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BERNICE HARRE, and ALFRED HARRE, Complainants,	*	
v.	*	CFTC Docket No. 06-R028
MAN FINANCIAL, INCORPORATED, AG & INVESTMENT SERVICES, INC., SUSAN MARTIN, and GARY MARTIN, Respondents.	*	

INITIAL DECISION

Introduction

This dispute arises from the liquidation of two short feeder cattle futures contracts in the late fall of 2005. During the summer, the Harres had accepted Gary Martin's recommendation to short the feeder cattle market, which was then trending upward. Martin had expected an eventual sell-off, based on an interpretation of a variety of fundamental factors, such as low demand for U.S beef from Japan, and technical factors, such as indications that cattle was overpriced. Over the ensuing months, the market trended upward longer than the Martins had calculated, but they continued to advise clients to stay short in cattle, in expectation of an eventual sell-off. As a result, the Harres twice rolled contracts forward to avoid delivery, and several times added margin to hold the short positions. Eventually, the Harres decided enough was enough and rejected the Martins' advice to meet yet another margin call, and the two contracts were liquidated for a total loss of $14,138. Three days later, the price of feeder cattle sharply dropped in the sell-off long anticipated by the Martins.

The Harres allege that the Martins recklessly advised them to initiate and hold a short position "against the trend and the fundamentals," and seek to recover their trading loss. In reply, respondents deny any violations or liability, assert that their advice had a reasonable basis, and further assert that the Harres' losses were caused by their ultimate decision to reject their advice. As explained below, after reviewing the parties' documentary evidence and oral testimony, I have concluded that the Harres have failed to show any violations by the Martins.

Factual Findings

1. Bernice Harre and Alfred Harre, in their late 70's and early 80's respectively, raise corn, wheat and soybeans on their 350 acre farm near Okaville, in southern Illinois. The Harres had speculated on and off in futures on agricultural commodities for a few years before their dispute with the Martins arose. Bernice Harre handled most communications with respondents. Mrs. Harre was a sincere and forthright witness, but has forgotten the details of some of the relevant conversations with respondents. [*See* pages 7-13, 29-31, and 33-35 of hearing transcript.]

2. Susan Martin and Gary Martin are registered principals of AG & Investment Services, an introducing broker in Webster City, Iowa. Mr. and Mrs. Martin both offered convincing and credible testimony. [*See* pages 37-40, and 42, of hearing transcript.]

3. Man Financial, Incorporated, located in Chicago, Illinois, is a registered futures commission merchant that cleared the Harres' account, which was introduced by AG & I.

4. The Harres opened their account with AG & I in 1992. At the time, the account was carried by Linnco Futures, Inc. The Linnco customer agreement, signed by Mr. and Mrs. Harre,

provided that, if the customer failed to maintain adequate margin, Linnco could liquidate the customer's open position at its discretion, "without notice to the customer."

5. Gary Martin acted as the Harres' broker since 1992. Over the years, Bernice Harre would occasionally call Martin, ask for his opinion about a specific market mentioned by Harre, and place a trade. [*See* pages 13-16, and 37-39, of hearing transcript.]

6. On July 26, 2006, Bernice Harre and Gary Martin discussed the cattle market. Martin explained that the market was trending up, but that he expected a coming bear market in feeder cattle, due to fundamental factors such as record high energy prices, record high long interest in the cattle markets by funds, low Japanese demand for U.S. beef, and forecasts of low consumer demand for beef, plus technical factors such as the inability of the market to exceed August highs, and indications that cattle was overpriced. Harre asked Martin for a cattle trade, and accepted his recommendation to sell one October feeder cattle future, which was filled at $104.75. The next week, the cattle market rose. Nonetheless, Martin's view of the cattle market held steady, and, on August 4, Harre accepted his recommendation to sell a second Feeder Cattle contract, which was filled at $107.90. [*See* pages 15-20 of hearing transcript.]

7. During the life of the disputed trade – from July 26 to November 28, 2005 – Harre and Martin would speak almost every day, with Harre initiating a large majority of the calls. [*See* phone records produced by the Martins; and pages 14-15 of hearing transcript.]

