UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

YRAG TRADERS, LLC,
Complainant,

v.

LIBERTY TRADING GROUP, JAMES CORDIER, and MICHAEL GROSS,
Respondents.

CFTC Docket No. 12-R33

OPINION AND ORDER

Respondents Liberty Trading Group ("LTG"), James Cordier, and Michael Gross (altogether, "Liberty Group") filed a notice of appeal from an Initial Decision by a Commodity Futures Trading Commission ("Commission" or "CFTC") Judgment Officer granting, in part, reparation damages to Complainant Yrag Traders. For the reasons given below, we affirm the Judgment Officer's awards of $48,421 for unauthorized trading between July 2010 and April 16, 2011, and of $1,302 for unauthorized trading on September 15, 2011. Commission Rule 166.2 requires that such trading be authorized in writing, and there is no evidence in the record that Liberty Group obtained such authorization. We also conclude that this unauthorized trading was not ratified by Yrag Traders. Accordingly, Yrag Traders is entitled to these reparations. On appeal, Yrag Traders argues that it is entitled to additional reparations, but such claims are not before the Commission.

BACKGROUND

While the parties disagree on how to characterize certain facts, there is no dispute as to the operative facts bearing on the Commission's decision in this matter. The findings of the Judgment Officer are supported by the weight of the evidence, and we adopt them. *See* Initial

Decision, R.102 at 2-22, ¶¶ 1-28 (factual findings). Professor Gary Kimmelman was the sole principal of Yrag Traders. R.48-7. He was a novice options trader. He opened his account under the name Yrag Traders with LTG in July of 2010. R.10, ¶ 10 (opening documents executed July 9, 2010, and approved for trading July 15, 2010); R.34-2 at 4; R.48-6 (account opening statements); R.102 at 5, ¶ 5; R.33 at 9 (trading commences August 2, 2010); R.15-D3 at 2 (same); R.48. The account experienced losses of which Professor Kimmelman was informed. Aware that LTG had been trading on his behalf, and that such trading had led to losses, Professor Kimmelman was at first patient. He told LTG in October 2010: "I expect those losses, and [I am] not concerned." R.15-D2 at 37. *See* R.34-2 at 10-11 (October trades). By January of 2011, his patience was running out. Professor Kimmelman began to ask LTG when he could expect "to see substantial profits to draw on." R.15-D2 at 98. However, in February 2011, Yrag Traders' account with LTG suffered losses due to options pricing in the energy markets. R.15-D3 at 20-21; R.48-3; R.34-2 at 39-45; *see* R.15-D2 at 117.

The losses in February 2011 and events thereafter led to a decided change in the relationship between Professor Kimmelman and LTG. *See, e,g,* R.15-D2 at 196-197. On April 16, 2011, he asked LTG that trading activity in his account be frozen.[1] LTG employees believed this was unwise and encouraged Professor Kimmelman to liquidate certain positions. R.15-D2 at 225. They also offered fee credits to resolve his concerns and resume normal trading. R.15-D2 at 248-249. He rejected or disregarded these various LTG entreaties. Thus, LTG followed his instruction to freeze all trading.[2] This freeze led to additional, substantial losses. *See* R.34-2;

[1] R.15-D2 at 192 (3:12 p.m. email requesting freeze for all options expiring in the near future); *see* R.15-D2 at 352; *see* R.15-D2 at 284; R.102 at 28 (July 14, 2011 extension to all expiring contracts).

[2] Thereafter, one inadvertent keypunch error was remedied. R.15-D2 at 213.

R.48-4; R48-5. Professor Kimmelman's correspondence with LTG from mid-2011 onward was often angry and accusatory, but *not* about the fact that LTG was trading his funds without authorization. Instead, his complaints were about his account's performance. *See, e.g.*, R.49 at 3-4; R15-D2 at 250. LTG representatives began to encourage him to facilitate a final accounting and settlement of his account. *E.g.*, R.39 at 9.

