Office of Proceedings

TIMOTHY J. BLACH, Complainant, v. ADM INVESTOR SERVICES, INC., Respondent.	* * * * * CFTC Docket No. 07-R052 * * * *

INITIAL DECISION

Introduction

Timothy Blach's claim to recover trading losses arises from two related electronic orders: the first, a limit buy order which was elected despite the fact that the market had not touched his limit price, and which was then re-priced by the CBOT; and the second, a stop-loss sell order which was rejected by the CBOT as a dynamic trade. As explained below, after carefully reviewing the parties' documentary submissions, I have concluded that Blach is not entitled to recover any damages from ADM Investor Services. [1]

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[1] The evidentiary record includes: (1) Blach's complaint; (2) Blach's un-sworn statement (dated June 7, 2008); (3) ADM's answer; (4) ADM's un-sworn statement (dated June 27, 2008); (5) the e-mail communications between Blach, and ADM and CBOT (produced by Blach and ADM); (6) CBOT "Appendix 9B-2 – e-cbot Error Trade Policy" (7-31-06) (Exhibit A to answer); (7) CBOT "e-cbot Bulletin #37 of 2006: Dynamic Price Limits and Stop Orders" (4-26-06) (Exhibit C to answer); (8) the monthly account statements for Blach's account, from December 2006 to June 2007; (9) the confirmation statements for February 12 and 14, and June 26, 2007; (10) the time and sales report for the July eCBOT Mini Silver future, for February 12, 2007, from 10:00 a.m. to 10:05 a.m. CST; (11) the CBOT error trade notification, dated February 12, 2007, at 11:10 a.m (produced by Blach and ADM); (12) the CBOT error trade general announcement dated February 12, 2007 (Exhibit B to answer); (13) CBOT price and volume data for the July 2007 e-cbot Mini Silver futures contract, for February 12 to 28, 2007 (Exhibit D to answer); (14) the March 2, 2007 printout of the on-line open order report for order # 28623 (Attachment D to complaint); and (15) Man Financial candle chart for the July 2007 e-cbot Mini Silver futures contract, dated June 27, 2007 (Attachment D to complaint; and response to ¶ 4 of May 21, 2008 Order).

Factual Findings

The Limit Order

In January 2007, Blach placed an electronic e-cbot limit order to buy two Mini July 2007 futures contracts, at $13.20. For reasons not explained on this record, the order was erroneously executed, at 10:04:20 a.m. on Monday February 12, 2007, when the market was trading at $13.82. Later that morning, the Chicago Board of Trade e-cbot Market Operations Department issued a directive that all trades executed between 10:04 and 10:06 a.m. must be re-priced to $13.82. About half of the trades executed during this two-minute period were deemed error trades and re-priced, including Blach's limit buy order. Blach's order was determined to be an error because it had been executed at a price more than eight cents away from the reference price, or last trade price. In the group of re-priced error trades, Blach's was the furthest from the $13.82 reference price.

ADM has offered no explanation for who or what caused the patently erroneous election of the limit order, beyond surmising that illiquidity in the July contract may have been a factor in the error. Blach, understandably, finds the circumstances around the execution of his limit order to be dubious and "bizarre." In the absence of any explanation from ADM, or CBOT, Blach has asserted that the circumstances suggest that some sort of "manipulation," by agents of ADM or other traders, may have triggered the execution.

Later on February 12th, Blach's ADM broker notified him about the execution and re-pricing of his limit order, and referred him to Jennifer Baum, a managing director of the CBOT Office of Investigations and Audits. Also that day, the July contract traded up, and Blach decided to lock in a modest profit, by placing a stop-loss order, at $13.88.

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On Thursday February 15th, Blach e-mailed a complaint to CBOT, alleging a "possible fraudulent" trade. On Friday February 16th, Baum replied by e-mail. She acknowledged that the CBOT's determination to re-price the trade had "left you with a fill that is worse than the terms of your order." Baum explained that the CBOT e-cbot error trade policy was designed to ensure "trade continuity," and that the policy provided: one, that, when a trade is called in question, the exchange may re-price, rather than bust, the trade; two, that, if the trade is re-priced above a limit buy price, the customer cannot reject the re-priced trade; and three, that the customer can seek arbitration against "the party responsible for the error."[2] Baum did not offer an explanation for the cause of the error, but told Blach that, if he decided to seek arbitration, she would "put you in touch with the appropriate parties."[3] Baum also referred Blach to a website link for the e-cbot error trade policy, the text of which provided that the arbitration had to be brought within ten days of the disputed trade. On this record, it is not clear whether that would have been ten calendar days – i.e., February 22nd, or ten trading days – i.e., February 28th.

Blach did not respond to Baum's February 15th e-mail, did not seek arbitration through CBOT, and did not press his complaint with ADM. In the meantime, for eleven consecutive trading days, from February 12th to 28th, the July contract traded above $13.82, hitting a high of $14.99 on February 26th. Thus, during this time Blach could have exited the disputed position at

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[2] The CBOT e-cbot error trade policy states:

> The CBOT's error trade policy is designed to preserve the integrity of CBOT product markets by striking an appropriate balance between trade certainty and erroneous price discovery. The policy provides a mechanism to promptly address transactions that are executed at obviously erroneous prices substantially inconsistent with the last trade of the contract or alternative determination of the contract's fair value. This policy does not relieve market participants from potential financial responsibility or liability for the execution of trades that are deemed or asserted to be an "error trade" if their actions caused financial loss to other parties.

