U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
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Office of Proceedings

FEDRIC KELLEY, Complainant, v. REFCO LLC d/b/a Refco Private Client Group Division of Refco LLC, Respondent.	* * * * * * * * * * *	CFTC Docket No. 06-R001

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INITIAL DECISION

Introduction

Fedric Kelley's complaint arises from his first attempt to trade coffee futures via his on-line trading platform. Previously, Kelley had electronically traded grain futures without incident. Unfortunately, his success bred a false confidence that an on-line "complete" report – which merely confirmed that an order had been successfully entered, and queued up – was functionally quivalent to an on-line "confirm" report -- which confirmed that an order had actually been executed or actually been cancelled.

On the day in question, over a one-hour stretch, Kelley had placed a sequence of several five-lot buy orders, cancel-replace orders and straight cancel orders. The hour-long sequence of orders indicates that Kelley had intended to be long no more than five coffee contracts during the hour, and then to be flat at the end of the hour. For each order, the trading platform quickly reported that the order was "complete," that is, that the order had been successfully entered.

However, during this hour-long stretch, Kelley did not receive a confirmation that any of the buy orders had been filled or had been successfully cancelled.

After a second hour passed, but before open outcry trading closed, the system belatedly reported back that three of the buy orders had been "too-late-to-cancel" or "TLTC." Kelley realized that he was long fifteen coffees, and called the trading desk of Lind-Waldock, a division of Refco, which confirmed that three buy orders, each to buy five May Coffee futures, had been executed. The Lind-Waldock employee surmised that the floor trader may have received the cancellation orders too late, because coffee futures are not electronically traded and thus Kelley's various orders had to be electronically routed to a printer on the trading floor of the NYBOT and then physically carried to the trading pit.

Kelley did not give any instructions to liquidate the long positions. At the close, the fifteen coffee futures were under-margined. The next day the positions were liquidated for a loss of $17,160.

Kelley asserts that various delays in fills, delays in the fill reports, and delays in the too-late-to-cancel reports were facially unreasonable and dubious, and thus evidence that Refco, or agents of Refco, had mishandled his orders. Kelley also asserts that Refco should have disclosed that he should expect delays in confirmations for coffee trades.[1] In response, Refco denies any violations. Refco asserts that it adequately discharged any disclosure obligations, and asserts that it diligently handled and reported Kelley's orders. Refco further asserts that Kelley is responsible for his losses, because he placed cumulative buy orders, and multiple cancel-replace

[1] After Kelley had filed his complaint, Refco notified the CFTC that it had filed for voluntary bankruptcy, and the Director of the Office of Proceedings dismissed the complaint. Subsequently, the bankruptcy trustee notified the Commission that the bankruptcy court had modified the automatic stay with respect to certain litigation, including Kelley's reparation claim, for the purpose of allowing the liquidation of claims in which the litigation was pending. Next, the Commission vacated the order of dismissal, and the complaint was served on respondent. Due to the passage of time, Kelley has understandably forgotten many details of the day in question, and Refco has been unable to produce any former employee or agent with first-hand knowledge of the underlying events, and has been unable to produce certain records, such as phone records.

and cancel orders, before receiving any confirmation that the initial buy order, and the subsequent buy orders, had been successfully cancelled. Refco similarly asserts that Kelley failed to mitigate his losses in a timely fashion upon receiving the TLTC reports. As explained below, after reviewing the parties' documentary submissions and oral testimony, it has been concluded that Kelley has established that Refco mishandled his orders; that Refco has established that Kelley failed to mitigate his losses; and that Kelley is entitled to an award of $2,962.50.

Factual Findings

1. Kelley, a resident of Los Angeles, California, had traded stocks for about seven years before opening his self-directed account with Lind-Waldock, a division of Refco, LLC. Kelley executed various account-opening documents, including a Lind-Waldock *Customer Agreement; Online Order Entry Agreement; E-Sign Disclosure* form; and *Consent to Delivery of Statements by Electronic Media*. Paragraph 10 of the Customer Agreement provided that Lind-Waldock "shall not be held responsible for delays in the transmission or execution of orders due to a breakdown or failure of transmission or communication facilities, or for any other cause beyond Lind-Waldock's control." The Online Order Entry Agreement provided in pertinent part:

> User acknowledges that the accuracy, completeness, timeliness, or correct sequence of the information concerning User's trading and account activity . . . is not guaranteed by Lind-Waldock. . . . User agrees that in no event shall Lind-Waldock . . . have any liability for the accuracy, completeness, timeliness, or correct sequence of the information or for any decision made or taken by User in reliance upon the information. . . .

