UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

MICHELLE J. SHEHEE and JENNIE B. SHEHEE	
v.	CFTC Docket No. 03-R021
IRA EPSTEIN & COMPANY and MAN FINANCIAL, INC.	OPINION AND ORDER

Respondents Ira Epstein & Company ("Epstein") and Man Financial, Inc. ("Man")[1] appeal the Judgment Officer's initial decision awarding complainants Michele J. Shehee and Jennie B. Shehee $1,700 in reparations. *See Shehee v. Epstein*, No. 03-R031, 2004 WL 147523 (C.F.T.C.) (June 30, 2004) ("I.D."). Respondents also move to file additional evidence. Complainants oppose respondents' motion and ask the Commission to affirm the I.D. For the reasons stated below, we reverse the reparations award and dismiss the complaint.

BACKGROUND

Michele Shehee ("Shehee") opened an electronic trading account with Epstein in late 2001.[2] There is no indication in the record that she dealt directly with an Epstein broker. On the account application, dated October 20, 2001, Shehee stated that she had learned of Epstein in an advertisement and that she had "paper traded" options for two years. An "Internet Electronic Trading Addendum" to the account agreement, signed by complainant, states in pertinent part:

[1] Man is the guaranteeing futures commission merchant ("FCM") for Epstein, an introducing broker ("IB").

[2] Although the account was opened in both complainants' names, only Michele Shehee traded it or dealt with Epstein. She is treated in this opinion as the sole complainant.

> All orders that you initiate are not considered to be received by our Company until such time as you receive notification through the Internet that your order has been either accepted or rejected for placement. . . . Unless you receive notification from our Company, through the Internet in the form of a confirmation number, you must not assume that the order has been accepted by our Company for placement.

Ans. Exh. C.

The parties' dispute turns on which bears responsibility for a double fill in complainant's account on December 10, 2001.[3] According to Shehee:

> On December 10, 2001, I placed [an order to purchase three S&P 500 call options] and received order number 69586 . . . . I went back online to cancel this order because of being unsure if I did it correctly. I repeated this process twice gaining three order numbers, 69586, 69587 and 69588. The first two orders 69586 and 69587 both were cancelled within five minutes of entry with 69588 being the finalized order of entry. I received a message for both 69586 and 69587 [that] both had been cancelled with an order type code of CXL. The following day I was informed that my account was in the red due to the two approved orders of 69586 and 69588.

Comp. Exh. A (Dec. 21, 2001 email to Epstein).

On December 11, Shehee failed to pay a margin call and respondents liquidated the account. Shehee lost $1,700. When Shehee complained to Epstein, the company denied responsibility for the loss. Its response to Shehee stated in pertinent part:

> We agree that you placed orders to be cancelled. However, . . . an order to cancel does not guarantee that the order will be able to be cancelled.
>
> ***
>
> You placed your orders electronically. Each order you placed was given an order number and confirmation that it had in fact been placed. This confirmation is not a guarantee that what your order instructs us to do will in fact be done. Rather, market conditions dictate such. One of the key areas you are mistaken in has to do with what "order confirmation" is. The confirmation you are talking about . . . is not confirmation that your order has been cancelled, but rather is a confirmation that the order entry system had taken you [*sic*] cancellation order and forwarded it on for action.

[3] This was Shehee's second transaction. She placed her first trade on November 16, 2001.

> Your original entry order on December 10th was filled prior to the pit broker receiving your instruction to cancel the order.
>
> ***
>
> We agree that you received an order confirmation, a confirmation that you were trying to cancel your original order. That is all you received at that time.

See Comp. Exh. G; Ans. Exh. B (Jan. 23, 2002 letter to Shehee).

Epstein stated that if Shehee had wanted assurances that her order actually had been cancelled, she should have "instructed [Epstein's] order entry system [to]'CXL/Confirm Out,'" but did not. "Rather, you and you alone decided that since you had placed a cancel on the original order, that the cancel was complete . . . ." *Id.*

* * *

Shehee filed a complaint with the Commission alleging that Epstein "fail[ed] to properly define its operating procedures." Amended Statement of Facts, June 6, 2003. Shehee argued that the trading instructions were ambiguous and that she followed the margin desk's instructions. She submitted with her complaint the two documents quoted above—her December 21, 2001 letter of complaint to Epstein and the company's January 23, 2002 response—and a series of emails between herself and various Epstein employees on December 10 and 11, 2001, after she discovered the double fill.

In their joint answer, respondents blamed Shehee for the error. They relied on a clause in the Customer Agreement that states: "Customer . . . is . . . fully responsible for 'knowing and using proper procedures in the placement, modification and cancellation of orders.'" Ans. at 4-5; *see also* Exh. C (Customer Agreement at ¶ 1). Respondents submitted with their answer the January 23, 2002 letter to Shehee, a copy of her customer agreement, and a printout of a page from its website showing a sample on-line internet trading account. At the bottom of the screen

screen there are various options, including "Cancel/Replace Order;" "Cancel Order;" and "CXL Confirm Out." Ans. Exh. D.