Appendix 9B-2, CBOT rules, Exhibit A to Answer.
[3] It is not clear whether Baum was referring to the parties responsible for the error, or to managers in the CBOT arbitration department.

a decent profit, but chose not to do so. Blach has offered no explanation for why he decided to hold the contracts.

The Stop-Loss Order

On Thursday March 1st, the CBOT notified Blach that it had rejected the stop loss order because it was a "dynamic trade." Blach similarly has offered no explanation for why he did not to limit his losses by immediately placing a new sell order upon notification of CBOT's rejection of his stop loss order.

On Monday March 5th, Blach e-mailed Baum. However, he did not mention the rejection of the stop loss order on March 1st. Rather, he renewed his discussion about the execution and re-pricing of the limit order on February 12th. He also stated: "I would like to know how to start the exchange arbitration process." In an e-mail later that day, Baum addressed Blach's comments and stated: "I am waiting to hear from our market Operations Department as to the arbitration issue, and will get back to you on that when we do."

On Tuesday March 13th, Blach e-mailed Baum, and stated that he had a second issue for arbitration: asserting that he should have been stopped out on March 1st, because the time and sales report showed "multiple opportunities" for the stop loss order to be executed. The next day, Baum replied by e-mail. In contrast to her e-mails about the re-priced erroneous limit order, Baum offered a detailed explanation for why CBOT had rejected the stop loss order:

> I have looked into the order, and this is what I have found. Just prior to the point when your 13.88 stop would have been first elected (with a 13.85 quote, at 11:51:38.807, on March 1st), the market depth looked like this in the July Mini Silver:

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Volume Bid	Price	Volume Offered
	14.708	1
	14.700	1
	14.650	1
1	13.85	
1	13.75	
1	13.65	

When a party entered an offer at 13.85, the 13.85 on the bid was taken out, and that trade elected your stop. The e-cbot system employs dynamic price limits that limit the amount that a market can move related to a stop election. In the case of the mini-sized Silver, this amount is 8 cents.

So, in this case, when your stop order was activated, the best bid in the market was 13.75, which was over 8 cents below the last trade price of 13.85. Therefore, at this point, your order could not have been filled, and was therefore cancelled by the trading engine, in accordance of the functionality of the e-cbot. So, when the order would have been executable again, your order was no longer working in the market.

I would recommend taking a look at the Electronic Trading Reference Manual that is available at our website. This document outlines how situations of this nature are handled.

On March 15th, in response to another e-mail from Blach in which he asserted that his "initiating broker" had told him that the stop order was initiated by open outcry, Baum responded:

All of our metal products, with the exception of metal options, are electronically traded only.

With respect to the arbitration issue, I have checked with Market Operations and looked at the activity myself. In this situation, it does not appear that there is a specific party responsible for the market move. The move was the result of resting orders in the market being triggered and traded down. As a result, there is not a party to arbitrate against for your losses.

This would be the last communication about the rejected stop loss order.

In a final inconclusive e-mail exchange in mid-April, Blach asked ADM to help determine the cause and "accountability" for the erroneous election of the limit order back on February 12th. ADM responded by forwarding another copy of the CBOT re-pricing notice on February 12th. On June 26th, Blach sold the two contracts for a loss of $3,292.

Conclusion

Whenever a limit order is elected at a price that is substantially inconsistent with the last trade price, mishandling of the order will be implicated as a plausible cause. Here, Blach's limit order was 62 cents away from the last trade price, and 30 cents away from the closest error trade, in a market where a six-cent deviation was grounds for an error trade determination. In these circumstances, the burden shifts to ADM to establish that its conduct did not contribute to the error. ADM, an exchange member, was in the best position to obtain from CBOT , via direct request or by subpoena, information about the disputed election of the limit order that was similar to the information that CBOT provided Blach about the disputed rejection of the stop loss order. Such information would have illuminated the circumstances around the patently dubious election, and thus helped establish the cause of the error. ADM determination not to make a concerted effort to obtain and produce this information is sufficient grounds to make an adverse inference that ADM's conduct was at best negligent and contributed to the erroneous election of the limit order.

In order to recover damages, Blach must show that any violation by ADM proximately caused his trading loss. Here, Blach cut off proximate causation when, after he had been told by CBOT that he could not reject the re-priced error trade, he placed a stop loss order to lock in a profit, rather than promptly selling the contracts. At this point, Blach's conduct was consistent with an intention to keep the trade, and inconsistent with the notion that the trade should have never happened in the first place. In these circumstances, ADM cannot be held responsible for Blach's losses, particularly where he could have liquidated for a profit for eleven straight days. Finally, nothing in the record suggests any violations in connection with the rejection of the second disputed order.

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ORDER

Complainant has failed to show any violations by respondent causing damages.

Accordingly, the complaint in this matter is dismissed.

Dated August 1, 2008.

Philip V. McGuire,
Judgment Officer