U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
www.cftc.gov

Office of Proceedings

RECEIVED CFTC
Office of Proceedings
Proceedings Clerk
2:53 pm, Mar 26, 2020

Richard C. Whited, III,	*	CFTC Dkt. No. 18-R030
Complainant,	*	**Served electronically**
v.	*	
E*Trade Futures LLC,	*	
Respondent.	*	

INITIAL DECISION &
ORDER DISMISSING COMPLAINT
AND AWARDING COUNTERCLAIM

This case arises out of a complaint brought by Richard C. Whited, III against E*Trade Futures LLC for purportedly placing his account in liquidation status inappropriately, and then liquidating his futures account in bad faith after fraudulently miscalculating (and misrepresenting) the amount of margin required to sustain his account. Whited claims these wrongdoings caused him $280,658.59 in damages, including $252,324.33 in lost profits. E*Trade counters that it is entitled by both contract and law to increase the amount of margin required at any time, including in periods of volatility, and to liquidate accounts once they fall under their margin requirements. E*Trade also filed a counterclaim for $159,443.11, which reflects Whited's negative account balance.

E*Trade filed a Motion for Summary Disposition on December 6, 2019. That Motion was fully briefed by both parties as of January 3, 2020. In addition, full productions had been made by both parties, and included: 1) E*Trade's and OptionsHouse Futures' Customer Agreements; 2) Whited's E*Trade securities and futures account statements from October 2017 to June 2018; 3) daily account statements for Whited's E*Trade account for February 2, 5 and 6, 2018; 4) an excerpt from E*Trade's website discussing margin requirements; 5) excerpts of best bid and offer data from CME for various times on February 5, 2018; 6) account alerts sent to Whited on February 5, 2018 from 2:02 pm to 3:40 pm, and 8:29 to 9:05 pm; 7) emails between E*Trade and Whited from February 9 to 13, 2018; 8) audio recordings of telephone calls between Whited and various E*Trade employees from February 5, to June 22, 2018 (15 in total); and 9) emails between CME Group and Whited from August 2019 (some of which is stricken from the record as described below).

After carefully considering their arguments and evidence, I find that a hearing is not required to resolve this dispute and that Respondent E*Trade is entitled to summary disposition on its defenses and counterclaims.

I. Relevant Procedural History

On September 17, 2018, Whited filed this reparations complaint seeking $453,232.86 in damages. Then, in response to a November 7, 2018 Deficiency Letter regarding his damages calculation, Whited filed a First Amended Complaint on November 26, 2018, revising his damages claim to $280,658.59 ($28,334.26 in

out-of-pocket losses and $252,324.33 in lost profits). *See generally* First Amended Complaint; Letter from Pugh to Whited (Feb. 15, 2019). Respondent timely filed its Answer and Counterclaim on April 17, 2019. Whited filed for a Motion for Default Judgment shortly thereafter, which was denied by Gene Smith, Director of the Office of Proceedings.

This case was forwarded to my docket on June 12, 2019, and discovery commenced immediately. During the course of discovery several issues arose that were resolved at a recorded telephonic hearing held on September 12, 2019. *See* Hearing Tr. (Sept. 12, 2019); Amended Complaint and Discovery Order (Sept. 13, 2019); Scheduling Order (Sept. 13, 2019).

I resolved certain outstanding discovery issues regarding dueling motions to compel discovery on that hearing.[1] I also granted Whited's Motion to Amend his Amended Complaint (Second Motion to Amend) (July 10, 2019) because his proposed amendments fell within the statute of limitations and the amendments posed no prejudice to Respondents in what was the early stage of discovery. Thus the operative complaint is Complainant's Second Amended Complaint, filed as

[1] During the hearing, we also discussed a motion for issuance of a subpoena Whited filed on October 3, 2019, requesting that CME authenticate certain documents he himself retrieved from the CME website and from CME publications. *See* Whited's Request for Issuance of Subpoena (Oct. 3, 2019). This first request became moot when the parties requested a 45 day timeline to meet and confer and stipulate to certain facts, including the information Whited requested from CME in his subpoena request. *See* Emails between Whited, Counsel for E*Trade (Richard Davis and Brandt Hill), and the Office of Proceedings (Oct. 8, 2019 and Oct. 16, 2019). The parties were given until November 8, 2019 to stipulate to certain facts. *See* Scheduling Order (Oct. 16, 2019). The parties were unable to come to an agreement, *see* email from Respondent to JO (Nov. 8, 2019), and Whited timely filed a Renewed Motion for Issuance of Subpoena on November 8, 2019. I denied his Renewed Motion by way of Order on November 27, 2019 because Whited himself could testify as to how he retrieved the documents and their source or sources if necessary.

