Capital to make margin calls, and there is no evidence that

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[11] In his brief, West argues that, in his telephone conversations with Gain Capital's sales representatives, those representatives "downplayed the risks of West's positions, [and] misrepresented Respondent['s] margin requirements . . . ." Tab 65 at 2. Had Gain Capital misrepresented the risk of West's positions or misrepresented margin requirements, this might be sufficient to trigger an obligation to make further disclosures. We find no indication in the transcripts of the telephone conversations that Gain Capital made such misrepresentations.

[12] The Initial Decision cites *Avis v. Shearson Hayden Stone, Inc.*, [1980-82 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,379 at 25,828 (1982). ID at 17. But in that case, the Commission held that the respondents had a fiduciary relationship with the complainant, and that they had pledged to inform him if his account no longer showed a profit. Here, Gain Capital specifically disavowed any fiduciary relationship with its customers, RDS at ¶ 6, and also informed them that its interests might be in conflict with theirs, Secondary Risk Disclosure. Further, in this case, there was no pledge similar to the one in *Avis*. As described above, although Gain Capital's disclosure documents state that it does not make margin calls, those documents also contain some statements from which it could be inferred that Gain Capital might make such calls. We need not determine whether those statements could create an obligation to provide clarifying disclosures because West admitted that he had not read any of the disclosure documents.

[13] The Initial Decision held that West needed a second warning regarding leverage, but it may be that what he actually needed was more education regarding margin requirements. When West purchased his first contract, West's representative (Jonathan) explained that, for every hundredth cent increase in the price of the euro, West would be responsible for an additional $10 in margin. However, during the telephone hearing, and in his brief to the Commission, it appears that West believed that he would receive $10 in profit for every hundredth of a cent that the euro dropped in price, but would be responsible for only $1 in margin for every hundredth of a cent the price increased.

Gain Capital made any statement to West that would create such an obligation. Nor did Gain Capital need West's permission to liquidate his account: Gain Capital specifically advised that it would liquidate a customer's positions if there were insufficient funds in that customer's account to satisfy margin obligations. Customer Agreement at ¶ 9.[14]

During the telephone hearing, and in his brief on appeal, West claimed that NFA Rule 2-40 requires that a customer be notified before his positions are liquidated. But West misunderstands Rule 2-40. That rule applies only to bulk liquidations – liquidations that occur when a dealer closes the accounts of all of its customers (as might happen if the dealer ceases business) – not to a situation in which the dealer closes out the positions of only one customer who is unable to satisfy margin requirements. NFA Rule 2-40 has no application here.

3. Even if we could affirm the Initial Decision's conclusion that Gain Capital had committed fraud, however, we would still have to reverse because the damages awarded by the Initial Decision are inappropriate. In a reparations case such as this one, we are authorized to award "actual damages proximately caused by such violation." 7 U.S.C. § 18(a)(1)(A). Normally, we limit such damages to a complainant's out-of-pocket losses. *Los Angeles Trading Group, Inc. v. Peregrine Financial Group, Inc.*, [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30805 at 61,781 (2008). Here, West has suffered no out-of-pocket expenses because Gain Capital has already refunded to him the amount he lost when it liquidated his account. As a result, West has been restored to the position he was in before he contacted Gain Capital.

The Commission has generally limited recovery of lost profits to cases involving unauthorized liquidation of a complainant's market position. *Id.*; *Adams v. Black Diamond*

[14] West recognized that the price of the euro spiked on the day after he purchased his contracts. However, he was confused as to how much additional margin this required him to post. *See* note 13, *supra*, and Tab 65 at 3.

Futures & Trading, Inc., [2005-2007 Transfer Binder] Comm. Fut. L. Rep. ¶ 30,492 at 59,403 n.8 (2007). Although West alleged that Gain Capital had improperly liquidated his account, he presented no evidence to support that allegation. In particular, in his complaint, he represented that he had been promised that Gain Capital would automatically withdraw post-purchase margin requirements from his credit card account. But there is nothing in the record to support this – indeed, nothing in any of the transcripts of West's telephone conversations with Gain Capital employees indicates that such a promise was ever made. To the contrary, although the disclosures that Gain Capital provides to its customers are not a model of clarity, those disclosures do specifically state that the customer is responsible for monitoring his account balance. It is undisputed that West did not monitor his account.

Thus, the Initial Decision did not hold that Gain Capital's liquidation of West's account was improper. Instead, it concluded that West should never have purchased the second contract. Once West made that purchase, there was nothing improper about the liquidation. And even assuming that Gain Capital committed a fraud that induced West's second purchase, the appropriate remedy would be a refund of West's out-of-pocket expenses, *see Sanchez v. Crown*, [2005-2007 transfer Binder] Comm. Fut. L. Rep. ¶ 30,183 at 57,728 (2006), an amount that West has already received. Because the Initial Decision's award of speculative profits is unjustified, we reverse. [15]

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[15] Even if an award of speculative profits would have been appropriate, there is no justification for the award of $10,000. As we have explained, in those unusual situations where an award of speculative profits is appropriate, we calculate the amount "using either: (1) the value of the futures position at the time of the conversion, or (2) the position's 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." *Severance v. First Options of Chicago, Inc.*, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,132 at 57,517 (2005). The Initial Decision awarded the profit that West would have received if he had purchased only one contract and held it until the contract reached his stated target price – which did not occur until several months after his account was liquidated. This is not an appropriate calculation of an award of speculative profits.

CONCLUSION

We reverse the Judgment Officer's award of speculative profits. We hold that the evidence in the record does not support a conclusion that Gain Capital violated section 4b of the Commodity Exchange Act. We further hold that, even if Gain Capital had violated section 4b in connection with West's purchase of the second contract, West was at most entitled to an award of his out-of-pocket losses. Since Gain Capital voluntarily refunded that amount to him, there is no additional remedy that we can award. Accordingly, we reverse the Initial Decision and dismiss this matter with prejudice.

IT IS SO ORDERED.

By the Commission (Chairman GENSLER and Commissioners SOMMERS, CHILTON, O'MALIA, and WETJEN).

Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission

Dated: April 4, 2013