In early August, the value of the Yrag Traders account plummeted as the market moved against gold and crude oil positions held in the account. *See* R.48-5 at 4 (debit listings for August 9 entries & following); R.34-2 at 71; R39 at 9 (ultimate losses of over $40,000). LTG and Peregrine Financial Group ("PFG"), a now bankrupt firm, conducted loss-limiting liquidation of these particular positions to avoid a debit position. *See* R.34-2.

In the fall, LTG initiated settlement discussions with Professor Kimmelman to conclude their business relationship and liquidate his account. These discussions were also contentious. *See* R.39 at 16-17. At one point, Professor Kimmelman insisted that he exit from his relationship with LTG with a net profit. R.39 at 51; *see also* R.15-D2 at 250 (Professor Kimmelman seeks high water mark of his trading account as early as June 2011). LTG later emailed Professor Kimmelman with a settlement offer, stating that "If you accept this offer, Liberty will liquidate the current positions in your account." R.39 at 49-50; Initial Decision, R.102 at 20, ¶ 27. In response to this offer to liquidate, Professor Kimmelman stated as follows: "The situation is now closed. Thank you for your time and effort to resolve this unfortunate matter." R.39 at 50 (Sept. 13, 2011 3:20 p.m. email).

Yrag Traders filed its reparations claim on August 27, 2012 (R.1), pursuant to the Commission's rules for formal decisional proceedings. *See* 17 C.F.R. § 12 Subpart E, §§ 12.300-12.315. The claim demands damages for unauthorized trading that can be broken

down by time period: July 2010 (account opening) to April 15, 2011; April 16, 2011 to September 13, 2011 (after Prof. Kimmelman's instruction to freeze the account); and September 15, 2011 (liquidation). After extensive discovery and briefing, a Commission Judgment Officer issued an Initial Decision on December 18, 2013. R.102.

Respondents Liberty Group filed a timely appeal on December 30, 2013. R.103. Yrag Traders did not file a separate appeal of the Initial Decision within the required 15 days, 17 C.F.R. § 12.401(a). Yrag Traders nonetheless raised challenges to the Initial Decision in its March 28, 2014 responsive brief on appeal. *See* R.114.

DISCUSSION

I.

Commission Rule 166.2, 17 C.F.R. § 166.2, requires either written authorization to trade generally in a customer's account, 17 C.F.R. § 166.2(b), or specific authorization (written or oral) to make a particular trade in a precisely specified commodity for an exact amount, 17 C.F.R. § 166.2(a). *See* Section 4d(a)(2) of the CEA, 7 U.S.C. § 6d(a)(2) (requiring futures commission merchants to "treat and deal" with all property received from a customer "as belonging to such customer"). Because Liberty Group could not produce signed authorization and because there is no evidence that Professor Kimmelman expressly authorized a particular trade, the Commission sees no basis to disturb the Judgment Officer's finding that Liberty Group violated 17 C.F.R. § 166.2 and 7 U.S.C. § 6d(a)(2). In the absence of specific, written authorization for trades or a signed power of attorney, what Professor Kimmelman knew or reasonably believed is irrelevant. *Adams v. Black Diamond Futures*, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. ¶ 30,493, 2007 WL 1110753 (CFTC April 11, 2007) (an acknowledged failure to obtain either a written discretionary trading authorization required by

Rule 166.2 or a customer's express authority for specific trades constitutes *per se* unauthorized trading).

Liberty Group does not contest the Initial Decision's finding that it could not produce any evidence of Professor Kimmelman's written authorization. *See* R.1 at 66; Brief for Liberty Group at 3; *see* R.102, Initial Decision at 5 & n.7 (Liberty Group does not know if it failed to obtain the power of attorney or if it was subsequently lost). Instead, it argues that Professor Kimmelman knew all along that his trading account was a managed account, and ratified all of the trades at issue. But while Liberty Group's factual assertion of Professor Kimmelman's knowledge is supported by the record,[3] we hold in accordance with prior decisions that this fact does not, without more, establish the defense of ratification.

