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GUIDE TO UNITED STATES AND UNITED KINGDOM DERIVATIVE AND COMMODITY MARKET ENFORCEMENT REGIMES

2019 EDITION

Preface

This Guide began in 2010 as a brief update for clients on the changes that the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA" or "Dodd-Frank") made to the U.S. Commodity Exchange Act ("CEA"), and how this would affect the U.S. Commodity Futures Trading Commission's ("CFTC") jurisdiction and its approach to claims of derivative and commodity market abuse. However, over time, in light of the expansion in market abuse enforcement activity and the increased national and international cooperation in derivative and commodity market enforcement, this Guide has grown.

This edition of this Guide has been updated with discussion and analyses of major actions, cases, and trends from the past year. Some of these updates stem in part from the appointment of new personnel within the enforcement functions of U.S. government, and include policy pronouncements and guidance issued by representatives of the CFTC and the U.S. Department of Justice ("DOJ"). Other updates are based on the development of new markets, such as Bitcoin and other cryptocurrencies.

This edition also incorporates observations regarding trends in CFTC and DOJ enforcement priorities and tactics, including an analysis of new CFTC and DOJ cooperation guidelines and how these guidelines have been applied. In addition, we have included an expanded analysis of CFTC insider trading prosecutions, including additional case studies discussing major enforcement actions and the CFTC's newly announced insider trading task force. We have also added several additional case studies to elucidate the types of purported misconduct that enforcement agencies have targeted. This update also includes discussion of antitrust considerations in the U.S. commodities markets, in light of the overlapping nature of certain provisions of the CEA and U.S. antitrust law, and the conduct that can lead to simultaneous violations of those two legal regimes.

Finally, in light of the CFTC's increased activity in prosecuting market manipulation, the Guide has been changed to include significantly more analysis of the new, more aggressive approach to market manipulation that the CFTC has advocated in a number of recent cases it is litigating. It also includes an expanded guide to internal investigations, including a new section on protecting privilege in government investigations.

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This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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UNITED STATES DERIVATIVE AND COMMODITY MARKET ENFORCEMENT REGIMES

I. INTRODUCTION

The wholesale physical and derivative markets for "commodities" are highly regulated and subject to regulatory enforcement by at least three U.S. regulators –the CFTC, FERC, and the Federal Trade Commission ("FTC"). Each agency has its own jurisdictional authority, set of standards, and enforcement tools, and the various regulatory provisions are backstopped by criminal provisions enforced by the Department of Justice ("DOJ").

Since the enactment of the Energy Policy Act of 2005 ("EPAct"), FERC has exercised greater authority in both regulating a broader range of activities and imposing more severe penalties for wrongdoing in energy markets. The CFTC's already broad commodities market jurisdiction has also expanded with the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") in 2010.

Congress's expansion of the regulatory authority of these agencies signals an increased interest in detecting, deterring, and punishing manipulation of the derivatives, commodities, and energy markets. It is not yet clear, however, precisely where the boundaries of each agency's jurisdiction lie or how the agencies will approach areas of overlapping jurisdiction.

This guide outlines the regulatory jurisdiction and enforcement mechanism of each agency, with example cases and case studies illustrating the scope of each agency's powers, and the likely direction and outcome of future enforcement efforts.

II. U.S. COMMODITY FUTURES TRADING COMMISSION JURISDICTION AND MARKET ENFORCEMENT REGIME

A. INTRODUCTION

In recent years, the CFTC has expanded its enforcement activities, as demonstrated by recent enforcement figures:

- In fiscal year 2018, the CFTC filed 83 enforcement actions. It obtained orders imposing over $947 million in monetary penalties, composed of approximately $50 million in restitution and disgorgement and $947 million in civil monetary penalties. The CFTC collected over $856 million that was deposited at the U.S. Treasury.[1]

- In fiscal year 2017, the CFTC filed 49 enforcement actions. The CFTC obtained orders imposing $413 million in monetary sanctions, composed of $78,896,162 in restitution and disgorgement and $333,830,145 in civil monetary penalties. The CFTC collected over $265 million, which was deposited at the U.S. Treasury.[2]

- In fiscal year 2016, the CFTC filed 68 enforcement actions. The CFTC obtained orders imposing $1.29 billion in monetary sanctions, composed of $543 million in restitution and disgorgement and over $748 million in civil monetary penalties. The CFTC collected over $484 million, which was deposited at the U.S. Treasury.[3]