Attachment 1 to his Second Motion to Amend. *See* Amended Complaint and Discovery Order at 2 (Sept. 13, 2019). Respondent filed its Answer to the Second Amended Complaint and Counterclaim on October 9, 2019. Discovery in this case was closed on November 8, 2019. *See* Scheduling Order (Sept. 13, 2019).

Respondent filed its Motion for Summary Disposition on December 6, 2019, and its Reply in Support thereof on January 3, 2020. Whited filed his Opposition to Respondent's Motion for Summary Disposition on December16, 2019. Whited then filed an Objection and Motion to Strike (Motion to Strike) certain evidence on January 6, 2020. That Motion to Strike was fully briefed by January 13, 2020.

On January 29, 2020, I issued an Order staying the deadlines in this case until I made a ruling on Respondent's Motion for Summary Disposition and Whited's Motion to Strike.

This case is now ready for disposition.

II. Factual Findings

Richard C. Whited III is an individual residing in Oklahoma City, Oklahoma. *See* Reparations Complaint Form. Whited opened commodity futures and securities accounts with OptionsHouse, LLC in May 2016. In September 2016, E*Trade's parent company acquired OptionHouse's parent company along with OptionHouse's customer accounts. To that end, OptionHouse's customer accounts, including in relevant part Whited's commodity futures and securities accounts, were transitioned to E*Trade in August 2017. Second Amended Compl. ¶¶ 3-4; Resp. Mot. for Summ. Disp. Ex. 2.

E*Trade informed its soon-to-be-transitioned customers as early as May 9, 2017 that their E*Trade accounts would be governed by the E*Trade Customer Agreement, which includes a Base Account Agreement, and its supplements such as the Margin Account, Commodity Futures, Options and Retirement Supplements. Resp. Mot. for Summ. Disp. Ex. 3 (Customer Agreement).

Whited traded commodity options contracts on margin. E*Trade's Customer Agreement and its supplements spoke directly to the risks associated with these financial products and trading on margin. For example, it warned that the customer was "borrowing money or securities from E*Trade" and as a result the customer's "financial exposure could exceed the value of [the account's] assets." Resp. Mot. for Summ. Disp. Ex. 3 (Margin Account Supplement ¶ 6(b)).

The Customer Agreement also warned that "trading contracts in commodity interests is highly speculative" and is "only suitable for those customers who understand and are willing to assume the economic, legal and other risks involved." *Id.* (Customer Agreement ¶ 3; Options Supplement). It further warned that "the low margin deposits associated with volatile price movements in the markets for commodity interests can result in rapid and substantial losses." *Id.* (Commodity Futures Supplement ¶ 3; Options Supplement ¶ 6(a)(iii)).

With respect to its margin calculation, the Customer Agreement states that the "margin requirements of E*Trade may exceed margins established by Applicable Law," and that E*Trade "<u>may change the margin requirements at any time without notice . . . including without limitation on an intra-day basis</u>." *Id.*

(Commodity Futures Supplement ¶ 6(a) (emphasis added)). And if a customer account went into margin deficiency, E*Trade could "without prior notice" to its customers, "liquidate positions," "refuse to accept any order," or take any other actions that it "in its discretion, deems advisable for its protection." *Id.* (emphasis added). In addition, with respect to options trading, the Customer Agreement reserved E*Trade's "right to terminate, restrict, or reduce the Account Holder options trading privileges if it determines that the Account Holder's trading activities or option positions present a risk to the firm." *Id.* (Options Supplement).

On Friday, February 2, 2018, Whited's futures account was short 44 put options for E-mini S&P futures with at the close of trading. Resp. Mot. for Summ. Disp. Ex. 4 (Feb. 2, 2018 Daily Account Statement). As of that date, Whited's futures account contained $8,902.95 and his initial margin requirement was $20,353, giving him a margin deficit of $11,450.05. *Id.* Whited also had a sweep account, which as of February 2, 2018 contained $19,732.39. Second Am. Compl. ¶ 12, Ex. 2. Accordingly, on Monday, February 5, 2018, E*Trade transferred $11,405.05 from Whited's sweep account to his securities account and again to his futures account. Second Am. Compl. ¶ 14, Ex. 5. Whited's sweep account was thus decreased to $8,282.34.

