UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

ZAKARIA W. TOWDROSMATTA, Complainant, v. OMID MATHEW FARR, FARR FINANCIAL, INCORPORATED, BRIAN JEFFREY McCOY, and PROFESSIONAL MARKET BROKERAGE, INCORPORATED, Respondents.	*	CFTC Docket No. 00-R083

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INITIAL DECISION

Introduction

Zakaria Towdrosmatta filed his reparations complaint soon after Farr Financial had filed a complaint in California Small Claims Court to recover the debit balance in Towdrosmatta's non-discretionary, discount account. After a brief informal hearing, the Small Claims Court rejected Towdrosmatta's request to dismiss Farr Financial's complaint on jurisdictional grounds, and issued an award in Farr Financial's favor. Farr Financial has not collected on that judgment.

Before he had made his first trade, Towdrosmatta, an unsophisticated, novice trader, had rejected respondents' advice that he first gain some experience with a full-service, broker-assisted account before switching to a self-directed discount account. When Towdrosmatta suffered persistent problems placing and tracking his orders, respondents repeated this advice, but Towdrosmatta determinedly insisted on trading for himself, at least until he traded into a $211,973 margin call.

Towdrosmatta placed all of his trades through Professional Market Brokerage's on-line trading system. Over two months, he made a total of 22 round-turn trades, all involving the June CME Swiss Franc future contract. From the beginning, Towdrosmatta was frustrated and confused by a combination of numerous keypunch errors by PMB and by his own novice trading mistakes. Most significantly, after Towdrosmatta had traded into margin deficits on six of the first eight days of trading, and after he had disregarded respondents' warnings to heed margin requirements, Farr Financial suspended his trading privileges for about a week. Towdrosmatta then deposited more funds and resumed trading with one-contract to four-contract trades, which were generally profitable. However, after about a month, he reverted to making larger, more aggressive trades, which triggered more margin calls, the last one for $211,973, on a Friday afternoon just before the CME market closed.

One minute and 49 seconds before the close that Friday, Towdrosmatta placed a 37-lot market buy order, which he believed – incorrectly -- would leave him flat. However, this order was soon reported back "TLMC," *i.e.*, "too late to sell." As a result, Farr advised Towdrosmatta that, since he was headed into the weekend with insufficient funds in the account, Towdrosmatta "had no choice" but to hedge his exposure. Farr rejected Towdrosmatta's offer to wire $150,000 as inadequate to cover a $211,973 margin deficit, and obtained Towdrosmatta's approval to purchase 74 MidAm Swiss Franc contracts as a hedge for the 37 short CME contracts. Subsequently, Towdrosmatta determined that he held an additional ten short CME contracts, which Farr liquidated through an exchange-for-physical. The following Monday Farr liquidated the CME

position for a profit of $450, and liquidated the MidAm position for a loss of $4,075, which resulted in a debit balance of $1,725.66.

In his elaborate and extensive submissions, Towdrosmatta alleges that respondents "cheated" him in connection with nearly each and every trade in his account. The alleged violations fall into three categories: several delayed written confirmations, a few bad fills, and a handful of unauthorized trades. Out of the various allegations, the one charge that raises a serious question is a fleeting assertion by Towdrosmatta that one minute and 49 seconds before the market close should have been ample time for respondents to fill the 37-lot market order. Respondents deny any violations, and assert that Towdrosmatta's claim is barred by principles of *res judicata*. After carefully considering all of the parties' documentary submissions, it has been concluded that the complaint is not barred by principles of *res judicata*, but that Towdrosmatta has failed to establish any violations causing damages.

Factual Findings

The parties

1. Zakaria Towdrosmatta is a resident of Palmdale, California and owner of a travel agency, Khaton Travel. Before becoming a U.S. citizen, he had worked for ten years in Kuwait as an engineer. In 1998, he began investing in residential real estate. He had no other investment experience. On his PMB account application, Towdrosmatta represented that he had an annual income of $25,000, a net worth of $62,000, and approximately $3,000 in risk capital.

2. Farr Financial, Incorporated is an introducing broker located in Santa Clara, California. Omid Farr ("Farr") is the owner of Farr Financial. Brian McCoy is a registered associated person with Farr Financial. [NFA records.]