- In fiscal year 2015, the CFTC filed 69 enforcement actions, bringing the total over the last five years to 419. The CFTC obtained orders imposing a record $3.144 billion in civil monetary penalties. The CFTC collected over $2.8 billion, which was deposited at the U.S. Treasury. These were the highest figures in the CFTC's history with respect to the amount of civil monetary penalties imposed and collected during a fiscal year. These penalties were more than 12 times the CFTC's operating budget. In addition to the $3.144 billion in civil monetary penalties, the CFTC was also awarded $59 million this year in restitution and disgorgement orders, bringing the CFTC's total monetary sanctions for fiscal year 2015 to over $3.2 billion.[4]

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[1] U.S. Commodity Futures Trading Comm'n, CFTC Releases Annual Enforcement Results for Fiscal Year 2018 (2018), http://www.cftc.gov/PressRoom/PressReleases/pr7841-18.

[2] U.S. Commodity Futures Trading Comm'n, CFTC Releases Annual Enforcement Results for Fiscal Year 2017 (2017), http://www.cftc.gov/PressRoom/PressReleases/pr7650-17.

[3] U.S. Commodity Futures Trading Comm'n, CFTC Releases Annual Enforcement Results for Fiscal Year 2016 (2016), http://www.cftc.gov/PressRoom/PressReleases/pr7488-16.

[4] U.S. Commodity Futures Trading Comm'n, CFTC Releases Annual Enforcement Results for Fiscal Year 2015 (2015), http://www.cftc.gov/PressRoom/PressReleases/pr7274-15.

- In fiscal year 2014, the CFTC filed 67 enforcement actions. The CFTC obtained orders imposing $3.27 billion in monetary sanctions, including $1.8 billion in civil monetary penalties and more than $1.4 billion in restitution and disgorgement.[5]

- In fiscal year 2013, the CFTC filed 82 enforcement actions. The CFTC obtained orders imposing over $1.5 billion in civil monetary penalties and more than $200 million in restitution and disgorgement.[6]

Many of the CFTC's recent investigations have made headlines, including its investigations into benchmark interest rates, conduct by foreign traders, charges against the CEO and the Chairman of the Board of an interdealer broker, the multi-billion-dollar trading losses at JPMorgan Chase in connection with the "London Whale," and spoofing.

Recent investigations have also been notable for their increased cooperation with law enforcement. In 2015, approximately 90% of the CFTC's major fraud and manipulation cases involved a parallel criminal proceeding. During that period, 35 judgments were entered in these federal criminal proceedings, resulting in prison sentences against 24 persons and restitution totaling over $265 million and almost $4.2 billion in penalties and fines. The CFTC has continued its cooperation efforts with foreign regulators and criminal authorities. For example, in fiscal year 2018, the CFTC filed a record 14 actions in parallel with criminal counterparts, including what Acting Assistant Attorney General John P. Cronan described as "the largest futures market criminal enforcement action in [DOJ] history."[7]

The CFTC has also pursued new and more aggressive theories in some of its recent investigations. In particular, it has taken positions in enforcement litigation that would lower the bar for proving unlawful price manipulation. The CFTC has taken this approach by attempting to abandon the requirement of proving that the accused had a specific intent to create an artificial price and replacing it with an intent to influence price. The CFTC's position has been strongly questioned by the futures industry from a legal and policy point of view. In November 2018, it was firmly rejected by a New York federal judge who stated that the CFTC's position was "little more than an 'earth is flat'-style conviction."[8]

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[5] U.S. Commodity Futures Trading Comm'n, CFTC Releases Annual Enforcement Results for Fiscal Year 2014 (2014), http://www.cftc.gov/PressRoom/PressReleases/pr7051-14.

[6] U.S. Commodity Futures Trading Comm'n, CFTC Releases Enforcement Division's Annual Results (2013), http://www.cftc.gov/PressRoom/PressReleases/pr6749-13.

[7] John P. Cronan, *Acting Assistant Attorney General John P. Cronan Announces Futures Markets Spoofing Takedown* (Jan. 29, 2018), https://www.justice.gov/opa/speech/acting-assistant-attorney-general-john-p-cronan-announces-futures-markets-spoofing.