On February 5, 2018, the markets were turbulent. The CBOE volatility index, which measures volatility in the S&P 500 index, jumped by a record 20 points. The spike in volatility exacerbated or precipitated wide-spread securities sell offs. *See* https://www.bloomberg.com/news/articles/2019-02-06/the-day-the-vix-

doubled-tales-of-volmageddon. And in fact, the S&P 500 index fell 4.1% by the close of trading on February 5, 2018. Whited does not dispute that the market was unusually volatile that day.

Whited started out February 5, 2018 short 44 put options. Whited shorted six put options at or before 11:08 am, making him short a total of 50 put options for the S&P 500 E-mini futures. Resp. Mot. for Summ. Disp. at 7-8. Whited had a total of $29,170.42 in his accounts at this time. Second Am. Compl. ¶¶ 15-16 (attached as Ex. 1 to Motion to Amend Amended Complaint (July 10, 2019)).

If the market did not stay above the strike price in the put options Whited wrote, Whited would have to close out the put option trade (by buying an option to offset the loss), or let the option expire and be exercised. If the put option expired and was exercised, Whited (as the put writer) would own the underlying asset—in this case S&P 500 E-mini futures—having paid more than it was worth, since he would have to exercise it at the strike price. As discussed above, the market moved against Whited's positions.

At 2:02 pm that same day, Whited submitted an order to purchase a single put option. E*Trade rejected that order because of insufficient margin. Resp. Mot. for Summ. Disp. Ex. 6 (E*Trade Response to Interrogatory No. 10)). The rejection message stated "No margin available after satisfying existing position margin (if any). Available margin = USD 16340, portfolio margin = USD 16891." *Id.* Ex. 7 (E*Trade Fix Logs); Second Am. Compl. ¶¶ 21-22. Whited then attempted to sell the underlying S&P 500 E-mini futures at 2:22 pm and 2:24 pm for $2,673.25 and

$2,692 respectively. Resp. Mot. for Summ. Disp. Ex. 7 (E*Trade Fix Logs). These trades were rejected because Whited's account had insufficient margin, as Whited himself has conceded. Resp. Mot. for Summ. Disp. Ex. 8 (Letter from Whited to E*Trade at E*Trade_000116 (April 11, 2018)).

Whited called E*Trade at 2:51 to discuss the margin message and his inability to trade. E*Trade customer service representative Bill told Whited "Obviously today is pretty, pretty traumatic here," to which Whited responded "Yeah, it's been brutal." Bill also told Whited:

> Okay. Richard, obviously this is one of the kind of days where they warn you about selling options, what could happen . . . . You're, you're on liquidation only, the only way you're getting out of this is by buying back options. You could potentially be in a debit here. . . I – risk is probably going to start liquidating your account here. There's only so many people here, but just be prepared for that . . . . You're welcome to get out on your own but at some point here in the next half an hour, he's probably going to start blowing out these positions, regardless of where the market is. So just keep that in mind.

After some back and forth, the E*Trade customer service representative informed Whited "I don't do the liquidating. But we'll have a better, we'll have an update for you on that here soon. So someone will probably be calling you, it might be me or a colleague of mine, but we'll, we'll figure it out from there."

Although the E*Trade representative specifically informed Whited that "he was welcome to get out on his own" and Whited knew he could liquidate on his own (Resp. Mot. for Summ. Disp. Ex. 17 (Whited Supp. Resp. to Interrogatory 21)), Whited made no moves to start liquidating his positions. At 5:20 pm, roughly two hours after Whited's first call with E*Trade concluded, E*Trade emailed Whited to

"call the Futures desk as soon as possible." Resp. Mot. for Summ. Disp. Ex. 10 (Feb. 5, 2018 Email from E*Trade to Whited).

Whited returned that email with a phone call at about 7:40 pm—two hours later. Whited spoke with E*Trade customer representative David Stark. In relevant part, Stark informed Whited that the margin call would be $60,000 and that "the risk department was wondering what you were intending to do as far as either lightening up or, moving money in." Then Whited and David had the following exchange:

> WHITED: Well I, you know, I talked with a guy earlier and he said that they were going to liquidate the positions.
>
> DAVID: He said they will need to liquidate, I think they're giving you another, yea, there was, well that was at about, that was pretty close to the call. We had a lot of liquidations today. You know if you were, if you were okay with that they can do it or you can start liquidating positions too, if you want. . . ."