Neither party participated in discovery; nor did either party file affidavits or verified statements of fact as authorized under Commission Regulation 12.208. Accordingly, the Judgment Officer decided the case based upon the complaint and answer and the exhibits submitted with those pleadings.

The Judgment Officer issued a decision in Shehee's favor, finding that "because the online order system notified Ms. Shehee that her cancellation [of her first purchase order] was accepted and given the CXL code, her trade based on that order should not have occurred." I.D., 1475223 at *1. The Judgment Officer found respondents' argument unpersuasive. He rejected the distinction respondents attempted to draw between a confirmation that an order had been accepted for placement and a confirmation that an order had been executed. "[W]hether Ms. Shehee received confirmation is not in dispute," the Judgment Officer stated, quoting the January 23, 2002 Epstein letter ("'[w]e agree you received an order confirmation'"). *Id.* at *3. "Neither side indicates that the CXL code was sent to Ms. Shehee with any reservation whatsoever, such as that the cancellation order was merely 'working'—or would somehow be subject to later rejection until some new confirmation number was issued." *Id.*

He noted: "A company seeking to disavow a CXL 'confirmation' had better be able to establish with some degree of certainty that the customer has been adequately notified exactly what hoops must be jumped through before being justified in believing that the 'confirmation' means what it appears to say." I.D. at *3 n.4.

The Judgment Officer concluded that "respondents improperly executed an order that had been cancelled, and subsequently charged complainants' account with the resulting (and thus

unauthorized) trade, violating CFTC Rule 33.10 prohibiting fraud in connection with commodity futures transactions." I.D. at *3. He ordered respondents to pay $1,700, plus interest and complainant's filing fee.

On appeal, respondents contend that the Judgment Officer misunderstood the facts before him and improperly shifted the burden of proof to respondents. App. Br. at ¶¶ 3-8. Respondents contend that the Judgment Officer failed to grasp the difference between a confirmation acknowledging receipt of an order and a confirmation that an order had been executed, and thus erroneously found they had filled an order after confirming that it had been cancelled. They ask the Commission to reweigh the evidence in their favor. App. Br. at ¶¶ 7, 12-13.

Respondents also move for permission to supplement the record below with new evidence and arguments. Significantly, respondents argue for the first time on appeal that Shehee had actual notice that her first trade, 69586, was filled and too late to cancel *before* she placed the last order, 69588, that resulted in the double fill. App. Br. ¶¶ at 8-9; Motion for Leave to Adduce Additional Evidence ("Motion to Adduce") *passim.*

In requesting permission to supplement the record, respondents contend that the Judgment Officer's decision would have been different had this evidence been before him. They claim that the additional evidence is material and that reasonable grounds existed for their failure to introduce it at the hearing. Respondents admit that they did not submit the evidence initially because the claim was small and they had tailored their defense to the size of the claim. Motion to Adduce at ¶¶ 1-3. They argue that the Judgment Officer unforeseeably reached issues outside the scope of the parties' dispute, and construed the lack of evidence on these issues against respondents, although Shehee had the burden of proof. *Id.* at ¶¶ 5-7. The proposed new evidence responds to the Judgment Officer's expansion of the issues, they contend. Finally,

respondents urge that this appeal has industry-wide implications regarding self-directed electronic trading extending beyond the damage award in this case. Self-directed customers should be held responsible for their own decisions, actions and instructions, respondents contend.

Complainants oppose the introduction of new facts and legal arguments on appeal. They contend that both the facts and the legal theories that respondents seek to produce now were available to them at the time that they filed their answer to the complaint. Respondents oppose acceptance of complainants' objection to the motion to adduce additional evidence as untimely.

DISCUSSION

As a general rule, we do not consider an issue for the first time on appeal if the appealing party could have raised it before the trier-of-fact, but chose not to do so. *In re Spiegel,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,103 at 34,764 (CFTC Jan. 12, 1988 *citing In re Bentley*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,620 at 30,562 (CFTC May 22, 1985). This is especially appropriate when the party, as here, is represented by counsel, the waiver is made knowingly, and the issue involves disputed facts best resolved by the presiding officer. *Id.*

Similarly, Commission Rule 12.405[4] permits the reopening of the evidentiary record on appeal under very limited circumstances. A party seeking to reopen the record must show that (1) the additional evidence is material, and (2) there were reasonable grounds for failing to

[4] Commission Rule 12.405 provides:

> Any time prior to issuance of its final decision pursuant to § 12.406, the Commission may, after notice to the parties and an opportunity for them to present their views, reopen the hearing to receive further evidence. The application shall show to the satisfaction of the Commission that the additional evidence is material, and that there were reasonable grounds for failure to adduce such evidence at the hearing. The Commission may receive the additional evidence or may remand the proceeding to the Judgment Officer or Administrative Law Judge to receive the additional evidence.

adduce such evidence before the presiding officer. *McGough v. Bradford,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,265 at 50,600 (CFTC Sept. 28, 2000).

