

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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WALRUS MASTER FUND LTD.,

Plaintiff,

08 Civ. 2404 (DAB)
MEMORANDUM AND ORDER

-against-

CITIGROUP GLOBAL MARKETS, INC.,

Defendant.

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DEBORAH A. BATTS, United States District Judge.

Walrus Master Fund Ltd. ("Plaintiff" or "Walrus") brings suit against Citigroup Global Markets, Inc. ("Defendant" or "Citigroup"). Plaintiff alleges (1) violation of §4b of the Commodity Exchange Act, 2 U.S.C §6b (the "CEA"); (2) common law fraud; (3) breach of fiduciary duty; and (4) negligence arising from an order for futures commodities that Plaintiff placed with Defendant, who was acting as a Plaintiff's broker. Defendants move to dismiss the complaint under Federal Rules of Civil Procedure 12(b)(6) and 9(b). For the reasons stated herein the Motion to Dismiss is GRANTED.

I. BACKGROUND

A. The Futures Agreement

Plaintiff in this action is Walrus Master Fund LTD., a Cayman Islands limited liability investment company, also known as a "hedge fund." (Compl. ¶ 7.) Defendant Global Markets Inc. is a New York Corporation registered as a futures commission merchant and a member of the Chicago Mercantile Exchange ("CME"). (Compl. ¶¶ 8-10.) In October 2005 the Defendant entered into an Institutional Futures Account Agreement (the "Futures Agreement") with Plaintiff, under which Defendant acted as "prime broker," (1) financing Plaintiff's trades, (2) confirming and executing futures orders received from Plaintiff, and (3) clearing and settling those orders.¹ (Compl. ¶¶ 12-13, 15.) Plaintiff also maintained its funds and securities in an account with the Defendant. (Compl. ¶ 14.)

Plaintiff used a software by a company called Trading Technologies, referred to as "TT", to send trade orders to Defendant for placement on the CME, as well as to receive confirmations from Defendant of the executed orders. (Compl.

¹ Although often a third party actually purchases and sells such securities in its role as an "executing broker," at least for the trades at issue Plaintiff alleges that Defendant acted as both the executing and prime broker for Plaintiff. (Compl. ¶ 13.)

¶¶ 16, 18.) After receiving confirmation of a trade's price from Defendant, the TT software would display the results for each trade in the "Fill Window," as well as the daily average price of all executed trades for that security or financial instrument in the "Average Price Window." (Compl. ¶ 20.) Walrus used this data to generate its daily profit and loss statement as well as to calculate other financial information. (Compl. ¶¶ 21-22.)

Plaintiff engages in short-term trading of equity securities, fixed income securities, foreign exchange contracts and currencies, futures and forward contracts, and other securities and instruments. (Compl. ¶ 23.) Among these securities and instruments are stock market index futures contracts, one of which is the E-Mini S&P ("S&P Mini"), whose notional value is \$50 multiplied by the value of the S&P 500 stock index, and which is traded on CME's Globex electronic trading platform. (Compl. ¶¶ 24, 26.)

B. The August 17, 2007 Trades

On August 17, 2007 a few seconds after 8:15:00 AM, and seconds after the Federal Reserve Board announced a 50 basis-point reduction in the primary credit discount rate, Plaintiff's employee Adam Sender instructed Walrus trader Andrew Flug to purchase 300 S&P Minis futures contracts, at no higher than 10 points above the then current selling price

of \$1,429.75 (i.e. not above \$1,439.75). (Compl. ¶¶ 28-29, 31-32.) Flug then allegedly immediately clicked on the buy side of the TT screen and an order for 50 S&P Minis was instantly confirmed as executed. (Comp. ¶¶ 32-33.) Flug then quickly clicked on the buy side of the TT screen again, issuing an order for 250 S&P Minis, which within seconds were allegedly confirmed as executed at an average price of no more than \$1,439.75. (Compl. ¶ 34.) Flug and other Walrus traders continued to trade S&P Minis for the remainder of the day, as well as to monitor the average execution price for these trades. (Compl. ¶¶ 35-37, 39.) Following the Federal Reserve Board announcement, there had been a dramatic increase in the average price of S&P Minis. (Compl. ¶ 38.)

The following Monday, August 20, 2007, Plaintiff received the account statement for Friday, August 17 from Defendant, which listed an average price of \$1,441.33063 for the 800 S&P Mini orders that Walrus had executed that day, and which clashed with its own records of an average price of \$1,430.33063. (Compl. ¶¶ 40-41.) In response, Plaintiff contested Defendant's report and Defendant produced and sent to Plaintiff an audit trail for April 17, which differed in three respects from Plaintiff's account of the events of that day. (Compl. ¶ 42-43.)