[8] *U.S. Commodity Futures Trading Comm'n v. Wilson*, 2018 WL 6322024, *21 (S.D.N.Y. Nov. 30, 2018).

B. REACH OF THE CEA

1. Product Coverage

The CFTC is responsible for enforcing the Commodity Exchange Act ("CEA"). Pursuant to the CEA, the CFTC has jurisdictions over swaps and "commodities." Since "commodity" is broadly defined under the CEA to include a list of specified agricultural products, as well as "goods and articles" and "all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in"[9] it is an expandable concept.[10] The exact reach of the CFTC's jurisdiction remains subject to debate,[11] but CFTC enforcement has generally been limited to the wide and often changing categories of products – including traditional agricultural and industrial commodities as well as newer commodities such as currencies, financial instruments and cryptocurrencies – that currently have futures contracts. [12] Two notable exclusions from the definition of "commodity" are onions[13] and, since the passage of the DFA, motion picture box office receipts.[14]

In general, CFTC enforcement has focused on commodity futures and options as well as certain swaps and forward transactions that are traded through a CFTC regulated exchange . This allows the CFTC another avenue to monitor the derivatives markets. The CFTC also has enforcement over manipulation and attempted manipulation of "the price of any commodity in interstate commerce." [15] This authority has typically only been used in enforcement actions related to manipulation or attempted manipulation of a commodity that underlies a futures contract, where that manipulation or attempted manipulation is capable of affecting the related derivatives markets.[16] However, because of the broad definition of a commodity, the CFTC could theoretically assert the authority to prosecute manipulation or attempted manipulation of any good or service that could in the future support a futures contract.[17]

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[9] 7 U.S.C. § 1a(9).

[10] *See CFTC v. Am. Bd. of Trade, Inc.*, 803 F.2d 1242, 1248 (2d Cir. 1986) ("[A]nything other than onions could become a 'commodity' . . . simply by its futures being traded on some exchange.").

[11] According to one commentator this definition could, in theory, support three different interpretations of CEA enforcement reach. First, it could be limited solely to the specific products that support a futures contract subject to CEA enforcement. Second, it could reach a broader class of products that include products similar to a product that supports a futures contract subject to CEA enforcement. Or third, it could reach any product that could in theory (if not yet in reality) support a futures product subject to CEA enforcement. *See* Geoffrey F. Aarnow, *What is a Commodity? Potential Limits on the CFTC's Fraud Jurisdiction*, 38 Futures & Derivatives L. Rep. No. 11 (December 2018).

[12] *See infra* at Section II(E) for a discussion of the CFTC's regulation of cryptocurrencies.

[13] 7 U.S.C. § 1a(9).

[14] *Id*.

[15] 7 U.S.C. § 13(a)(2).

[16] 7 U.S.C. § 9(1); CFTC Rule 180.1.

[17] For more on this topic, please see Aarnow, *supra* note 11.

As a result of the CFTC's broad jurisdiction, there is also overlap between the CFTC and FERC's jurisdiction. The DFA amendments to the CEA, particularly § 2(a)(1)(A)(I),[18] provide some clarity regarding the jurisdictional boundaries between the CFTC and FERC. Specifically, this new section preserves FERC's jurisdiction over transactions that are either (1) entered into pursuant to a tariff or rate schedule approved by FERC (or a state authority) and not executed, traded, or cleared on a CFTC-registered entity; or (2) executed, traded, or cleared on a CFTC-registered entity or trading facility that is owned or operated by a regional transmission organization or an independent system operator.[19]

The DFA significantly expanded the CEA's jurisdiction by, among other changes, adding swaps. The DFA does so by creating a complex definition of what constitutes a "swap." Among the products included under this definition is any contract or transaction:

1. that is a put, call, cap, floor, collar, or similar option . . . for the purchase or sale, or based on the value, of one or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind;

2. that provides for any purchase, sale, payment, or delivery . . . that is dependent on the occurrence, nonoccurrence . . . of an event or contingency associated with a potential financial, economic, or commercial consequence; [or]

3. that provides on an executory basis for the exchange . . . of one or more payments based on the value or level of one or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction . . . the financial risk associated with a future change in any such value or level without also conveying a current or future . . . ownership interest in an asset . . . or liability that incorporates the financial risk so transferred.[20]

The DFA specifically excludes ten types of contracts from the definition of "swap."[21] They are:

1. any contract of sale of a commodity for future delivery (or option on such a contract); leverage contracts; security futures products; or certain types of off-exchange agreements, contracts, or transactions in commodities, including foreign currency, in which one of the parties to the transaction is not an eligible contract participant;

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[18] 7 U.S.C. § 2(a)(1)(A)(I).