3. Professional Market Brokerage ("PMB"), during the relevant time, was a registered futures commission merchant located in Chicago, Illinois. In that capacity, PMB carried Towdrosmatta's account.[1] PMB is no longer in business, and has defaulted in several reparations cases. [CFTC and NFA records.]

The account-opening

4. Towdrosmatta contacted Farr Financial after reading an advertisement in Investor's Business Daily that claimed that Farr Financial charged a "$15 flat" round-turn commission, and provided "fast professional service," on-line trading, and direct access to floor brokers in "select markets."

Towdrosmatta and McCoy discussed trading futures, and McCoy suggested that Towdrosmatta start out with a broker-assisted account. However, Towdrosmatta insisted that he was only interested in a self-directed, discount account. McCoy then sent him an account-opening package and Farr Financial promotional materials.

The Farr Brochure prominently featured the following claims about order executions and fills:

> Farr Financial prides itself on the quality and timeliness of its order execution. As a client, you will enjoy the $15 FLAT! commission rate as well as the ability to place your orders quickly through our professional order desk or on-line over the Internet. In selected markets, your orders are routed DIRECTLY to filling brokers with hand-held devices in the trading pit. Your order is sent directly to the filling broker in the trading pit without any interruption of any kind.

[1] The orders for Towdrosmatta's trades were executed by Lind-Waldock floor brokers.

The Farr Brochure included a page with several customer encomiums consistently praising the speed and reliability of PMB's electronic order entry system. The brochure also featured a profile of McCoy in which he is quoted:

> I am proud to work with a firm that prioritizes client services. That, combined with Farr's reputation for excellence in research and trade execution, is of great value to my clients.

Finally, McCoy included a copy of an article about on-line trading in Bloomberg Personal Finance, which quoted a Farr Financial executive claiming that direct orders could routinely be filled in ten seconds.

During discussions before the first trade, Towdrosmatta rejected McCoy's renewed suggestion that he should open a full-service account and trade with the assistance of a broker, and later switch to a discount account when he had sufficient experience. Towdrosmatta claims that his decision to open a discount account with PMB was influenced by McCoy's representation that orders placed through PMB's on-line trading system could be filled in 30 seconds, and confirmed in 60 seconds. However, Towdrosmatta does not dispute respondents' assertion that they also explained that those execution times applied to "direct order entry " markets such as the stock index markets, but that the Swiss Franc market was a "general order entry" market, not a direct order entry market, and thus that Towdrosmatta's orders would go to Farr Financial's order desk before going to the floor broker. In any event, after the first few days of trading, Towdrosatta knew enough not to expect respondents to provide 30-second fills and 60-second confirmations on his Swiss Franc trades.

Trading activity

5. Towdrosmattsa would deposit a total of $10,000 ($2,200 on February 24, $1,800 on March 11, $1,000 on March 25, and $5,000 on March 29), and withdraw a total of $2,800 ($800 on April 5, and $2,500 on April 28), for an aggregate net deposit of $7,200. After the last trade, Towdrosmatta's account had a $1,725.88 debit balance, which after a series of keypunch errors and corrections was adjusted to an ending debit balance of $1,800.66.[2] Thus, Towdrosmatta would lose a total of $10,000.66.

6. Towdrosmatta traded for about two months, from March 8 to May 3. He placed his orders through PMB's electronic order-placement system, and exclusively traded the CME June Swiss Franc future contract. Set out below is a summary of the trading activity:

Order	*Date*	*Trade*		*Gross profit/(loss)*
(1)	March 8	buy	1	
	March 9	sell	1	$ 75
(2)	March 10	daytrade	8	488
(3)	March 10	buy	2	
	March 11	buy	1	
	March 12	buy	2	
	March 15	buy	5	
	March 15	sell	10	(1,475)
(4)	March 11	daytrade	3	325
(5)	March 16	daytrade	15	2,400
(6)	March 16	sell	23	
	March 17	sell	4	
	March 17	buy	27	(4,200)

[2] On this record, it cannot be determined why Farr Financial claimed in its Small Claims complaint that the debit balance was $1,980.66.

