UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

RECEIVED
C.F.T.C.

2006 JUN - 1 A 11: 22

OFFICE OF PROCEEDINGS
PROCEEDINGS CLERK

YUL CHANG, Complainant,	*	
v.	*	CFTC Docket No. 04-R047
FARR FINANCIAL, INCORPORATED, and MARK EDWARD GAY, Respondents.	*	

INITIAL DECISION

Yul Chang seeks to recover trading losses caused by respondents' allegedly false advice in connection with the liquidation of a long Live Cattle futures position. Chang had acquired the long futures position after a short put option position had expired in the money. Two weeks before the expiration date, Chang had partially unwound an option spread, which left him short one put option. Two days before the expiration date, Chang shorted a second put. At some point, Chang had lost track of the expiration date and allowed the exercise of the two short Live Cattle puts. As a result, the two long Live Cattle futures were assigned to Chang's account, at a price well above the prevailing price, in a declining market.

A Farr Financial order desk clerk informed Chang that, since the options had expired in the money, "a futures position" had been assigned to Chang's account, and that, if Chang wished to avoid delivery, he should "liquidate the futures position." Chang alleges that he informed the clerk that he was not sure whether the assignment of the short put position had resulted in a short or short futures position, and that he asked the clerk what kind of order would liquidate the futures position. Chang further alleges that the clerk answered, wrongly, that Chang should place a buy order. Chang then placed an order to buy two more futures.

A few minutes later, Chang logged onto Farr Financial's online platform and discovered that the order had been filled, but that his exposure had been doubled to four long Live Cattle futures. Chang called Farr and complained to Mark Gay, the supervisor of the order desk. Chang explained that he had told the order clerk that he wanted to be flat and that the clerk had told him to place a buy order. Gay told Chang that he had been assigned a long futures position, and that Chang should have placed a sell order. Chang then instructed Gay to sell the four futures. Gay then consulted with the order clerk off-phone and told Chang that the clerk had denied advising Chang to place a buy order. Gay also told Chang that since he had a self-directed account it was Chang's responsibility to know his positions and to know the necessary order to liquidate a position. Thus, Gay asserted, Chang was responsible for the trade. Chang and Gay exchanged sarcastic pleasantries and terminated the conversation before resolving their dispute. Despite this problem, Chang continued to place trades with respondents for several more months.

Chang filed his reparations complaint six months after the disputed trade and three months before the last transaction. Upon receipt of the reparations complaint, respondents credited Chang's account the amount of trading losses that respondents calculated had directly resulted from the bungled attempt to liquidate the Live Cattle futures position, plus the costs of the commissions and the filing fee for Chang's reparations complaint. The amount of this credit – which would constitute the bulk of the cash balance left in Chang's account after the last trade -- was about half of what Chang claimed for damages.

In reply to the complaint, respondents asserted: that Farr had resolved the dispute by reimbursing Chang for his losses from the disputed trade; that it has always been Farr Financial policy for order desk clerks not to give trading advice; that, consistent with that policy, the Farr Financial order desk clerk had informed Chang about the assignment and the risk of delivery, but had not advised Chang to place a buy order to avoid delivery; that Chang neither informed the clerk that he wanted to liquidate the futures position nor asked the clerk for advice on how to liquidate; and that Chang had placed the buy order without further consultation.

My efforts to settle this dispute failed principally because the two sides could not agree on the size of the loss caused by the botched liquidation. Chang's loss calculation has been based on the decline in the reported "Account Liquidity" on the day of the disputed trade. Respondents' loss calculation has been based on the difference between the purchase price for the two additional Live Cattle futures and the sale price for the four Live Cattle futures. In essence, Chang and respondents disagree on who should be responsible for the difference between the strike price and the price prevailing at the time that Chang wished he had exited the market.

A telephonic hearing was held with Yul Chang and Omid Farr testifying. Respondents did not offer the testimony of the Farr Financial order desk clerk. The findings and conclusions below are based on the parties' documentary submissions and oral testimony, and reflect my determination to credit Chang's un-rebutted testimony about the conversation with the order desk clerk. As explained below, I have concluded that Chang has established a violation by respondents, but has failed to establish that he is entitled to an award beyond the amount that respondents have already refunded to Chang.

Factual Findings

The findings of fact are based on the parties' documentary submissions and oral testimony. The essential relevant facts are not in dispute, with the crucial exception of the conversation with the Farr Financial order desk clerk which preceded Chang's decision to buy two additional Live Cattle futures contracts.