The circumstances of this case do not warrant allowing respondents either to raise the new defense (actual notice) on which they now seek to rely, or to admit the new evidence they have tendered to support it. The evidence respondents seek to submit is undoubtedly material to the new defense, and if presented below may have affected the outcome. Respondents, however, have not shown that reasonable grounds existed for their failure to adduce this evidence at the hearing. Respondents' stated reason is that they tailored the scope of their defense to the size of the claim. The evidence they seek to present was available to them, but they elected not to devote the resources necessary to collect and prepare it. In these circumstances, respondents are bound by the litigating strategy they chose. They assert on appeal that the initial decision sets a bad precedent regarding the respective obligations of self-directed traders and their brokers, but the prospect that a case may result in a precedent to be applied in futures cases is inherent to litigation.

The complaint was sufficiently clear for respondents to understand that Shehee blamed her trading loss on Epstein's failure to explain its procedures adequately and her inability to determine whether her orders were executed. The chronology tendered on appeal is highly relevant to the question of whether Shehee knew, or should have known, the status of her orders. Respondents' argument that the judgment officer reached issues outside the complaint is beside the point, because the proposed new evidence is relevant to the allegations raised by complainant. Respondents could have offered the chronology below, but instead presented a limited defense centered on Shehee's failure to understand trading terminology and instructions.

Accordingly, we deny the Motion to Adduce Additional Evidence and have not considered the proffered evidence in deciding this appeal.

* * *

In deciding reparation appeals, we do not defer to the findings of fact made in the initial decision, but do defer to the factfinder's credibility determinations. *Ahlstedt v. Capitol Commodity Services, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,131 at 45,290 n.12 (CFTC Aug. 12, 1997).

Shehee charged Epstein with "failure to properly define its operating procedures, which resulted in several faulty processed trades." This may be read as a claim that Epstein's instructions were so deficient or confusing to a reasonable customer that they constituted a material misrepresentation or omission. We understand Shehee to allege that she would not have placed the second order but for the confusing instruction and confirmation that she received. Among other evidence, Shehee supported this claim with (1) correspondence from herself to Epstein, demanding to know how she could have gotten a double fill after receiving notice that her first two orders had been cancelled; and (2) Epstein's January 23, 2002 letter stating that she misunderstood the nature of the confirmations she received. Respondents relied on the same letter to dispute Shehee's claims.

The above-quoted language in the Internet Electronic Trading Addendum, upon which respondents rely, does not support their contention that Shehee should have known that "confirmation" could be used in more than one context. The Addendum focuses on the importance of a customer receiving a confirmation acknowledging receipt of an order, but does not state directly or indirectly that a further confirmation of execution is needed. Nevertheless,

nothing in the record indicates that Epstein intentionally misled Shehee or acted recklessly in providing trading instructions.

Commodity professionals have a duty to ensure that instructions to customers are clear and unambiguous. That said, we must add that not every breach of the duty gives rise to a claim for damages. *Tysdale v. Jack Carl/312 Futures, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,242 (CFTC Feb. 27, 1992). Under Section 14 of the Commodity Exchange Act ("Act"), we may make reparation awards only when a violation of the Act or Commission regulations has been established, which generally requires proof of scienter.

Reparation claims typically arise under Section 4b (prohibiting futures fraud), and other antifraud provisions of the Act and Commission rules. The Commission formerly did not require a claimant to prove scienter in a case alleging fraud. *See Gordon v. Shearson Hayden Stone, Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,016 (CFTC Apr. 10, 1980). Ten years later, in the face of pervasive federal authority to the contrary, the Commission rejected *Gordon* and held that violations of Section 4b require proof of scienter, which could take the form of intentionally deceptive conduct or reckless disregard for statutory requirements. *Hammond v. Smith Barney, Harris Upham & Co., Inc.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617 (CFTC Mar. 1, 1990). The Commission later extended the scienter requirement to options fraud. *In re Staryk*, [1996-1998 Transfer Binder] Comm. Fut. L. (CCH) ¶ 27,206 at 45,810 (CFTC Dec. 18, 1997).