Whited confirmed that he did not have $60,000 to meet the margin call. He also wanted to know how this situation could have occurred:

> WHITED: -- my, my problem is I don't really know how you know, like how this would work because I mean I, I started off, there was close to $30,000 in the account when I started off.
>
> DAVID: Uh-huh.
>
> WHITED: And then you know there were no, no triggers for liquidation, nothing, nothing happened and I mean I . . . don't know how, how it got so deep like that without any triggers happening. I mean nothing fired off anywhere.
>
> [omitted conversation]
>
> DAVID: -- there were no triggers. What happened was, was pretty sudden and it was pretty, pretty extreme and having been in this, having been in the markets for about 20 years, you know, you know and this brought back memories of, of 2008, only it was a much steeper one day decline than what we saw back then.
>
> Whited: Right.

DAVID: You know that's –

WHITED: Exactly.

DAVID: Yeah. What, what can you do in a situation like that, you know, the those are the prices, that's the market. So I mean it probably, you know, you know if, if, you know you're not wiring in the money or you don't take a look at (indiscernible) value either tonight or you know like during the morning hours when there's a tighter spread, they'll probably liquidate you. We like to get ahold of people on a best efforts basis just to let them know what's happening. We can't always do that, of course, because you know the markets will move pretty quickly, but you know, but a lot of people were, were selling S&P puts you know in the market so.

WHITED: Yeah. Well, so I guess my question is I mean what happens if I can't meet the margin call then?

DAVID: Well you know what happens is they'll start, they'd start liquidating your positions and 2561, one moment, oh they'd start liquidating your positions, you know at, at that point. Okay. Just to you know get you out of the, out of the market.

When Whited responds that closing out everything would cost "way more . . . than what I actually have available," David reminds him that "that's a risk." He further reminds him that "selling puts is you know, is a very risky, very risky proposition." Clearly concerned about the fact that he may end up owing money on the trades in his account, Whited then states "if there's more of a loss . . . than what's in the account . . . I can't pay that back, you know, I don't have that kind of money." David informs him that if there is a debit it would go to legal, and Whited then reiterates: "Well, I, I mean I guess, I guess I'm kind of, I'm stuck here because you know on one hand you're telling me that, that, you know, that you know I'm not going to get good pricing if I try to liquidate now and, and I know that. If I try to liquidate . . . I'm going to end up with this massive balance, that it's, there is no way I can pay that at all."

Whited then complains that the fact that there was no automatic liquidation put him in this financial position. David states "no one is going to use stop orders on an option" and that "[a] lot of people are in the same boat," because "you're talking about the biggest one day single point drop in market history, that's going to strain everybody's reserves."

Whited again takes no action with respect to his account after this second phone call. Then around 8:30 pm, E*Trade began liquidating Whited's positions, buying to cover his short positions on the put options. E*Trade liquidated his account for $187,754.50, leaving his account with a debit balance of $161,465.52. Answer ¶¶ 38-40 (April 17, 2019) & Exhibit 7 (Whited's February 2018 Monthly Statement). As of March 2019, Whited still had a debit balance of $159,443.11 in his futures account. Answer Ex. 8 (March 2019 Monthly Statement).

III. Analysis and Legal Discussion of Whited's Claims

Whited brings twelve counts or claims for relief in his Second Amended Complaint, filed as Exhibit 1 to a motion submitted July 10, 2019. These claims can be streamlined as follows: Whited alleges that E*Trade committed fraud during their relationship and fraudulently solicited Whited's business by (1) representing that the Customer Agreement—without any supplements or addenda—constituted the entirety of the contract between them and did not allow for the imposition of trading restrictions; (2) failing to specify the conditions under which Whited's account could be placed on trading restrictions; (3) acting as an investment advisor, which was prohibited by the Customer Agreement, when it imposed a "liquidation

only" trading restriction on Whited's account; (4) failing to liquidate Whited's positions on his behalf within a short or reasonable time after the close of his 2:51 pm phone call with an E*Trade representative on February 5, 2018; (5) failing to notify Whited promptly of the trading restrictions it had placed on Whited's account; (6) changing its intraday margin calculation in violation of its stated policies; and (7) acting in bad faith when it did these things.