It is true that "a customer may be barred from collecting the damages arising from a violation of Rule 166.2 if respondent establishes the elements of ratification or estoppel." *In re Roger Heitschmidt, et al.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. ¶ 26,263, 1994 WL 621593 *5 (CFTC Nov. 9, 1994) (citing cases).[4] This is an affirmative defense requiring the respondent to carry the burden of proof that 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 trade executed for his account without his authorization." *Adams v. Black Diamond Futures*, Comm. Fut. L. Rep.

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[3] *See* R.102, Initial Decision at 6-8, 23 (summarizing factual findings that Professor Kimmelman was aware of LTG trading in the Yrag Traders account and in fact communicated often with Liberty Group on details connected with various trades from the inception of the account); *see generally* R15-D2; R.39.

[4] By contrast, when the CFTC brings a case pursuant to its enforcement powers, whether or not a violation of law was later ratified is essentially irrelevant. "The goal of our enforcement actions is vindication of public policy and deterrence of wrongdoing, however, not recovery of damages by customers." *In re Roger Heitschmidt, et al.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. ¶ 26,263, 1994 WL 621593 *5 (CFTC Nov. 9, 1994) ("For enforcement purposes, whether or not a fraudulent act was later 'ratified' is essentially irrelevant") (citation omitted).

¶ 30,493, 2007 WL 1110753 *4 (CFTC 2007), *citing Symon v. Fullet,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,121 at 45,271, 1997 WL 447331, at *5 (CFTC Aug. 7, 1997), and *Sherwood v. Madda Trading Company*, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,728 at 23,020, 1979 WL 11487, at *4 (CFTC Jan. 5, 1979).

We have also explained that, to establish ratification, the respondent must establish not only that the customer knew of the agent's wrongdoing, but *also* that he, the customer, knew he had a right to avoid financial responsibility for unauthorized trades. *Adams*, *quoting Gilbert v. Refco, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,081 at 38,058, 1991 WL 127404, at *9 (CFTC June 27, 1991). Without this additional qualification, we cannot say that the customer consciously ratified the broker's unauthorized trading. Nor is the customer under a duty to know these aspects of the Commission's regulations. A broker is under such a duty, violates the rules at its peril, and is in a position to seek ratification from the customer by informing the customer of his right to not accept a trade that the customer did not authorize in advance. Without this requirement, the right to avoid unauthorized trades would be undermined, and the ratification defense would be a frequent and easy out for brokers who fail to abide by Rule 166.2.

In this case, Liberty Group, which has the burden of proving its affirmative defense, did not present convincing evidence that, as *Adams* requires, Professor Kimmelman knew he could avoid financial responsibility for unauthorized trades. Liberty Group points to Professor Kimmelman's reparations complaint as evidence that he did know. The argument is meritless: The complaint post-dates Liberty Group's unauthorized trading and is hardly probative of what the customer knew at the time Liberty Group violated Rule 166.2. It would be grossly unfair to hold that a customer who exercises his rights to demand reparations would somehow be

foreclosed from doing so on the theory that the reparations complaint itself is evidence that he knew his rights all along. Consistent with our prior decisions in this area, we will not ensnare Yrag Traders and Professor Kimmelman in that Catch-22.

Liberty Group states that the Judgment Officer ignored the ratification defense. The Initial Decision repeatedly cited the *Adams* decision, but whether the Judgment Officer was sufficiently explicit on this point is immaterial: Liberty Group cannot establish ratification within the meaning of *Adams* based on the facts in the record. Accordingly, the Judgment Officer's decision is affirmed as to Yrag Traders' trading losses incurred between account opening and market close on Friday, April 15, 2011, in the amount of $48,421.[5]

II.