[19] The CFTC also exempts from regulated markets – but not from CEA enforcement – "[c]ontracts for the purchase and sale of crude oil, condensates, natural gas, natural gas liquids or their derivatives which are used primarily as an energy source," so long as those contracts are bilateral agreements between qualifying entities and create binding physical-delivery obligations. U.S. Commodity Futures Trading Comm'n, *Exemption for Certain Contracts Involving Energy Products*, 58 Fed. Reg. 21,268-02 (Apr. 20, 1993) (Final Order).

[20] 7 U.S.C. § 1a(47)(A).

[21] 7 U.S.C. § 1a(47)(B).

2. any sale of a nonfinancial commodity or security for deferred shipment or delivery that is intended to be physically settled;

3. any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof, that is subject to the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act");

4. any put, call, straddle, option, or privilege relating to a foreign currency entered into on a national securities exchange registered pursuant to § 6(a) of the Exchange Act;

5. any agreement, contract, or transaction providing for the purchase or sale of one or more securities on a fixed basis that is subject to the Securities Act and the Exchange Act;

6. any agreement, contract, or transaction providing for the purchase or sale of one or more securities on a contingent basis that is subject to the Securities Act and the Exchange Act, unless the agreement, contract, or transaction predicates the purchase or sale on the occurrence of a bona fide contingency that might reasonably be expected to affect or be affected by the creditworthiness of a party other than a party to the agreement, contract, or transaction;

7. any note, bond, or evidence of indebtedness that is a security, as defined in § 2(a)(1) of the Securities Act;

8. any agreement, contract, or transaction that is (1) based on a security and (2) entered into directly or through an underwriter by the issuer of such security for the purposes of raising capital, unless the transaction is entered into to manage a risk associated with capital raising;

9. any agreement, contract, or transaction a counterparty of which is a Federal Reserve bank or the federal government, or a federal agency that is backed by the full faith and credit of the U.S.; and

10. any security-based swap, other than a security-based swap as described in 7 U.S.C. § 1a(47)(D).

The DFA also includes rules for construction and other provisions to be used to interpret whether a contract is a swap.[22]

2. Extraterritorial Application of the CEA

In the past, courts applied the CEA extraterritorially where either the conduct or effects test was satisfied. The conduct test applied where a plaintiff alleged that manipulative conduct in the

[22] 7 U.S.C. § 1a(47)(C)–(F).

United States caused harm abroad.[23] The effects test applied where a plaintiff alleged that foreign activities caused "foreseeable and substantial harm to interests in the United States."[24]

In light of the Supreme Court's 2010 holding in *Morrison v. National Australia Bank*, [25] it is unlikely that the conduct and effects tests will continue to be applied in cases brought under the CEA. Post-*Morrison*, although there have been no reported criminal case decisions where defendants claimed that a prosecution was barred as an extraterritorial application of the CEA, courts hearing civil CEA claims brought by private litigants have begun to apply *Morrison*, and the Second Circuit Court of Appeals endorsed the application of *Morrison*'s transaction-based test to private suits under the CEA in *Loginovskaya v. Batratchenko*.[26]

In *Loginovskaya*, the court held that "a private right of action brought under CEA § 22 is limited to claims alleging a commodities transaction within the United States."[27] The court first found that there is an "absence of any 'affirmative intention' by Congress to give the CEA extraterritorial effect," and thus, it must be presumed that the CEA "is primarily concerned with domestic conditions."[28] The court next considered the "focus of congressional concern" for the § 22 private right of action, deciding that because "CEA § 22 limits the private right to suit over transactions [in the commodities market], the suits must be based on transactions occurring in the territory of the United States." [29] Finally, the court found that the plaintiff had not sufficiently alleged a "domestic transaction," because, although the plaintiff took certain steps toward her transaction within the United States, the complaint failed to allege that either title had passed or irrevocable liability was incurred within the United States.[30]

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[23] *See*, *e.g.*, *CFTC v. Lake Shore Asset Mgmt. Ltd.*, No. 07 C 3598, 2007 WL 2659990, at *26–27 (N.D. Ill. Aug. 28, 2007) (exercising subject matter jurisdiction over the CFTC's claim under the conduct test because the foreign defendant used a U.S. futures exchange to defraud foreign investors), *vacated in part on other grounds*, 511 F.3d 762 (7th Cir. 2007).