Deciding the merits of each of these claims depends on the answer to a few straightforward questions: (1) Whether Whited's accounts were governed by the Customer Agreement, and Commodity Futures, Margin Account, and Options Supplements; (2) Whether these documents, in total, authorized E*Trade to take the complained-of actions; (3) Whether on February 5, 2018 E*Trade promised its compliance department would liquidate Whited's positions on his behalf before a time certain; and (4) Whether, nonetheless, any of E*Trade's conduct amounts to bad faith. I find that Whited is bound by the Customer Agreement and its Supplements, which specifically authorize the complained-of conduct, and that E*Trade did not act in bad faith in its treatment of Whited's account. I further find there was no promise to liquidate Whited's positions on his behalf by any specific time. For these reasons, Whited's claim must be dismissed.

A. Standards of Analysis for Motions for Summary Disposition

Under Commission Rule 12.310(e), summary disposition is appropriate when each of three conditions has been met: (1) there is no genuine issue of material fact; (2) there is no need for further factual development; and (3) the moving party is entitled to a decision as a matter of law. *Elliot v. Jay De Bradley et al.*, CFTC No.

11-R004, 2012 WL 6087468 at *6 (CFTC Dec. 5, 2012); *Levi-Zeligman v. Merrill Lynch Futures, Inc.*, CFTC No. 92-R125, 1994 WL 506234 at *6 (CFTC Sept. 15, 1994). The purpose of summary disposition "is to avoid the empty ritual of an oral hearing," *Elliot*, 2012 WL 6087468 at *6 (internal citation omitted), and at this stage:

> [T]he judge's function is not to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial. All reasonable doubts about the facts should be resolved in favor of the non-moving party. If reasonable minds could differ on any inferences arising from undisputed facts, summary judgment should be denied.

Id. A hearing on the issues raised by Whited is not required because there is no genuine issue of material fact relevant to his claims, and his claims are foreclosed as a matter of law.

B. The Customer Agreement Governs Whited's Account

Whited complains that E*Trade was not authorized to place his account in a liquidation-only status without notifying him of the change and specifying in advance the conditions under which it could implement such a change. He further complains that E*Trade was unauthorized to change the margin calculation applicable to his account. He argues that the provision in the Customer Agreement and its Supplements authorizing E*Trade to take these actions do not apply to him. I find Whited was bound by the Customer Agreement and its incorporated documents.

E*Trade's Customer Agreement and its Supplements are binding on Whited for a myriad of reasons. First, he was on notice before his account was moved from

OptionsHouse to E*Trade that there would be a new customer agreement in place. As early as April 27, 2017, E*Trade sent Whited an e-mail informing him that his account would be moved to E*Trade that summer. Resp. Mot. for Summ. Disp. Ex. 2 at WHITED000016. And then on May 9, 2017 E*Trade sent Whited another e-mail providing him with a link to, among other documents, the E*Trade Customer Agreement, noting that "[t]hese documents provide details about the move to E*Trade and how it may affect [him]." *Id.* at WHITED000017. Whited also received an e-mail on June 28, 2017 informing him that his account would go live on E*Trade on August 6, 2017. *Id.* at WHITED000022. Despite having received the documents that would "affect" his account, Whited never objected to any of the terms in those documents.

Second, the Customer Agreement expressly incorporates its supplements. Resp. Mot. for Summ. Disp. Ex. 3 (Customer Agreement). It states: "The Customer Agreement, consisting of this base account agreement, the Options Supplement and the following supplements to the extent applicable based on the Account Holder's selections on the Account Application, . . . sets forth the terms and conditions under which E*Trade will establish and maintain one or more accounts. . . ." *Id.* ¶ 1. It lists the following supplements: Margin Supplement, Commodity Futures Supplement and Retirement Account Supplement. The Options, Margin, and Commodity Futures supplements plainly apply to Whited's accounts given the kinds of accounts he has.