The Online Order Entry Agreement also provided that Kelley was obligated to "immediately" notify Lind-Waldock in the event that the order entry system failed to provide an "accurate acknowledgement" of an order and an "acknowledgment" of the execution of the order. In this connection, the "Welcome to Lind-Waldock" brochure stated that each on-line client would be assigned to a specific trading desk, and that a client could "always call your assigned Trade Desk for help in placing an order, checking a fill, or asking a question." [*See* Kelley testimony at pages 5-11, and 28-29, of hearing transcript; Kelley's responses to interrogatories 1, 2, and 3; ¶¶ 1-9, of Answer; Account Application Form (attachment to addendum to complaint); Customer Agreement (Exhibit A to Albert Togut's verified statement); Online Services and Electronic Trading Agreement (Exhibit B to Togut's verified statement); and "Welcome to Lind-Waldock" brochure (produced by Kelley).]

2. Kelley traded his account, without significant problems, for about nine months before he placed the disputed coffee futures orders. Kelley principally traded grains, but could not recall whether he traded during open out-cry hours, or traded after hours via Globex. Over time Kelley fell into the mistaken habit of treating on-line "complete" reports – which merely confirmed that orders had been successfully entered, and queued up by the trading platform – as the functional equivalent of on-line "confirm" reports -- which confirmed that orders had actually been executed or actually been cancelled. [*See* Kelley testimony at pages 10-14, and 27-33, of hearing transcript.]

3. On March 14, 2005, the May Coffee future opened between 137.50 and 138.25. As explained below, Kelley would place three root orders to buy five May Coffee futures -- #4632, #4783, and #5063 – which would be filled, and then belatedly confirmed, between 52 and 78 minutes after the fact, as too-late-to-cancel.

At 10:11:30 a.m., Kelley placed order *#4632*, to buy 5 May Coffee futures ("KC05"), at a 135.60 limit.[2] The market would hit the limit price at 10:15:00. Order #4632 would be filled, three contracts at 135.60, and two contracts at 135.40. The market would not hit 135.40 until

[2] All times are Central Time.

10:41. Refco has not explained the circumstances around the fill of two contracts at the lower, albeit better, price.

At 10:13:00, Kelley placed order #4648, to cancel #4632, and buy 5 KC05, at a 135.40 limit. At 10:19:37, Kelley placed order #4745, to cancel #4648, and buy 5 KC05, at a 135.00 limit. At 10:19:59, Kelley placed order #4763, to straight cancel #4745. For each of the above orders, the on-line system reported that the order had been successfully submitted and queued up, but the system did not confirm that the initial buy order had been filled, or cancelled. Despite the absence of a confirm report for any cancellation, Kelley would assume that he had successfully cancelled all of these orders, until 11:28:12, when Lind-Waldock would report that #4632 had been "too-late-to-cancel," and thus had been filled. Refco has not explained the 78-minute lapse between the fill, and the first confirmation of the fill.

At 10:21:56, Kelley placed order *#4783*, to buy 5 KC05, at a 134.35 limit. The market would hit the limit price at 11:20. Order #4783 would be filled, three contracts at 134.40, and two contracts at 133.80. The market hit 134.40 at 11:20:47, and hit 134.80 at 11:23:09. Refco has not explained the circumstances around the timing of the second fill. At 10:23:45, Kelley placed order #4815, to straight cancel #4783. For both of these orders, the on-line system reported that the order had been successfully submitted and queued up, but the system did not confirm that the initial order had been filled, or cancelled. Despite the absence of a confirm report for any cancellation, Kelley would assume that he had successfully cancelled the buy order, until 11:20:40, when Lind-Waldock would report that #4783 had been "too-late-to-cancel," and thus had been filled. Refco has not explained the 58-minute lapse between the fill, and the first confirmation of the fill.

At 10:27, Kelley placed order #4877, to buy 5 KC05, at a 133.50 limit. At 10:39, Kelley placed order #5060 to cancel #4877. This cancellation was successfully executed. On the record, it cannot be reliably determined when Kelley received confirmation of this successful cancellation.

At 10:39:53, Kelley placed order *#5063*, to buy 5 KC05, at a 134.50 limit. The market would hit the limit price at 10:54, and order #5063 would be filled at 134.50. At 10:44:18, Kelley placed order #5128, to cancel #5063, and buy 5 KC05, at the market. At 11:00:18, Kelley placed order #5345, to straight cancel #5128. For each of these three orders, the on-line system reported that the order had been successfully submitted and queued up, but the system did not report that the initial order had been filled. Kelley apparently was not concerned that the initial market order had not been confirmed after 16 minutes, and would assume that he had successfully cancelled the buy order and thus was flat, until 11:32, when Lind-Waldock would report that #5063 had been "too-late-to-cancel," and thus had been filled. Refco has not explained the 51-minute lapse between the fill, and the first confirmation of the fill.