(7)	March 17	daytrade	1	150
(8)	March 25	daytrade	2	388
(9)	March 11	sell	1	
	March 25	buy	1	800
(10)	March 25	buy	1	
	March 26	buy	1	
	March 31	sell	2	(913)
(11)	April 5	buy	3	
	April 6	sell	3	1,163
(12)	April 6	sell	3	
	April 8	buy	3	2,588
(13)	April 8	buy	3	
	April 9	sell	3	638
(14)	April 9	sell	4	
	April 13	buy	4	1,050
(15)	April 13	buy	1	
	April 20	buy	6	
	April 20	sell	7	975
(16)	April 13	buy	3	
	April 21	buy	17	
	April 21	sell	20	(1,775)
(17)	April 22	daytrade	41	4,738
(18)	March 10	sell	2	
	April 22	sell	6	
	April 23	sell	33	
	April 23	buy	41	5,263
(19)	April 23	buy	3	
	April 26	buy	63	
	April 26	sell	66	(8,025)
(20)	April 27	sell	3	
	April 28	buy	3	975

(21)	April 28	sell	3	
	April 30	sell	20	
	April 30	buy	23	(4,513)
(22)	April 30	sell	50	
	April 30	buy	10	
	May 3	buy	40	450
(23)	April 30	buy	74[3]	
	May 3	sell	74	(4,075)

7. During the first eight trading days (March 8 through 17), Towdrosmatta experienced numerous problems, some of respondents' making, some of his own. PMB often failed to provide timely written confirmations. Towdrosmatta botched an attempt to cancel and replace an order. And, most significantly, Towdrosmatta's trading triggered margin calls on six of the first eight trading days: on March 8, 10, 11, 12, 16, and 17. McCoy and Farr warned Towdrosmatta to heed margin requirements, and when he failed to do so, Farr suspended his trading privileges between March 17 and 25. When he resumed trading, Towdrosmatta restrained the size of his trades until April 21st when he substantially increased the size of his trades and incurred a margin call.

8. As noted above, in early March, PMB's on-line and written confirmations for several trades frequently were substantially delayed, which understandably confused and concerned Towdrosmatta. However, for each of these delayed reports, McCoy or Farr verbally assured Towdrosmatta that PMB's back office had verified his trades, and PMB eventually generated on-line and written statements reporting the fills. Also, PMB issued statements confirming trades in early March that Towdrosmatta protested he had never placed. Eventually, on March 30th, PMB would remove the trades from his account.[4]

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[3] Midam contracts.

[4] Towdrosmatta also alleges that the March 30th adjustment, which removed trades that he had alleged were unauthorized, was itself unauthorized.

Finally, Towdrosmatta was unhappy about a fill on a market order on March 12. However, Towdrosmatta's evidence indicates that he received a fill at the prevailing market price at the time that he had placed the market order.

When asked to explain why he had not promptly closed his account after the initial round of daily problems, Towdrosmatta replied that other, unidentified, brokers had advised him to continue trading to prevent respondents from "punishing" him by not correcting keypunch errors and not returning his money. However, this peculiar rationale for not closing the account cannot be reasonably squared with Towdrosmatta's decisions in late March to commit additional funds and in late April to withdraw funds just as he reverted to the aggressive trading style that had previously triggered substantial margin calls.

9. On a Friday afternoon just before the CME market closed, Towdrosmata was short 47 contracts and faced a $211,973 margin deficit. One minute and 49 seconds before the close, Towdrosmatta placed a 37-lot market buy order, which he believed – incorrectly -- would leave him flat. However, this order was soon reported back "TLMC," *i.e.*, "too late to sell." As a result, Farr advised Towdrosmatta that, since he was headed into the weekend with insufficient funds in the account, Towdrosmatta "had no choice" but to hedge his exposure. Towdrosmatta offered to wire $150,000. But Farr replied that amount would be inadequate to cover a $211,973 margin deficit.[5] Farr then obtained Towdrosmatta's approval to purchase 74 MidAm Swiss Franc contracts as a hedge for the 37 short CME contracts. Subsequently, Towdrosmatta determined that he held an additional ten short CME contracts, which Farr liquidated through an exchange-

[5] In this connection, Towdrosmatta has not produced any evidence that he actually had the means to wire immediately an amount of money that far exceeded his apparent financial resources.

for-physical. The following Monday Farr liquidated the CME position for a profit of $450, and liquidated the MidAm position for a loss of $4,075, which resulted in a debit balance of $1,725.66.