Liberty Group's liquidation of Professor Kimmelman's positions on September 15 was also unauthorized. Liberty Group sent Professor Kimmelman a settlement proposal two days earlier, on September 13th (R.39 at 49), and asserts that Professor Kimmelman accepted their settlement proposal including liquidation when he said "[t]his situation is closed" and "[t]hank you for your time and effort to resolve this unfortunate matter." These responses were, however, ambiguous—they could just as easily be read as a rebuff. *See* Initial Decision, R.102 at 20, ¶ 27. Liberty Group should have asked for clarification.[6] Professor Kimmelman had previously threatened to file suit, and his September 13th response could simply have meant "Thanks for trying to settle the matter, but settlement negotiations are over." The Initial Decision's reasoning is sound: Before liquidating some positions on September 15, 2011, Liberty Group would need

[5] This amount represents a $200,000 account deposit less the $151,579 liquidation value of the account on April 15, 2011. *See* R.102 at 28; *see also* R.48-1 through 48-4 (PFG trading statements for this time period); R.34.

[6] Instead, Liberty Group's representative emailed Professor Kimmelman that he would "get the settlement documents to you shortly." R.39 at 50.

more evidence of authorization, such as reaffirmation or confirmation that Professor Kimmelman was agreeing to the settlement offer.[7] Thus, on balance, the weight of the evidence shows that Liberty Group failed to obtain written or other clear authorization to liquidate the account, in further violation of Commission Rule 166.2. Because there was no ratification of this violation, Liberty Group is liable in the additional amount of $1,302, the amount of losses associated with the liquidation. *See* R.48-5 at 7.[8]

III.

In his responsive brief on appeal, Professor Kimmelman argues that he should also be compensated for trading losses between April 16, 2011 (after he told Liberty Group to freeze his account) and September 13, 2011. Brief for Complaint at 4-5. However, he did not file an appeal on behalf of Yrag Traders within 15 days of service of the December 30, 2013 Initial Decision. 17 C.F.R. § 12.401(a).[9] These claims are, accordingly, not properly before the Commission and are now time-barred. *See Camp v. First National Monetary Corporation*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,190 at 32,505, 1986 WL 66138, at

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[7] Even in Professor Kimmelman's subsequent October 31, 2011 email discussions about what these words meant, he is unclear. *See* R.39 at 18 (1:47 p.m. email) (asserting there was an implied contract but also unauthorized trades); *id.* at 18-19 (1:08 p.m. email) (asserting the existence of an implied contract); *id.* at 22 ("clearly there was no agreement"). Especially in the context of Professor Kimmelman's opaque communication style, well known to Liberty Group by the fall of 2011, the statement was ambiguous.

[8] Thus the total damages award, excluding interest, is $49,723, the sum of $1,302 and $48,421.

[9] Commission Rule 17 C.F.R. § 12.401(a) provides:

> The failure of a party timely to file and serve a notice of appeal, and to pay the appellate filing fee, in accordance with this paragraph, ... shall constitute a voluntary waiver of any objection to the initial decision, or other order disposing of the proceeding, and of further administrative or judicial review under these rules and the Commodity Exchange Act.

Commission staff informed Professor Kimmelman of this deadline. *See* R. 93.

*3 (CFTC July 24, 1986) (request for damages award pressed in responsive brief on appeal denied as untimely, citing 17 C.F.R. § 12.401(a)).

Alternatively, Yrag Traders' various arguments for damages for all his losses (including losses associated with the decrease in value of options held during the time period when trading in his account was frozen) are unconvincing and warrant little discussion. Brief for Yrag Traders at 8-10. There is no genuine dispute about the relevant facts, and those facts do not establish fraud or failure to disclose the risks of LTG's trading strategies. As the Initial Decision correctly observes, the fact that a trade proves to be unsuccessful cannot, standing alone, constitute a basis to obtain a reparations award. For the reasons set forth in the Initial Decision, Yrag Traders' claim for return of losses based upon an alleged unsound trading strategy is meritless.

ORDER

Based on the foregoing, we

AFFIRM the Initial Decision.

The costs, interest, and joint and several liability remain as set forth in the Initial Decision.

IT IS SO ORDERED.

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

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

Dated: December 11, 2014