[*See* Kelley testimony at pages 15-22, of hearing transcript; March 14th confirmation statement (attachment to complaint); floor tickets #4648, #4751, #4763, #4783, #4877, #5060, #6063, #5128, and #5345 (Exhibit D, Togut's Verified Statement); screen reports (Exhibit E, Togut's Verified Statement); March 31st letter from Refco Compliance to Kelley (Exhibit F, Togut's Verified Statement); Time and Sales report for May Coffee futures contract, for March 14, 2005 (produced by Refco); ¶¶ 7-11, Togut's Verified Statement; ¶¶ 10-15, pages 4-5, Refco's Answer; Kelley's replies to Refco's Request for Admissions 14-22; and Kelley's factual description, initial reparations complaint.]

4. Upon receipt of the third TLTC report, Kelley called the Lind-Waldock desk, which confirmed that he was long fifteen May coffee futures, because the floor broker selected by Refco had filled the three buy orders. When Kelley asked about the apparent delays in delivering the cancellation orders to the floor broker and the delays in the TLTC reports, the Lind-Waldock employee explained that the delays were probably due to the fact that coffee futures are not electronically traded, and thus Kelley's various orders had to be electronically routed to a printer on the trading floor of the NYBOT, and then physically carried to the trading pit.

Kelley did not give any instructions to liquidate the long positions. At the close, the fifteen coffee futures were under-margined. The next day the positions were liquidated for a loss of $17,160. [*See* Kelley testimony at pages 22-27, and 32-38, of hearing transcript; Kelley's replies to Refco's requests for admissions 21 and 22; and ¶¶ 11-15, Togut's verified statement.]

Conclusions

In resolving disputes under the Commodity Exchange Act, the Commission has traditionally focused on the obligations that Sections 4d and 4b of the Commodity Exchange Act impose on futures commission merchants, rather than the waivers implicit in certain provisions of standardized agreements between FCMs and their customers. Once an FCM opens an account for a customer, the Act imposes duties that relate to the control the FCM exercises over its customers' money and property as well as its superior access to material information. For example, Section 4d of the Act compels FCMs to treat and deal with a customer's money as belonging to the customer, and thus to follow customer instructions regarding their money and property. *Lee v. Lind-Waldock & Company*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,173 at 50,159-50,160 (CFTC 2000). Here, the fact that coffee futures were traded old school style by open outcry was widely known, or readily available, in the public realm. From this fact, any reasonable trader could easily have deduced that the transmission, execution and confirmation of manually handled orders would not necessarily be instantaneous. Since Kelley never informed Refco that he would be relying on Refco to provide this sort of information, Refco was under no obligation to provide advance warning to expect reasonable delays in the delivery of orders and confirmation reports for trades in the open outcry coffee pit. However, the number and length of the delays for various fills and reports were sufficiently questionable to support a strong inference that Refco, or agents designated by Refco to execute Kelley's coffee orders, had mishandled the orders in a grossly negligent or reckless manner. In the absence of any detailed explanation of the circumstances around the various delays, it must be concluded that Refco mishandled Kelley's coffee orders in violation of Section 4d of the Act.

The proper measure of damages for this violation should reflect the fact that Kelley's sequence of orders manifested an intention to be flat before the close, and should reflect the fact that Kelley knew by 11:32 a.m. that he was actually long fifteen May coffee futures. Consistent with an intention to be flat, Kelley could have immediately liquidated the fifteen futures at 11:32, when the market traded at 134.20, and limited his loss to $2,962.50. However, at this point, Kelley altered his strategy and decided not to liquidate. Since Kelley made this decision without seeking or receiving Refco's advice, Refco cannot be held liable for the additional losses that subsequently accrued.

ORDER

Complainant has established that Refco LLC violated Section 4d of the Commodity Exchange Act, and that this violation proximately caused $2,962.50 in damages. Accordingly, Refco LLC d/b/a Refco Private Client Group Division of Refco LLC is ORDERED to pay to

Fedric Kelley reparations of $2,962.50, plus interest on that amount at 1.69 % compounded annually from March 14, 2005, to the date of payment, plus $125 in costs for the filing fee.

Dated September 29, 2008.

Philip McGuire,
Judgment Officer