[24] *Id*. at *26.

[25] 130 S. Ct. 2869 (2010). In *Morrison*, a private civil suit alleging securities fraud under the Exchange Act of 1934, the Supreme Court rejected the conduct and effects tests and instead imposed a transactional test limiting the reach of § 10(b) of the Exchange Act to (i) transactions in securities listed on domestic exchanges and (ii) domestic transactions in other securities. *Id*. at 2884. However, while a domestic transaction is necessary, it may not always be sufficient. *See Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198, 216 (2d Cir. 2014).(finding the Exchange Act did not apply to off-exchange securities-based swap agreements for Volkswagen shares because the underlying security was traded in Germany, the scheme was "primarily in Germany" and "in the case of securities not listed on domestic exchanges, a domestic transaction is necessary but not necessarily sufficient").

[26] 764 F.3d 266 (2d Cir. 2014).

[27] *Id*. at 268.

[28] *Id.* at 273.

[29] *Id.*

[30] *Id.* at 275; *see also Myun-Uk Choi v. Tower Research Capital LLC*, 890 F.3d 60, 68 (2d Cir. 2018) (holding that commodities transactions on foreign exchanges that were matched on the CME Globex platform in the United States were a domestic transaction under *Morrison* because irrevocable liability occurred upon matching in the United States).

In another case, *In re LIBOR-Based Financial Instruments Antitrust Litigation*,[31] the court applied *Morrison* to a claim for manipulation under the CEA. The *LIBOR* court first found that, because § 9(a) of the CEA gives no indication of extraterritorial application, it has none.[32] After concluding that § 9(a) applies only domestically, the court then considered whether the plaintiffs' claim involved the types of domestic activities that are "the objects of the [CEA's] solicitude."[33] The court found that the plaintiffs had alleged manipulation of the price of domestically traded Eurodollar futures contracts, which was "precisely the conduct that the CEA was designed to regulate."[34] Therefore, the court held that, although the CEA does not apply extraterritorially, the manipulation alleged in this complaint fell within the CEA's reach.[35]

Although the DFA specifically provides for the Securities and Exchange Commission's ("SEC") continued use of the conduct and effects tests generally,[36] only limited provisions have been made for the CFTC.[37] As such, the exact application of *Morrison* for actions by the CFTC remains to be seen. In the only action to challenge the CFTC's jurisdiction on extraterritoriality grounds, the court applied Morrison's holding that extraterritoriality is a merits question, as opposed to a jurisdictional one, to find that a claim of impermissible extraterritorial application cannot be used to set aside a default judgment.[38]

(a) Limitation for Swaps

CEA § 2(i)(1) provides that the DFA provisions pertaining to swaps shall not apply to activities outside the United States, unless those activities "have a direct and significant connection with activities in, or effect on, commerce of the United States."[39] The CFTC has stated that it will interpret "direct" to require "a reasonably proximate causal nexus" and not to require foreseeability, substantiality, or immediacy.[40] The CFTC will consider the connection of swap activities, viewed as a class or in the aggregate, to activities in commerce of the United States to determine whether an extraterritorial application of the swaps provisions is warranted.[41] Although

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[31] 935 F. Supp. 2d 666 (S.D.N.Y. 2013), *vacated on other grounds*, *Gelboim v. Bank of Am. Corp.*, 823 F.3d 759 (2d Cir. 2016).

[32] *Id.* at 696.

[33] *Id.* (internal quotation marks omitted).

[34] *Id.* at 697.

[35] *Id.*

[36] *See* Dodd-Frank Act § 929P; 15 U.S.C. § 78a(a).

[37] Indeed, even the SEC's jurisdiction to regulate overseas transactions under the conduct and effects tests post-DFA is far from certain, due to an apparent drafting error in DFA § 929P. *See SEC v. Chicago Convention Ctr., LLC,* 961 F. Supp. 2d 905 (N.D. Ill. 2013).