Whited argues that because he never made any selections on an E*Trade account application—and the Supplements govern only to the extent they are applicable based on such selections—the Supplements are not part of his Customer Agreement. But he had already made his selections when he opened an account with OptionsHouse and it was clear that he did have a commodity futures account and he did trade on margin. The pre-existence of these accounts and their rollover was Whited's de facto account selection. If Whited did not want those accounts to transfer over to E*Trade, he could have closed them in advance of the August 6, 2017 move from OptionsHouse to E*Trade. E*Trade in fact gave Whited ample time to do so when it provided early and frequent communications about the migration from OptionsHouse to E*Trade. Resp. Mot. for Summ. Disp. Ex. 2 at WHITED000014-000030.[2]

It defies the common sense reading of the contract to hold that the Margins, Options, and Commodity Trading Supplements did not apply to his commodity

[2] And in any case, Whited's protestations that he could not be bound by such terms with respect to margin ring hollow because the original contract Whited signed with OptionsHouse gave OptionsHouse and Whited the same respective rights and duties set forth in the current E*Trade Customer Agreement. The OptionsHouse contract required Whited to agree and acknowledge that (1) Whited must promptly satisfy all margin and maintenance calls, (2) OptionsHouse was not obligated to request additional assets to satisfy margin deficiency, notify him of such deficiency, or allow him additional time to satisfy his margin deficiency, (3) OptionsHouse could "increase its margin requirements at any time without providing [Whited] advance notice of the change," which could subject him "to the loss of funds and loss of positions," and (4) OptionsHouse could liquidate his account if it determined he was under-margined "in its sole discretion," or sell positions to cover the margin deficiency that Whited would not have otherwise sold, Resp. Mot. for Summ. Disp. Ex. 1 (OptionsHouse Agreement ¶¶ 52-53 [E*TRADE_000014]).

trading account through which Whited traded options on margin. They therefore control his account relationship with E*Trade.

C. The Customer Agreement Authorized E*Trade's Conduct

Because Whited and E*Trade were bound by the terms set forth in the Customer Agreement, Options Supplement, Commodity Futures Supplement, and Margin Supplement, E*Trade was authorized by contract to: (1) place his account in liquidation only status without prior notice and "in its discretion";[3] (2) change his margin requirements without prior notice in a manner exceeding margins otherwise established by applicable law;[4] and (3) liquidate his positions without prior notice "in its discretion."[5] Moreover, nothing required E*Trade to disclose the "conditions" under which it could either liquidate his positions or place him in liquidation only status because these actions could be taken in E*Trade's "discretion."

[3] Options Supplement [E*TRADE000057] (E*Trade has the "right to terminate, restrict, or reduce the Account Holder options trading privileges if it determines that the Account Holder's trading activities or option positions present a risk to the firm"); Commodity Futures Supplement ¶ 6(a)) (authorizing E*Trade to "without prior notice" to its customers, "liquidate positions," "refuse to accept any order," or take any other actions that it "in its discretion, deems advisable for its protection" if a customer went into margin deficit); Margin Account Supplement ¶ 2 ("E*Trade reserves the right to refuse to extend credit or permit trading on margin at any time").

[4] Commodity Futures Supplement ¶ 6(a)) ("margin requirements of E*Trade may exceed margins established by Applicable Law," and that E*Trade "may change the margin requirements at any time without notice . . . including without limitation on an intra-day basis.").

[5] Options Supplement [E*TRADE000057] (E*Trade has the "right to terminate, restrict, or reduce the Account Holder options trading privileges if it determines that the Account Holder's trading activities or option positions present a risk to the firm"); Commodity Futures Supplement ¶ 6(a)) (authorizing E*Trade to "without prior notice" to its customers, "liquidate positions," "refuse to accept any order," or take any other actions that it "in its discretion, deems advisable for its protection" if a customer went into margin deficit).

The taking of these actions did not turn E*Trade into an "investment adviser," which would be prohibited by the Customer Agreement. The actions taken by E*Trade—placing his account in liquidation only status, changing the intraday margin calculation, and liquidating his account—are authorized by E*Trade's right under the Customer Agreement and its Supplements to guard against its own risk. They do not amount to "investment advice." *See Andregg v. Stotler & Co.*, CFTC No. 87-R61, 1987 WL 107002 (CFTC Oct. 29, 1987) (noting that liquidating positions did not constitute unauthorized trading by the futures commission merchant because the positions were under-margined).

Thus the Customer Agreement and its incorporated Supplements authorized each of E*Trade's actions with respect to Whited's account.

D. E*Trade Never Promised to Liquidate Whited's Positions on February 5, 2019 by a Specific Time

Whited also alleges that E*Trade failed to liquidate his positions for him by a certain time. This claim hinges on whether E*Trade represented that it would liquidate his positions by a specific time in the phone calls between E*Trade and Whited on February 5, 2018. Analyzing these calls makes clear that E*Trade made no such promise, and no testimony on this is needed where this Office has the recordings of those actual phone calls.