First, the audit trail indicated that Plaintiff had first purchased 250 and then 50 S&P Minis, while Plaintiff

alleges that it bought the 50 S&P Minis first. (Compl. ¶ 44.) Second, the disputed trade of the 300 S&P Minis appeared with an average price of \$1,470.00, while Plaintiff alleges that it placed a limit order and received a confirmation for an average price of \$1,439.75. (Compl. ¶ 45.) Third, the audit trail showed that Plaintiff cancelled the order for 250 S&P Minis at 8:15:46 AM and then later bought the same number of S&P Minis for \$1,470.00, despite the Plaintiff's allegations that it never cancelled the order. (Compl. ¶ 46.)

Plaintiff alleges that had the order actually been executed at \$1,470.00, as indicated in Defendant's audit trail, its employees would have quickly noticed a change in the TT Average Price Window as well as a drop in Plaintiff's profit and loss figures. (Compl. ¶ 47.) As a result of this discrepancy, Walrus alleges that it has been damaged in the amount of \$378,125.00; the difference between the limit price that Flug allegedly entered for the 250 S&P Minis and the average price which was reported to Walrus by Defendant. (Compl. ¶ 48.)

II. DISCUSSION

A. Legal Standard

For a complaint to survive dismissal under Rule 12(b)(6), the plaintiff must plead "enough facts to state a claim to relief that is plausible on its face." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 127 S.Ct. 1955, 1974, 167 L.Ed.2d 929 (2007). In other words, a plaintiff must satisfy "a flexible 'plausibility standard,' which obliges a pleader to amplify a claim with some factual allegations in those contexts where such amplification is needed to render the claim plausible." Iqbal v. Hasty, 490 F.3d 143, 157-58 (2d Cir. 2007). "[A] plaintiff's obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." Twombly, 127 S.Ct. at 1964-65 (internal quotation marks omitted). In deciding a motion to dismiss, the court "must accept as true all of the factual allegations set out in plaintiff's complaint, draw inferences from those allegations in the light most favorable to plaintiff, and construe the complaint liberally." Roth v. Jennings, 489 F.3d 499, 510 (2d Cir. 2007) (citation omitted). However, "general, conclusory allegations need not be credited ... when they are belied by

more specific allegations of the complaint." Mortimer Off Shore Servs., Ltd. v. Fed. Republic of Germany, No. 05 Civ. 10669, 2007 WL 2822214, at *7 (S.D.N.Y. Sept. 27, 2007).

Furthermore, under Rule 9(b), "in alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Fed. R. Civ. Pro. 9(b). To satisfy the particularity requirement of Rule 9(b), a complaint must "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." United States Fire Ins. Co. v. United Limousine Service, Inc., 303 F.Supp.2d 432 (S.D.N.Y. 2004) (citing Cosmas v. Hasset, 886 F.2d 8, 11 (2d Cir. 1989)).

B. Violations of the Commodity Exchange Act

To state a claim for fraud under § 4b of the Commodity Exchange Act a Plaintiff must allege "(1) the making of a misrepresentation, misleading statement, or a deceptive omission; (2) scienter; . . . (3) materiality"; (4) and reliance (5) "in or connection with any order to make . . . any contract of sale of any commodity for future delivery . . ." Commodity Futures Trading Com'n v. International Financial Services (New York), Inc., 323 F.Supp.2d 482, 499 (S.D.N.Y. 2004) (internal citations omitted). Critically, a

Plaintiff must prove reliance in order to succeed in a private action for fraud under the CEA. Id. at 502 (while an enforcement action brought by the Commodity Futures Trading Commission need not allege reliance, “[v]ictims generally must prove reliance to show that they sustained damage as a result of material misrepresentations made by the defendants, for absent reliance, they cannot establish causation.”); accord S.E.C. v. Princeton Economic Intern, Ltd., 73 F.Supp.2d 420, 424, (S.D.N.Y. 1999) (noting that reliance “is not a necessary element in an enforcement proceeding”).