During the same time, the cattle market would trend upward: to $110.175 at the end of August, $115.425 at the end of September, and $115.85 at the end of October. Three days after the liquidation of the Harres' short positions at $116.55, the cattle feeder market would hit a high of $117.90, and then would reverse in a sell-off and decline to levels well below where the

Harres had established the short positions. [*See* exhibit to Man's motion for summary disposition; and pages 47-48 of hearing transcript.]

8. On September 6, the Harres met a margin call by depositing $1,536. [*See* pages 17-20 of hearing transcript.]

9. In mid-September, Bernice Harre consulted a second broker at Northland Commodity, who disagreed with Martin's assessment of the cattle feeder market, as described to him by Harre, and who asserted that he believed that the fundamentals did <u>not</u> point to a sell-off in the near future. [*See* pages 21-22, and 31-32, of hearing transcript.]

10. On the record, it does not appear that the Harres immediately told the Martins about this conflicting second opinion. However, it does appear that it weakened their confidence in the wisdom of the Martins' advice. Nonetheless, they decided to stay short, and made a series of margin deposits to cover the short positions: $3,000 on September 16, $1,000 on September 29, $1,500 on October 4, $2,600 on October 17. The Harres also twice rolled over the short positions to avoid delivery: on October 25, rolling over from the October to the November contract; and on November 16, rolling over from the November to the January contract. [*See* pages 20-25, 32-33, and 46-47, of hearing transcript.]

11. During the fall, the Martins told Harre that they were surprised at the strength and duration of the bull market and surprised that the funds continued to add to their long positions, but that the Martins still believed that fundamental and technical factors pointed to a correction. [*See* pages 25-26, 40-41, and 43-45, of hearing transcript.]

12. On November 28, an employee of the Martins advised Harre that she faced a $1,328 margin call. In response, Harre told Gary Martin that she was resistant to committing more money to a strategy that did not appear to be working. He told her that their analysis still pointed

to a sell-off. However, Harre had lost patience and faith, and rejected Martin's advice. Martin told her that he would have to liquidate the short positions if she did not cover the margin call. Harre replied that she did not intend to send more funds. Accordingly, the two January contracts were liquidated, for an aggregate loss of $14,138. [*See* ¶ 10 of Man's motion for summary disposition; and pages 26-29, 42, and 46-48, of hearing transcript.]

CONCLUSIONS

The core of the Harres' claim is that the Martins acted recklessly first by advising the Harres to buck the trend by going short in a bull market and later by advising them to commit additional funds to sustain the short positions as the bull market lasted longer than the Martins had anticipated. Here, the Martins' basic strategy actually proved sound, because the market did eventually reverse and enter a sustained drop. However, the reversal took place later than the Martin's had expected, which compelled the Harres to meet multiple margin calls, until they decided to cut their losses, to reject the Martins' advice, and to permit liquidation just before the market downturn. Thus, the Harres ask that the Martins be held liable for losses arising from the Harres' initial decision to accept the Martins' advice and their subsequent decision to reject the Martins' advice to meet the last margin call, because, if they had followed the Martins' advice to meet the last margin call, the Harres would have quickly realized a significant profit.

In order to recover damages in these circumstances, the Harres must establish by a preponderance of the evidence that the Martins' trading advice lacked a reasonable basis. A recommendation has a reasonable basis when the commodity professional has considered reasonably ascertainable relevant factors and exercised rational judgment in light of these factors. The recommendation need not be beyond criticism and need not be the most preferable of the available alternatives. If the recommendation is within the range of acceptable alternatives it has a reasonable basis. *Syndicate Systems, Inc., v. Merrill Lynch, Pierce, Fenner & Smith*, Comm. Fut. L. Rep. ¶23,289, at 32,788 (CFTC 1986). Here, the Harres have shown no bad faith or deception by the Martins. Rather, the Harres have shown no more than a trading loss – which largely flowed from their rejection of the Martins' advice -- and the opinion of another broker who disfavored bucking the bullish trend. In contrast, the Martins have set out a combination of fundamental and technical factors from which they could rationally infer that the market was due for a sell-off, which in fact did happen a few days after the Harres had given up on the Martins' strategy. Thus, the Martins offered advice with a reasonable basis, and the Martins cannot be held liable for the Harres' losses.

ORDER

Complainants have failed to establish any violations by respondents. Accordingly, the complaint in this matter is dismissed.

Dated August 31, 2007.

Philip V. McGuire

Philip V. McGuire,
Judgment Officer