During the first call that occurred on February 5, 2018, the customer service representative told Whited several things. First, he told him "you're welcome to get out on your own." Second, he told him that "in the next half-hour here [the risk department] is probably going to start blowing out these positions." Third, E*Trade

represented that he himself does not do the liquidating, but that "someone will probably be calling you." Given that the E*Trade representative told Whited he was welcome to get out of these positions on his own, otherwise E*Trade would probably liquidate his positions, Whited's alleged expectation that they would liquidate on his behalf by some specific time is unreasonable. Moreover, the E*Trade representative specifically stated that someone would call him. And in fact, E*Trade did get in touch by email with Whited on a timely basis two hours later. Whited did not call E*Trade back as requested for another two hours.

When Whited did finally call E*Trade back, he was informed that his margin call would be $60,000 and that if he could not make that margin payment, E*Trade would probably start liquidating his account for him. Again, the E*Trade customer service representative explained that the previous representative told him that they would need to liquidate and that they would call. Whited hung up from that second call and still did not liquidate his positions.

Although E*Trade made it clear that it would need to start liquidating Whited's positions unless he could deposit additional margin funds, they never promised to do so by a certain time. There is nothing actionable about the fact that E*Trade waited until 8:30 pm that same day (and in fact within less than 6 hours of informing Whited that they would "probably" do so) to liquidate his account. There was no promise by E*Trade to liquidate any sooner than that.

E. E*Trade Did Not Act in Bad Faith

Despite the fact that the contract Whited signed expressly authorized E*Trade to engage in the complained-of conduct, Whited nonetheless argues that he

was both placed in liquidation status without prior notice in bad faith and that his account was liquidated in bad faith. Futures customers must prove that they were either mislead about the margin policy or their positions were liquidated in bad faith to demonstrate improper liquidation. This is because, in the futures context, the "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." *Laube v. Gain Capital Group*, CFTC Dkt. No. 13-R006, 2017 WL 132927, at *5 (CFTC Jan. 6, 2017) (collecting cases) (discussing futures precedent in context of claims involving forex). The only issue remaining here is whether any of E*Trade's conduct amounts to bad faith, since the contract clearly disclosed that Whited's account could be liquidated or frozen from trading without notice if under-margined and that the FCM could change the intraday margin rates without notice.

Although it is difficult to find affirmative examples of bad faith conduct with respect to forced liquidation of under-margined accounts and changing margin requirements without notice, each of E*Trade's actions here have specifically been found to not constitute bad faith.

First, forced liquidation of under-margined accounts does not constitute bad faith conduct. In *J.W. Macara, Incorporated*, the Judgment Officer held that having twice allowed a customer to maintain under-margined positions does not mean that disallowing it a third time constituted bad faith. *J.W. Macara, Inc. v. Peregrine*

Fin. Grp., CFTC Dkt. No. 95-R115, 1996 WL 465361 at *6 (CFTC Aug 15, 1996). This is particularly true where the customer made no attempt to provide additional margin or otherwise appropriately manage his account. *Id.* Whited similarly disclaimed the ability to pay the additional margin but otherwise made no attempt to start liquidating his positions. And the "Commission has summarily affirmed cases involving FCM liquidations, including total liquidations, under contractual provisions that authorize liquidation without notice in the event of a margin default. *Laube*, 2017 WL 132927 at *6 (collecting cases).

Second, E*Trade did not engage in bad faith conduct when it placed Whited's account in liquidation only status. Whited's account was under-margined, and allowing Whited to continue trading without depositing additional funds would have shifted the risk onto E*Trade. "Just as a customer cannot enter positions without initially having the funds to finance them, neither can the customer force a broker to keep positions open without having the funds to keep them properly margined. To hold otherwise would allow customers to force their risk upon brokers." *Comtrade Inc. v. Cargill Investor Servs.*, CFTC Dkt. No. 94-R188, 1996 WL 397219 at *6 (CFTC July 15, 1996). Because this risk-shifting is impermissible, a "broker generally has a duty to accept customer orders to liquidate existing positions, but has no duty to accept customer orders for new positions. *Capital Options Investments v. Goldberg Bros. Commodities*, Dkt. No, 88 C 2073, 1990 WL 180583 at *7 (N.D. Ill. Nov. 5, 1990), *aff'd* 958 F.2d 186 (7th Cir. 1992). And "a

customer cannot enter positions without initially having the funds to finance them." *Id.*