[38] *U.S. Commodity Futures Trading Comm'n v. Alcocer*, No. 12-23459-CIV, 2018 WL 3730218, at *4 (S.D. Fla. June 26, 2018).

[39] 7 U.S.C. § 2(i)(1).

[40] Codified at 7 U.S.C. § 2(i)(1).

[41] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45291, 45300 (July 26, 2013) (codified at 17 C.F.R. ch. 1).

this language has not yet been tested in court, the CFTC has noted that, in light of the DFA amendments providing the CFTC with jurisdiction over swaps, the CEA is no longer "silent" with respect to its extraterritorial application.[42] In the CFTC's view, Congress has specified that the CEA *does apply overseas* to swaps activity with a "sufficient nexus" to U.S. commerce.[43]

Practice Note: As discussed in more detail below in Sections III and VII, U.S. laws have significantly broader extraterritorial application than the relevant English laws, which as a rule apply only to instruments trading on an EU market.

Case Study: Increasingly Common Arrests of Foreign Citizens

On September 13, 2017, Andre Flotron, a Swiss citizen and former UBS precious metals trader, was arrested by U.S. authorities while visiting his girlfriend in New Jersey. Flotron was charged with commodities fraud and spoofing of U.S. futures market contracts. After his arrest, Flotron was denied bail pending his transfer to federal court in Connecticut where the charges against Flotron had been filed. This arrest highlighted the U.S. authorities' continued focus on investigating non-U.S. citizens for conduct that impacts U.S. markets. Given the government's continuing interest in prosecuting such offenses, foreign nationals engaged in trading and other forms of international business should be familiar with the substance and extraterritorial scope of U.S. criminal laws.

Flotron worked at UBS's precious metals trading desk in Stamford, Connecticut, where he traded U.S. futures market contracts in gold, silver, platinum, and palladium. The criminal complaint alleged that between July 2008 and November 2013, Flotron fraudulently manipulated the market in precious metals futures contracts, by spoofing and other means. Spoofing involves a trader placing one or more orders on a U.S. regulated exchange market to buy or sell a commodity contract (a futures, options, or swap contract) that the trader intends to cancel before execution of the order. In most cases, the trader will also place genuine opposite orders, which benefit from the price movement resulting from the unexecuted spoof orders. The complaint alleged that Flotron personally engaged in spoofing and also trained other UBS traders on how to spoof markets and engage in other deceptive trading practices.

Flotron's arrest came soon after the resolution of enforcement actions by the DOJ and the CFTC against another precious metals trader who operated overseas. In June 2017, David Liew, a Singapore resident and former Deutsche Bank trader, pled guilty to similar charges of commodities fraud and spoofing. Liew admitted his participation in a conspiracy to manipulate precious metals futures contracts traded on a U.S. commodities exchange while working at the bank's precious metals trading desk in Singapore. As part of the settlement with the U.S. enforcement agencies, Liew is permanently banned from trading in CFTC-regulated markets, which extend far beyond traditional "commodities" to various interest rate, foreign exchange, and credit securitiesproducts.

Other recent cases covering a wide range of sectors demonstrate that foreign nationals, even when operating outside the U.S., may fall within the ambit of U.S. criminal prosecution. U.S. prosecutors' use of sealed indictments, stayed statutes of limitations, and arrest requests to border

[42] *See* CFTC Letter to Clerk of Court, *Loginovskaya v. Batratchenko*, No. 13-1624, at 2 (2d Cir. Sept. 10, 2014).

[43] *Id.*

and overseas authorities suggest that non-U.S. citizens and residents engaged in international business should be aware of the potentially applicable prohibitions of U.S. criminal law. They should stay alert to current prosecutorial priorities as well as to the existence of investigations, which can relate to long-past conduct.

The DOJ is often able to establish jurisdiction despite the fact that the conduct at issue occurred largely, if not entirely, overseas. For example, the broad wire fraud statute criminalizes any scheme to defraud that affects "interstate or foreign commerce," and one may be prosecuted in the United States whenever an electronic communication, such as a telephone call or email, in furtherance of the alleged scheme travels through the United States.

