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KARLA GREGORY, Complainant,	
v.	CFTC Docket No. 07-R22
PEREGRINE FINANCIAL GROUP, INC., and WASENDORF & SON CO., Respondents.	

INITIAL DECISION

Introduction

Dr. Carla Gregory's claim arises from a "phantom" light crude futures trade that appeared on her on-line trading platform over the Martin Luther King holiday in 2007. The essential facts are not in dispute. The previous week, Gregory had actively traded the February and March light crude futures contract. Peregrine had complicated matters for Gregory with a series of key punch errors, which had resulted in delayed and partially inaccurate confirmations, but which Peregrine ultimately corrected, before the end of the week and without any cost to Gregory. However, by the end of the week, Gregory had lost her patience with Peregrine's back office, and closed out all open positions and e-mailed Peregrine that she planned to close the account. At the close on Friday, the on-line platform accurately reported that the Gregory account was flat. Later that night, Peregrine e-mailed the written daily statement, which also accurately reported that the account was flat.

On the morning of the Monday holiday, Gregory logged on and discovered that Peregrine's on-line platform now reported that her account was short nineteen March light crude futures contracts. Gregory called Peregrine's trading desk, and engaged in a series of cursory and inconclusive discussions over the span of about forty minutes. During this time, the market would begin to decline. Gregory informed the desk clerk that the short positions were not hers, because she had liquidated all open positions before the close on Friday, and had not placed any orders over the weekend. The clerk checked his screen and confirmed that the nineteen contracts had been sold "over the weekend." Next, the clerk started asking Gregory questions in an effort to understand the exact chronology of her orders. Gregory answered his first question, but then abruptly placed an order to buy nineteen March light crude futures. The next morning, before the open, Peregrine's risk manager removed the phantom short positions, which left Gregory long nineteen March light crude futures, which, in turn, were closed out shortly afterwards for a loss of $7,668.

Gregory claims that respondents should be responsible for this loss, because their phantom report had compelled her to buy the nineteen light crude contracts in order to limit her exposure and return her account to a flat status. Respondents disagree, and assert that Gregory should have taken no action beyond demanding that Peregrine remove the phantom trade, because they had consistently adjusted the account in Gregory's favor after any errors, and because the customer contract provided that, in the event of a discrepancy between a written statement and an on-line report, the written report would trump the on-line report. Respondents further assert that Gregory's unilateral decision to place an order to offset the phantom position was motivated, not by a desire to reduce her exposure, but by a desire to profit from Peregrine's mistake, in a declining market. As explained below, I have concluded that Gregory has failed to show any violations by respondents causing damages, and thus is not entitled to any recovery.

Factual Findings

1. Dr. Carla Gregory, a resident of Alvin, Texas, is an emergency room physician, who had previously maintained commodity accounts at R.J. O'Brian, one managed, the other self-directed. Gregory directed the trading in her account with Peregrine Financial Group and Wassendorf & Sons. [*See* Gregory's testimony at pages 10-12, 40-41, and 55-57, of hearing transcript; Gregory's replies to respondents' interrogatories 5, 11 and 12; and Gregory's account application.]

2. Peregrine Financial Group, Incorporated, is a registered futures commission merchant, with its principal place of business in Chicago, Illinois. Wasendorf & Sons, Company is a registered introducing broker, also located in Chicago. During the relevant time, Wasendorf & Sons was guaranteed by Peregrine. [*See* ¶¶ 1-3, joint answer.]

3. On December 23, 2003, Gregory opened a self-directed account, by submitting her account application, including the customer agreement, electronically to Peregrine. Paragraph 14 of the Peregrine customer agreement provided in pertinent part:

> Customer must review and report immediately errors on confirmations and statements. Failure to notify [Peregrine] immediately of any error or omission will bind Customer to the terms of such confirmation or statement, as the case may be. . . . <u>Customer agrees that written statements shall supercede all electronic information and the written statements shall be controlling</u>.

[Underscoring added for emphasis; exhibit to joint answer.]

4. Gregory traded her account electronically through Peregrine's "Best Line" on-line order entry system. Gregory logged in daily to electronically monitor the activity in her account. Peregrine e-mailed daily trade confirmation statements around 2:00 a.m., after the markets

closed. Peregrine considers these e-mailed reports to be "written statements" for purposes of the customer agreement. [*See* Wing's explanation at pages 4-8, and Gregory's testimony at pages 12-16, 43-44, 46-48, and 51-52, of hearing transcript; Gregory's replies to respondents' interrogatory 4; Gregory's letter to "Mr. Ricco;" and ¶¶ 1-4 of joint answer.]

5. From January 3 to January 12, 2007, Gregory actively traded February and March light crude futures contracts, and to a lesser extent, Treasury note and gold futures. Trading during these two weeks was generally not successful, and the account value declined from $69,679 to $18,102.

Due to a combination of key punch errors, two March light crude trades on January 8th were not reflected on the January 8th daily statement; and then when they were reflected on the January 10th daily statement they were incorrectly identified as trades "as of" January 5th.

By Thursday the 11th, Peregrine had completely corrected the errors, at no cost to Gregory. Also that day, Peregrine's director of customer relations, Paige Miller, e-mailed Gregory, asking her to contact Miller "regarding the status of your account."

On Friday, January 12th, Gregory decided to close her account, and so liquidated her February and March light crude positions, which left the account flat. During the afternoon, Gregory e-mailed Miller, and informed her that she was closing all positions, and intended to transfer her account to R.J. O'Brian, because she was fed up with Peregrine's key-punch errors.