The parties

Yul Chang, a California resident and owner of a mortgage company, had traded commodities, mostly for "fun," for eight years before opening his account with Farr Financial. Chang had maintained a self-directed discount account with Farr Financial since April 2001, with minimal problems. Chang had traded futures and options, futures predominantly, in a variety of markets without broker assistance, and had placed almost all of his trades electronically via the "FarrOnline" system. Chang typically had liquidated options at least ten days before the expiration date, because he "wanted to stay well clear of expiration." [*See* Chang testimony, at pages 5-8 of hearing transcript.]

Farr Financial Group, Incorporated is an introducing broker located in California. Mike Stefanski was employed by Farr Financial as an order desk clerk. It was Stefanski who informed Chang that he needed to liquidate "a futures position" to avoid delivery and who took Chang's order to buy two live cattle futures. Respondents did not produce written or oral testimony by Stefanski, who is no longer employed by Farr.

Mark Gay, registered as an associated person with Farr, was Stefanski's supervisor and handled Chang's initial complaint. Jae Ro, also registered as an associated person with Farr, was Gay's supervisor and followed up on Gay's handling of Chang's compliant.

The Disputed Live Cattle Trade

In May 2003, Chang began trading Live Cattle futures and options. From May to October 2003, Chang made five Live Cattle futures trades and two Live Cattle options trades. This series of Live Cattle futures and options trades generated a grand total of $6,690 in trading losses.

Chang's complaint would arise from the partial unwinding of a February Live Cattle put spread that Chang had initiated in late October 2003. For this spread, Chang had bought two February Live Cattle puts at a 74 strike price, bought two February Live Cattle puts at an 86 strike price, and sold four February Live Cattle puts at an 80 strike price.[1] Chang could not recall his strategy for this spread. [Chang affidavit dated October 12, 2005.]

The October, November, December and January monthly account statements reported that the expiration date for the February Live Cattle option was February 6, 2004. The December and January monthly account statement also reported that the "80" and "86" puts were in the money.

On January 20, 2004, Chang liquidated the two long legs for a $600 loss. On January 23, Chang liquidated three of the four short "80" puts, at 1.90, for a modest $40 per option profit. Chang could not recall why he had decided to remain short one

[1] Chang collected a $3,200 premium for the sale of the four live cattle puts at 2.00 points.

February Live Cattle "80" put. [*Id.*] On January 30, the February "80" put settled at 2.55, with a negative liquidation value of $1,420.

Chang conceded that he had lost track of the looming expiration date for the February live cattle options, despite the fact that it had been reported in his account statements. [*Id.*] Chang also did not dispute respondents' assertion that the "Contract Specs" page of Farr Financial's website had provided pertinent information about futures and options contracts, such as last trading dates and expiration dates. CME rules provide that for options on Live Cattle futures in the February bi-monthly cycle, the last trading day is the first Friday of the delivery month of the underlying futures contract. CME rules also provide that any Live Cattle option that is in the money at the close on the expiration date and that has not been liquidated or exercised prior to the termination of trading -- in the absence of contrary instructions delivered to the clearing house by the close of business on the last trading day -- will be automatically assigned a position in the underlying futures contract. [*See* CME rules 101A01.H and 101A02.B.] It cannot be determined on this record whether the Farr website explained that a buyer of a call and a seller of a put would be assigned a long futures position.

On February 4 -- just two days before expiration on February 6 -- Chang shorted a second "80" put, at 5.30 points, and collected a $2,120 premium. Chang could not recall why he decided to double his short exposure so close to expiration.[2] [Chang affidavit.]

On Friday, February 6, the puts expired in the money. On Monday, February 9, the two short puts were exercised, which resulted in the assignment of two February Live

---

[2] On February 4th, the "80" put option on the February live cattle future traded between 4.1 and 6.0. Thus, if Chang had decided to avoid the risk of assignment and delivery by purchasing, rather than selling, the "80" put, he would have paid a premium between $1,640 and $2,400, and thus his loss would have been between $840 and $1,600.

Cattle futures at 80.00.[3] At about 7:21 a.m. Pacific Time, the Farr Financial order desk clerk, Mike Stefanski, informed Chang that, since the options had expired in the money, "a futures position" had been assigned to Chang's account, and that, if Chang wished to avoid delivery, he should "liquidate the futures position." Chang credibly testified that he indicated to Stefanski that he was confused about whether he had acquired a long or short futures position and asked Stefanski what kind of order would liquidate the futures position, and that Stefanski -- after briefly consulting with someone else at the desk – told Chang to place a buy order. Chang then instructed Stefanski to purchase two February Live Cattle futures. This order was filled at 74.30.