For instance, in January 2017, Oliver Schmidt, a German citizen and former general manager of Volkswagen's U.S. Engineering and Environmental Office, was unexpectedly arrested at Miami International Airport, shortly before he was scheduled to board a flight to Germany. The DOJ charged Schmidt and several other Volkswagen executives with a number of offenses in connection with the Volkswagen emissions scandal, including conspiring to defraud the United States, defraud Volkswagen's U.S. customers, and violate the Clean Air Act. The DOJ argued that the actions of the indicted German executives fell within its jurisdiction because they conspired to impede the U.S. Environmental Protection Agency's ability to implement and enforce emissions standards, sent emails from and to the United States, and intentionally deceived U.S. consumers. On August 4, Schmidt pled guilty to one count of conspiracy to defraud the federal government and one count of violating the Clean Air Act. On December 7, Schmidt was sentenced to seven years in prison.

Similarly, in July 2016, Mark Johnson, a citizen of the United Kingdom and the global head of FX trading at HSBC, was arrested at New York's John F. Kennedy airport while attempting to board a flight to London. Following his arrest, the DOJ unsealed a criminal complaint that had previously been filed in secret against Johnson and one of his colleagues in the U.K., Stuart Scott. The complaint alleged that the defendants conspired to defraud an HSBC client using a scheme commonly known as "front running." While most of the trading activity occurred in London, related trading activity and wires used to settle accounts were routed through New York. Johnson pled not guilty to charges of wire fraud and conspiracy. His case is currently pending in the Eastern District of New York.

In contrast to criminal procedures in some European countries, U.S. federal criminal investigations are typically conducted through a "grand jury" (a group of citizens convened by the prosecutor to hear evidence) and occur in secret, often without notice to or the involvement of individuals under investigation. Likewise, indictments and criminal complaints are usually filed under seal when the defendant is outside of the United States. Indictments may remain sealed indefinitely and are often kept sealed until the defendant is apprehended. In addition, individuals who are arrested and charged with crimes may cooperate or plead guilty in sealed proceedings. The filing of a sealed indictment will pause, or "toll," the expiration of the statute of limitations, which prohibits the prosecution of crimes after a certain period of time (usually five years). The government may also toll the statute of limitations by making a request for information from another nation pursuant to a Mutual Legal Assistance Treaty ("MLAT"), which has become more common in the context of cross-border investigations.

After a criminal charge has been filed against a foreign national, the United States may seek the defendant's extradition. The U.S. has extradition agreements with more than 100 countries around the world. However, some countries will not extradite their own nationals. In the event that the U.S. does not have an extradition treaty with a particular country, or the treaty does not allow for extradition in a particular case, American authorities may seek an INTERPOL "red notice," which typically serves to trigger an alert at border crossings when an individual who is subject to a sealed arrest warrant travels internationally. The U.S. authorities may also wait until a suspect travels to or transits through the United States and then execute the arrest warrant when he or she arrives at the border.

For example, in June 2015, Gregg Mulholland, a dual citizen of the United States and Canada, attempted to fly from Canada to Mexico. When the plane stopped for a brief layover at Phoenix International Airport, F.B.I. agents arrested Mulholland. In a criminal complaint that was unsealed following his arrest, Mulholland was charged with conspiracy to commit securities fraud and money laundering arising from an alleged Belize-based stock manipulation scheme. Mulholland pled guilty to money laundering conspiracy and was ultimately sentenced to 12 years in prison.

While criminal investigations in the U.S generally are conducted in secret, prosecutors typically disclose, when asked, if a particular individual is a "subject" or "target" of an ongoing investigation. Prosecutors do this, among other reasons, to encourage cooperation by individuals under investigation – particularly when those individuals are located outside the subpoena power of the prosecutor. Thus, when there is reason to suspect that an investigation is under way, it is advisable to consult counsel regarding whether and when it may be appropriate to contact U.S. authorities and whether travel to the United States is prudent.

3. CEA Enforcement Methods

As discussed in § II(F) below, alleged violations of the CEA can be enforced by the CFTC, the DOJ, and/or private plaintiffs—most of the time by multiple entities concurrently.

The CFTC is empowered to impose a civil penalty for any violation of the CEA. These penalties were initially set at $1,000,000 (or triple the monetary gain) for (1) intentional manipulation, (2) fraud-based manipulation, and (3) reckless false reporting violations[44] and $140,000 (or triple the monetary gain) for all other CEA violations.[45] However, these amounts are subject to inflation adjustments. With those adjustments, the former maximum fine is now set at $1,191,842 (or triple the monetary gain) and the latter is $165,227 (or triple the monetary gain). The CFTC may also seek a number of other remedies including disgorgement of profits, an asset freeze, a bar or suspension of trading privileges, and other undertakings as part of a settlement.[46]

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[44] 7 U.S.C. § 9(10).