Third, waiting roughly six hours between informing Whited of his margin call and liquidating his account further does not demonstrate bad faith. "As a good business practice, a futures commission merchant should make a diligent effort to notify a customer that additional margin money must be deposited to avoid liquidation." *In re MF Global*, 531 B.R. 424 at 435 (June 2, 2015). That is exactly what E*Trade did. Whited's attempt to place trades was immediately followed by a notification that he could not execute those trades because of margin insufficiency. Whited was informed again on the Feb 5, 2018 call at 2:51 pm that unless he deposited additional margin, his account positions would likely be liquidated. Later that day, at 5:20 pm, E*Trade emailed Whited to tell him to call them back regarding his account. And then on the evening call, E*Trade told Whited that if he could not make an additional $60,000 deposit, his account would be liquidated. And within roughly an hour of that call, E*Trade liquidated the account—after giving Whited the ability to either deposit additional margin or liquidate his account on his own.

Whited essentially claims here that E*Trade should have liquidated his positions earlier in the day to mitigate his losses. But "federal law [does not] require[ ] an FCM to liquidate a customer's account in any particular manner." *In re MF Global*, 531 B.R. at 436-37. And "[i]mposing a 'less drastic alternative' standard on the contractual duty of brokers would strip them of their right to raise

margins when they perceived a potentially volatile market." *Cap. Options Invs. v. Goldberg Bros.*, 958 F.2d 186, 191 (1992).

Finally, changing the margin requirements without notice has specifically been held to not constitute bad faith where there is a contractual provision allowing such conduct. "The financial integrity and the efficiency of the market require brokers to be able to anticipate the possibility of future volatility and to exercise their discretion as a matter of business judgment to raise margins accordingly without the fear of subsequent claims of bad faith. . . ." *Cap. Options Invs.*, 958 F.2d at 190-191. More importantly, "the doctrine of good faith cannot be used to alter an allocation of the risk that the parties had agreed upon." *Id.* at 191. Whited agreed that his intra-day margin could be changed without notice at E*Trade's discretion, and has conceded in his phone calls that the market was highly volatile on the day in question.

In short, Whited's allegations "do not transform [E*Trade's] actions—entirely consistent with its contractual rights—into actionable conduct." Because Whited has not (and on the record cannot) show a violation of the Commodity Exchange Act or its Regulations, there is no need to evaluate whether the damages he claims, which include lost profits, are sustainable.

IV. Analysis and Legal Discussion of E*Trade's Counter-Claim

E*Trade established that Whited owes it a debt of $159,443.11. Whited does not dispute that amount, and the Customer Agreement states that the "Account Holder agrees to satisfy any Obligation to E*Trade and to pay any Debit Balance in

any of the Accounts on demand."[6] Therefore, Whited owes E*Trade the outstanding balance of $159,443.11. *See Hussain v. Saul Stone & Co., LLC*, CFTC Dkt. No. 98-R153, 2003 WL 1908052, at *9 (CFTC April 22, 2003) (awarding debit balance to Respondent); *Nacht v. Merrill Lynch, Pierce, Fenner & Smith*, CFTC No. 88-R295, 1995 WL 231237, at *6 (CFTC April 17, 1995) (awarding debit balance to Respondent).

V. Analysis and Legal Discussion of Whited's Motion to Strike

Whited filed a motion on January 6, 2020 seeking to strike Respondent's Exhibit 22, attached to its Motion for Summary Disposition because it was not previously produced in this reparations proceeding. That Motion to Strike is granted, and I have not relied on that document in rendering this decision.

CONCLUSION

Whited's telephone conversations with E*Trade make clear that Whited understood that he could not make his margin calls and would end up owing a rather large balance. Nothing about those unfortunate set of facts changes the agreements to which he consented or shifts the burden of Whited's own losses to E*Trade. For the reasons discussed above, Whited's reparations complaint is dismissed, but E*Trade's counterclaim is granted. Whited must repay E*Trade $159,443.11 within 180 days of this Order.

---

[6] The Commission has long held that it may award counterclaims arising out of the same course of events, such as a debit balance owed to the FCM by the customer. *See, e.g.*, *Friedman v. Dean Witter*, CFTC Dkt. No. R 77-46, 1981 WL 26050, at *2 (CFTC Nov. 13, 1981).

Dated: March 26, 2020

/s/ Kavita Kumar Puri
Kavita Kumar Puri
Judgment Officer