A few minutes later, Chang logged onto the FarrOnline platform and noticed that he was not flat, but rather was long four Live Cattle futures. Chang called Farr Financial and spoke to Mark Gay. Chang complained that he had told Stefanski that he wanted to be flat and that Stefanski had told him to place a buy order. Gay explained that a long futures position had been assigned, and that Chang should have placed a sell order if he wanted to be flat. Gay then took Chang's order to sell the four futures. This order was filled at 73.95. The purchase and sale of the four Live Cattle futures realized a loss of $5,120.[4] The $2,920 in premiums that Chang had collected on the sale of the two puts ($800 on October 30, and $2,120 on February 4) reduced Chang's overall out-of-pocket loss on the transaction to $2,200.

During the course of the conversation, Gay consulted with Stefanski, and then told Chang that Stefanski insisted that he had merely told Chang that to avoid delivery he should "liquidate the futures position," but that he had not specifically advised Chang to

[3] On February 9th, the February Live Cattle futures contract traded between 73.95 and 75.25.
[4] The lion's share of this loss was due to the $4,840 loss (6.05 point loss) realized on the liquidation of the two futures that had been assigned at 80.

place a buy order. Gay also emphasized that, since Chang had a self-directed account, it was Chang's responsibility to know his positions and to know the necessary order to liquidate a position. Thus, Gay asserted, Chang was solely responsible for the botched liquidation. Chang disagreed with Gay's assessment. Later, Chang spoke to Gay's supervisor, Jae Ro, but they were unable to resolve the disputed trade.

Despite the unresolved dispute, Chang continued to place trades with Farr Financial for several more months. Chang filed his reparations complaint six months after the disputed trade and three months before the last transaction in the account. Yet more time would pass before Chang would withdraw the $852 cash balance.

Upon receipt of Chang's reparations complaint, respondents credited Chang's account $661, which they believed represented the total of all losses and costs that directly flowed from Chang's mistaken decision to buy rather sell when he had intended to liquidate. Respondents calculated a $580 trading loss, based on the .35-point decline from Chang's purchase of two additional futures -- at 74.30 points -- to Chang's sale of the four live cattle futures -- at 73.95 points. Respondents then added to this amount the commissions and the filing fee for Chang's reparations complaint.

Conclusions

Respondents' hearsay evidence is insufficient to rebut or undermine Chang's sincere and plausible testimony that he had clearly informed the Farr Financial order desk clerk that he needed clarification on whether he held a long or short futures position after the short put position had been exercised; that he had expressly asked the order clerk to specify the order that would liquidate the futures position; and that the order clerk had wrongly advised Chang to place a buy order, which doubled, rather than eliminated, Chang's market exposure. In these circumstances, where Chang made an understandable and reasonable request to the order clerk that he needed more accurate and complete information in order to liquidate the futures position, respondents' assertion that the order clerk was under no obligation even to clarify that Chang held "a long futures position," as opposed to "a futures position," is, at best, without merit. *See Avis v. Shearson, Hayden Stone, Inc.*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,837, at 27,526 (A commodity professional will be understood to have agreed to carry out a customer's request to perform special duties with a professional standard of care, unless the commodity professional expressly disavows the duties, or clearly discloses that he cannot perform the duties or that he can only perform the duties conditionally or without warranty as to result.) Thus, it is concluded that an agent of Farr Financial recklessly violated Section 4b(a)(2)(C)(ii) of the Commodity Exchange Act by falsely reporting that Chang held a short futures position and had to place a buy order to avoid delivery; that Chang reasonably relied on this false report; and that Farr Financial is liable for this violation pursuant to Section 2(a)(1)(B) of the Commodity Exchange Act.

However, Chang has failed to show any violation by the respondents in connection with the sequence of decisions that resulted in Chang permitting the options to be exercised. Thus, Chang is solely responsible for the loss incurred before he received the false advice. In these circumstances, the proper measure of damages must be limited to the loss that Chang incurred after receiving the false information. Respondents have already reimbursed Chang for this loss.[5] Accordingly, the complaint in this matter is dismissed.

---

[5] Respondents have reimbursed Chang for the trading loss, plus the commissions and the filing fee. Chang's decision not to withdraw the cash balance for several months after the last trade supports the

Dated June 1, 2006.

Philip V. McGuire,
Judgment Officer

---

conclusion that he has not incurred any lost opportunity costs. Therefore, prejudgment interest will not be assessed for the eight and a half months between the disputed trade and the reimbursement.