Epstein's instructions may have been unclear, especially to a relatively inexperienced trader, but were not unreasonably ambiguous, as far as we can determine on this record. Indeed, the Internet Electronic Trading Addendum to Shehee's customer agreement shows a degree of care in its drafting aimed at forestalling customer confusion about whether an order transmitted

by computer arrives at its destination. The following passage from the Addendum (also quoted *supra*, at 2) states in relevant part:

> [O]rders . . . are not considered to be received . . . until such time as you receive notification through the Internet that your order has been either accepted or rejected for placement. . . . Unless you receive notification . . . in the form of a confirmation number, you must not assume that the order has been accepted by our Company for placement.

Addendum at ¶ 2, at Ans. Exh. C.

This passage informs the account holder that an order must be "received" and "accepted for placement" as prerequisites to the order's execution, and that a confirmation number will be issued as evidence that these prerequisites have been met. Since "execution" is not mentioned in Paragraph 2 of the Addendum, but "confirmation" is, the reader is advised that the two events are not invariably linked. "Execution" appears in Paragraph 4 of the Addendum, *to wit*: "Our Company reserves the right to export [sic, presumably "report"] executions of your orders by e-mail and/or Commodity/Fone, as determined in the sole discretion of our Company." *Id.* at ¶ 4.

Epstein's instructions are not flawless. For instance, in the Addendum, order placements are "confirmed," and order executions are "reported," but these terms are not used consistently in all of the firm's communications. One type of order that may be placed is a "Cancel/Confirm" order, which provides the customer with assurance that an earlier order was effectively cancelled and will not be executed. Nevertheless, the record before the Judgment Officer—which is the record on which we review his decision—does not show that the information Epstein provided to Shehee was inherently illogical or opaque. Nor have we identified material omissions in the information provided, without which a reasonable customer could not have been expected to use Epstein's system in the manner intended. Neither Shehee nor Epstein submitted the text of the confirmation that Shehee received. Were this evidence before us, we would be in a position to determine objectively whether the contents and presentation of the information Shehee received

were inherently ambiguous to a reasonable person in her position. As the record stands, we cannot tell whether Shehee's report of the message is the actual wording or whether it is her subjective understanding. Accordingly, we conclude that Shehee did not meet her burden of proof that Epstein acted recklessly in communicating with her on the status of her orders or on the use of its system.

The Judgment Officer characterized Epstein's conduct as "unauthorized trading" in violation of Commission Regulation 33.10.[5] Unauthorized trading occurs when trades are executed without a customer's permission. *Cange v. Stotler, Inc.*, 826 F.2d 581, 589 (7th Cir. 1987). The computer system executed the orders as entered by Shehee. Although Shehee's orders did not achieve the results she intended, Epstein did not transmit any orders to the exchange on Shehee's behalf other than those that she asked Epstein to place. The Judgment Officer's characterization rested on the assumption that Shehee received a communication from Epstein confirming that her order in fact had been cancelled: "The evidentiary record *firmly establishes* . . . that an order was placed; that a cancellation was confirmed; and that the original order was executed despite the cancellation." I.D., 147523 at *4 (emphasis added). Had that been the case, characterizing the double-fill as unauthorized trading might not have been inappropriate. We read the record to establish only that Shehee received a communication that she interpreted as telling her that her order was cancelled. Since the only orders executed on

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[5] Commission Rule 33.10 states:

> It shall be unlawful for any person directly or indirectly:
> (a) To cheat or defraud or attempt to cheat or defraud any other person;
> (b) To make or cause to be made to any other person any false report or statement thereof or cause to be entered for any person any false record thereof;
> (c) To deceive or attempt to deceive any other person by any means whatsoever in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction.

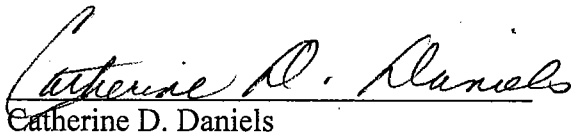
Shehee's behalf were those she asked Epstein to place, there was no unauthorized trading.

Accordingly, we reverse the finding that Epstein engaged in unauthorized trading.

For the foregoing reasons, we vacate the reparations award and dismiss the complaint.

IT IS SO ORDERED.[6]

By the Commission (Chairman JEFFERY and Commissioners LUKKEN, BROWN-HRUSKA, HATFIELD and DUNN).



Catherine D. Daniels
Assistant Secretary of the Commission
Commodity Futures Trading Commission

Dated: November 14, 2005

[6] Under Sections 6(c) and 14(e) of the Commodity Exchange Act (7 U.S.C. §§ 9 and 18(e) (2000)), a party may appeal a reparation order of the Commission to the United States Court of Appeals for only the circuit in which a hearing was held; if no hearing is held, the appeal may be filed in any circuit in which the appellee is located. The statute states that such an appeal must be filed within 15 days after notice of the Commission order, and that any appeal is not effective unless, within 30 days of the effect of the order, the appealing party files with the clerk of the court a bond equal to double the amount of the reparation award.