California small claims litigation

10. Farr Financial initiated a small claims law suit in the Santa Clara County Municipal Court of California, seeking to recover a $1,981 debit balance. In his small claims answer, Towdrosmatta sought dismissal on the grounds that he had filed a reparations complaint in which he sought recovery of $17,061 for "cheating" and other undefined violations. According to respondents, in the small claims proceeding Farr Financial produced a set of account statements to establish the existence of the debit balance, and produced a copy of a letter exchange with the NFA that briefly described the circumstances around the last margin call. Otherwise, respondents have not described in any meaningful detail the evidence presented, or the specific issues tried, before the small claims judge. In this connection, respondents have not disputed Towdrosmatta's assertions that when Towdrosmatta sought dismissal of the small claims, the judge advised him to drop his reparations claim and file a small claims counterclaim, and that when he tried to describe how respondents had cheated him, the judge abruptly terminated Towdrosmatta's testimony. Shortly afterwards, the small claims court issued a judgment in Farr Financial's favor for $1,981, plus costs.

Discussion and conclusions

Respondents' res judicata defense

Respondents assert that the issues raised in Towdrosmatta's reparations complaint are identical to the issues raised in defending the small claims case: "Namely that in the small claims case, [Towdrosmatta] was sued for failure to compensate Farr Financial for a deficit in his account, whereas in this case, [he] complains that the deficit was due to [Farr Financial's] "cheating." [¶6 of PMB's Motion to Dismiss.] However, respondents have failed to produce any evidence that establishes which, if any, of Towdrosmatta's various reparations claims were actually adjudicated and conclusively determined in the small claims court. Moreover, respondents' assertion that Towdrosmatta is barred from bringing a reparations action under the Commodity Exchange Act is incorrect.

Principles of claim and issue preclusion do not apply to Towdrosmatta's reparations claim. This determination is based on the following factors: (1) the questionable jurisdiction of the Small Claims Court to hear a claim arising under the Commodity Exchange Act, *see* Section 2(a)(1)(A) of the Act;[6] (2) the doubtful survival of common law fraud in commodity cases due to the exclusive remedy provision in

[6] The *Boston Cattle* decision relied on by PMB in its motion to dismiss can readily be distinguished because in that case the first forum -- NFA-sponsored arbitration -- clearly had jurisdiction under Section 17(b)(1) of the Act to hear claims alleging violations of the Act. Boston Cattle Group and Zachary Adelson had prevailed in two related NFA arbitrations, and respondent Blalock & Co. had been ordered to pay a total of $100,602. Blalock was a guaranteed introducing broker guaranteed by ADM Investor Services, Inc. Although BCG and Adelson had named ADM as a respondent, and the issue of ADM's liability as a guarantor had been before the arbitrators, the arbitrators did not address the issue either in the recitation of "issues presented and decided," or in the awards. Inexplicably, the NFA refused BCG's and Adelson's request to direct the arbitrators to clarify the award. After Blalock refused to pay the awards, BCG and Adelson sought payment from ADM, which in turn refused to pay. BCG and Adelson then filed an action in federal district court seeking payment from ADM. The Court then issued an order remanding the indefinite awards for clarification. *Boston Cattle Group et al. v. ADM Investor Services, Inc., et al.*, 1995 WL 723781, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,553 (N.D. Ill. December 1, 1995). On remand, the arbitrators issued clarified orders specifically finding that Blalock had violated the Act, which closed the loophole that ADM perceived when it refused to honor its obligation as Blalock's guarantor, and ADM satisfied the award. *Boston Cattle Group and Zachary Adelson v. ADM Investor Services, Inc., and Blalock and Co.*, 92-ARB-74 (NFA January 15, 1996).

Section 22 of the Act; and (3) the lack of a record in, or specific findings by, the Small Claims Court. In addition, issue preclusion should not apply due to the significant difference in the quality of the procedures followed in the two forums. Restatement (Second) of Judgments, ¶¶ 28(3) and (4) (1982). The California small claims court was established to obtain a speedy and inexpensive resolution of small claims by informal proceedings conducted in a spirit of compromise and conciliation. *Sanderson v. Nieman*, 17 Cal.2d 563, 110 P.2d 1025 (Cal. 1941). Thus, in small claims cases, no formal pleadings and orders are required other than the pleadings and the final order. Cal. Code Civil Proc. §§116.310 and 116.320(b) (Deering's Cal. Codes Ann. 2003). Also, in small claims court, claims and counterclaims are subject to a $2,500 jurisdictional limit. Cal. Code Civil Proc. §§116.220(a) and 116.380(a). (Deering's Cal. Codes Ann. 2003). Finally, a small claims appeal is an appeal in name only, because the small claims appeal is in fact an informal trial *de novo* in superior court. That court, in turn, issues a simple judgment that is final and cannot be appealed. Cal. Code Civil Proc. §§116.710 (b) and 116.770(b) (Deering's Cal. Codes Ann. 2003); *see ERA-Trotter Girouard Assoc. v. Superior Court,* 50 Cal App 4th 1851 (1st Dist, 1996), 58 Cal Rptr 2d 381. In contrast, although the reparations procedures may be less formal than federal or state civil court procedures, reparations cases involve significantly more formal procedures than small claims procedures, including pleadings supported with detailed factual descriptions, discovery, written decisions with findings of fact and conclusions of law, and appellate review.