At the close on Friday, Peregrine's on-line platform correctly reported that the Gregory account was flat. Later that night, Peregrine e-mailed the written daily statement for Friday the 12th, which accurately reported the trades and the account status. [*See* Gregory's testimony at pages 17-29 of hearing transcript; Gregory's reply to respondents' interrogatory 8; Gregory's discussion of "Issue #1" and "Issue #2" in complaint; Best Logs for January 8 through 12; email exchange between Gregory and Miller; ¶ 5a of O'Meara affidavit; and ¶¶ 7-14 of joint answer.]

6. On the morning of the Martin Luther King holiday, Monday the 15th, Gregory logged on and discovered that sometime over the weekend Peregrine had assigned to her account nineteen short March light crude futures. As can be seen from the transcript of that conversation, Gregory called Peregrine's trading desk, and told the clerk, Brian Connelly, that on Friday she had exited all positions and was supposed to be flat, but that the on-line system was reporting an open short position. Connelly confirmed that the platform reported that she was short nineteen March light crude futures, but before he could get a complete and accurate picture of the circumstances around the disputed order, and before he could offer Gregory any advice, Gregory peremptorily placed an order to buy nineteen March contracts, at a limit price one tick below the price of the short positions. As can be seen, it was Gregory who injected a sense of urgency, apparently because she had been closely monitoring the market, and expected her limit price to be quickly hit:

Gregory: I'm not supposed to have any positions in this account, and my platform shows I have nineteen short March crude. That should have been closed out Friday.

Connelly: It shows . . . you're short nineteen . . . at 653.73.

Gregory: I'm supposed to be flat. Those were gotten out Friday.

Connelly: You sold the 19 lot Friday? . . . . [It shows that] these were sold over [the weekend]

Gregory: It does show that?

Connelly: . . . . Is that the order you put in Friday? Or [interrupted].

Gregory: No. I got out of all that Friday. Well, in that case, can I get out of them now?

Connelly: Yeah. I can take an order now.

Gregory: I'll go ahead and buy 19 March crude oil, at 53.72.

Connelly: [Repeats details of trade, and then asks her to slow down as she reels off her phone number.] Whoa, whoa, slow down.

Gregory: It should have filled by now.

Connelly: Uggh, I have to put it in. I can't do that while I'm writing [down your number.] . . . . You're in the bid.

Gregory: When it gets filled, let me know.

Connelly: I will.

A couple of minutes later, the order had not been filled, and Gregory called back to reiterate that she had not placed an order over the weekend to sell nineteen March light crude futures, and to demand that she not be charged commissions:

Gregory: My statement as of Friday, it shows me to be completely flat, so I don't know where those trades come from, but those are not mine.

Connelly: OK. But it was the 19 lot that you had before, right?

Gregory: I had a 19 lot, but I got out of them Friday, and according to the statement that I was sent on Friday night.

Connelly: Alright. This selling of 19 is from after Friday. This isn't today's business.

Gregory: I did not enter any orders after Friday. Somebody else did, but I did not. . . . I'm not gonna be charged commissions.

Connelly: You just actually gotta stop. Today's a holiday. I'm the only person in the office right now. You've got to work that out with your broker.

Gregory: Okee, dokee. . . . We'll see how this comes out.

Connelly: OK.

About a minute later, Gregory called a third time and, without any discussion, instructed Connelly to cancel the buy order. About half an hour later, after the market had dropped almost thirty ticks, Gregory called a fourth time and, again without any discussion, placed an order to buy nineteen March light crude futures, at 53.40 or better. This order was filled shortly afterwards.

Early the next morning, Peregrine's risk manager removed the phantom trade from Gregory's account, which left Gregory long nineteen March light crude futures. After a brief discussion with Gregory, the risk manager closed out the long position, for a loss of $7,668.[1] [*See* Gregory's testimony, at pages 29-38, and 41-46, and O'Meara testimony, at pages 61-65, of hearing transcript; ¶¶ 5-8, O'Meara affidavit; and ¶¶ 15-21 of joint answer.]

Conclusions

Since Gregory's account was non-discretionary, respondents' primary obligations were to follow her instructions and to execute and report her orders in a diligent manner. Here, Gregory had good reason to know that the trade report which had appeared on her on-line platform over the weekend was an erroneous report or phantom trade, because by the close on Friday she had liquidated all open positions, she had placed no trades over the weekend, and she had e-mailed Peregrine her intention to close her account, and because early on Saturday she had received the written statement confirming that her orders had been executed and that her account thus was flat. In these circumstances, the prudent course would have been for Gregory to promptly advise Peregrine about the phantom trade, which she did; and then give Peregrine a reasonable opportunity to investigate and remove the phantom trade, which she did not.

[1] In the process of liquidating the long 19 contracts, Peregrine inadvertently bought 19 additional contracts, at 53.73. The next day, Peregrine adjusted Gregory's account by honoring the sell price of 53.73, and crediting the account $36,100.

Upon learning about the disputed trade, Peregrine's desk clerk notably did not offer any false information, did not state or suggest that Gregory was responsible for the trade, did not inject any sense of urgency into the situation, and otherwise did not steer her toward the abrupt decision to place the buy order. The desk clerk did begin to investigate the circumstances around the nineteen disputed short contracts, but once Gregory instructed him to buy nineteen contracts, he was obligated to place the order. Peregrine similarly was obligated to remove the phantom short trade from Gregory's account, once it confirmed that the trade in fact was not hers. In these circumstances, it is Gregory, not respondents, who is responsible for the loss from her hasty trading decision.

ORDER

Complainant has failed to establish any violations causing damages. Accordingly, the complaint in this matter is dismissed.

Dated May 16, 2008.

Philip V. McGuire

Philip V. McGuire,
Judgment Officer