Here, Plaintiff’s claim for fraud under the CEA fails to allege adequately reliance or loss causation. Under its fraud claims, Plaintiff alleges that Defendant “willfully made or caused to be made to Walrus a false report or statement of Walrus’s orders and contracts of August 17, 2007.” (Compl. ¶ 50(b).) According to the Complaint, this “report” of the August 17 orders was provided to Plaintiff “[w]hen the market reopened on Monday, August 20, 2007,” (Compl. ¶ 41)), after which an allegedly false audit trail, confirming the information in the report, was also provided to Plaintiff. (Compl. ¶ 42.) As a result of these alleged misstatements, Plaintiff asserts that it was damaged in the amount of at least \$387,125.00. (Compl. ¶ 48); (see also, Pl’s Mem. Of Law at 11) (“The Complaint specifies the false

and misleading statements, namely the Audit Trail that [Defendant] provided to Walrus on August 20, 2007.")

However, as Defendant rightly argues, even accepting as true the allegations that the report and/or audit trial were false and that Defendant intended to deceive, "Plaintiff makes no allegation about how it relied on that representation." (Def's Rep. Mem. Of Law at 5). Other than the conclusory statement that "Walrus justifiably relied on Defendant's representation," (Compl. ¶ 56), nowhere in its Complaint does Plaintiff allege any action it took in reliance on its receipt of the August 20, 2007 report or audit trail. Nor could Plaintiff make any such allegation, given that the only trading at issue in this case occurred on August 17, 2007, three days prior to the alleged misstatements. Accordingly, Plaintiff has not sufficiently alleged reliance to survive a 12(b)(6) Motion on its CEA fraud claim. See Granite Partners, L.P. v. Bear Stearns & Co., 58 F.Supp.2d 228, 259 (S.D.N.Y. 1999) ("Whether a plaintiff has adequately pleaded justifiable reliance can be a proper subject for a motion to dismiss.") (citing Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020, 1032-33 (2d Cir. 1993)).

Furthermore, Plaintiff cannot plausibly allege that the supposed misstatements on August 20, 2007 caused the alleged loss of \$387,125,00. Even assuming that they were false,

Defendant's August 20, 2007 report and audit trial did not cause Plaintiff's loss, but instead merely communicated it to Plaintiff. Defendant is correct that Plaintiff's claim, if it has one at all, is for breach of contract in failing to place Plaintiff's order at the price requested. (Def's Rep. Mem. Of Law at 4). It is simply not fraud for a party to report its failure to perform under a contract. As a result of Plaintiff's failure to plausibly allege either reliance or loss causation, Defendant's Motion to Dismiss the claim for fraud under the CEA is hereby GRANTED.

C. The State Law Claims

Because the Court has dismissed all of Plaintiff's claims arising under Federal Law, and because Plaintiff does not base subject-matter jurisdiction on diversity of the parties, the remainder of Plaintiff's Complaint must be dismissed for lack of supplemental jurisdiction under 28 U.S.C. § 1367.

III. LEAVE TO REPLEAD

Even when a complaint has been dismissed, permission to amend it "shall be freely given when justice so requires." Fed. R. Civ. P. 15(a). "While it is the usual practice upon granting a motion to dismiss to allow leave to replead,"

Cohen v. Citibank, 1997 WL 88378 at *2 (S.D.N.Y. Feb. 28, 1997), a court may dismiss without leave to amend when amendment would be futile. Oneida Indian Nation of New York v. City of Sherrill, 337 F.3d 139, 168 (2d Cir.2003) (citations omitted), reversed on other grounds by City of Sherrill v. Oneida Indian Nation of New York, 544 U.S. 197 (2005). "A proposed amendment to a pleading would be futile if it could not withstand a motion to dismiss pursuant to Rule 12(b)(6)." Id. (citing Ricciuti v. N.Y.C. Transit Auth., 941 F.2d 119, 123 (2d Cir.1991)).

Here, it would be manifestly futile for Plaintiff to replead its claim for fraud under the CEA,² because it cannot possibly allege that it relied on or was damaged by Defendant's statements of August 20, 2007, which occurred three days after the trades and alleged loss at issue. Thus, Plaintiff's claim for fraud under the CEA is DISMISSED with prejudice. The remainder of Plaintiff's state claims are DISMISSED without prejudice with leave to replead in state court.

² Although no longer before the Court, Plaintiff's common law cause of action for fraud appears to face similar hurdles as that of its statutory claim.

IV. CONCLUSION

For the foregoing reasons, Defendants' motion to dismiss is GRANTED. The Clerk of Court is directed to CLOSE the docket in this case.

SO ORDERED.

Dated: New York, New York
March 30, 2009

Deborah A. Batts

Deborah A. Batts
United States District Judge