Disputed market order

Towdrosmatta must show by a preponderance of the evidence that respondents mishandled the 37-lot market order at the close. Generally, if a customer establishes that he placed a market order that was not filled promptly, the burden shifts to the respondent to produce evidence justifying the delay and showing that they handled the order diligently. However, given the last-minute timing and relatively large size of Towdrosmatta's order, it is not unreasonable to conclude that even if his order had been simultaneously routed directly to the floor broker, the order may have been difficult to fill. Thus, the burden to show that respondents mishandled the order remains with Towdrosmatta who has produced no evidence beyond the fact that the order was not filled.

Towdrosmatta also asserts that Farr Financial unnecessarily exposed him to the margin call by breaching an implied guarantee to provide fill orders in 30 seconds. In support of this assertion, he points to respondents' representations that orders in "select markets" could be routed directly to the floor broker and filled in 30 seconds. However, respondents advised him that the Swiss Franc market was <u>not</u> a select market, and thus that he could not place direct orders or expect 30-second executions when he placed Swiss Franc orders. Also, within the first few days of trading, Towdrosatta knew enough not to expect respondents to provide 30-second fills and 60-second confirmations on his Swiss Franc trades. Furthermore, nothing in the record shows that Towdrosmatta ever informed respondents that he was relying on respondents to guarantee 30-second fills under any condition, or that respondents should have otherwise been aware of this purported reliance.

See Grist v. Shearson Lehman Brothers, Incorporated, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,962 (CFTC 1990).

Disputed margin call

Initial and maintenance margins are instituted for the protection of futures commission merchants and the market integrity as a whole, and reflect the amount of risk an FCM is willing to accept for a customer's position. For this reason, it is well established that when an FCM, or its agent introducing broker, determines that a customer cannot pay a margin call, the FCM's, and IB's, duty to protect the financial position of the FCM's other customers, and right to protect the FCM's own financial position, supercede any duties the FCM or IB owes to the defaulting customer. *Lee v. Lind-Waldock & Co.*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,173 (CFTC 2000). Thus, an FCM has considerable discretion to set and enforce its margin policies, absent evidence of fraudulent or bad faith conduct. Therefore, in order to establish wrongdoing by respondents, Towdrosmatta must show by a preponderance of the evidence either that respondents misled him about their margin policy or that they hedged and liquidated his large Swiss Franc position in bad faith. *Baker v. Edward D. Jones & Company,* [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,167 (CFTC 1981).

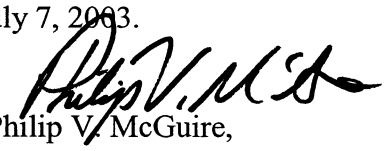
On this record, Towdrosmatta has not shown any deception by respondents concerning their margin policy. The customer agreement he signed authorized respondents to liquidate open positions under certain conditions, including unmet margin calls. Before the disputed trade, notwithstanding respondents' repeated warnings that he heed margin requirements, Towdrosmatta withdrew funds as he was radically ramping up the size of his trades, and then waited until the brink of closing to try to exit the market. As a result,

Towdrosmatta faced a $211,973 margin deficit, with no visible financial means to wire such a large sum. In these circumstances, Towdrosmatta has failed to show that respondents acted in bad faith when they purchased 74 MidAm Swiss Franc contracts as a hedge for the severely under-margined 37 CME contracts, and then liquidated the subsequently discovered ten CME contracts through an exchange-for-physical.

ORDER

No violations causing damages having been established, the complaint is DISMISSED.

Dated July 7, 2003.



Philip V. McGuire,
Judgment Officer