[45] 7 U.S.C. 13a.

[46] *See Remarks of CFTC Director of Enforcement James M. McDonald at the American Bar Association's National Institute on White Collar Crime* (Mar. 6, 2019); Press Release, U.S. Commodity Futures Trading Comm'n, U.S. Commodity Futures Trading Commission Obtains Federal Court Order Freezing Assets of California Commodity Pool Operator Galaxy Resources 2000 LLC and Manager Charles A. Defazio in Fraud Action (Jan. 25, 2006), https://www.cftc.gov/PressRoom/PressReleases/pr5152-06; Press Release, U.S. Commodity Futures Trading

The DOJ can enforce willful violations of the CEA (or CFTC rules or regulations promulgated under the CEA) by seeking punishments of criminal fines of not more than $1 million or imprisonment for not more than 10 years.[47] The DOJ may also bring charges under other federal criminal statutes, including wire fraud, bank fraud, securities and commodities fraud, and attempt or conspiracy to commit securities, commodities, bank, or wire fraud.

The CEA also allows for private rights of action against most individuals or entities who violate the CEA or willfully aid or abet a CEA violation, provided that the plaintiff suffers actual damages and there exists a certain relationship between the plaintiff and the defendant (although strict privity of contract is not required). A large number of civil suits are currently pending, stemming from the benchmark rate investigations that the CFTC and DOJ conducted.

C. Principal CEA Violations

1. Manipulation Violations – Traditional and Newer Fraud-Based Violations

(a) Manipulation and Attempted Manipulation (Traditional)

The prohibition against price manipulation [48] has existed since the CEA's enactment in 1936. Although the CEA has prohibited "manipulat[ing] or attempt[ing] to manipulate the price of any commodity in interstate commerce" [49] for more than 80 years, it does not define "price manipulation," [50] which the CFTC has never defined by any rule or interpretative guidance. Instead, judicial and CFTC precedents established the definition and elements of manipulation. Consistent with an early court decision, the CFTC has recognized that the means of price manipulation "are limited only by the ingenuity of man"[51] and has generally used "case-by-case judicial development" to determine whether certain trading is deemed manipulative. This approach continues to be followed even after the adoption of Rule 180.2, which codified the CFTC's traditional prohibition against price manipulation, in 2011.

Courts have defined manipulation broadly as "any and every operation or transaction or practice . . . calculated to produce a price distortion of any kind in any market either in itself or in relation to other markets. . . . [with] a purpose to create prices not responsive to the force of supply and

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Comm'n, CFTC Imposes a Monetary Penalty and Permanently Bars California Resident Garen Ovsepyan and Forex Trading Advisors Sharpe Signa, LLC and Haeres Capital, LLC from the Commodities Industry (Dec. 7, 2015), https://www.cftc.gov/PressRoom/PressReleases/pr7288-15.

[47] 7 U.S.C. § 13(a)(2).

[48] 7 U.S.C. §§ 9(1), 13(a)(2).

[49] *Id.*

[50] *See In re Ind. Farm Bureau Coop. Ass'n, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, *See In re Ind. Farm Bureau Coop. Ass'n, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, CFTC Docket No. 75–14, 1982 WL 30249, at *3 (Dec. 17, 1982) (explaining that "[n]either manipulation nor attempted manipulation is defined in the Commodity Exchange Act").

[51] *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971).

demand."[52] Manipulation may be accomplished by any means. As the U.S. Court of Appeals for the Eighth Circuit stated in *Cargill, Inc. v. Hardin*:

> We think the test of manipulation must largely be a practical one if the purposes of the [CEA] are to be accomplished. The methods and techniques of manipulation are limited only by the ingenuity of man. The aim must be therefore to discover whether conduct has been intentionally engaged in which has resulted in a price which does not reflect basic forces of supply and demand.[53]

The CFTC established the elements of manipulation in its seminal *Indiana Farm Bureau* decision in 1982.[54] The elements require: (1) that the defendant possessed an ability to influence market prices; (2) that the defendant specifically intended to do so; (3) that an artificial price existed; and (4) that the defendant caused the artificial price. [55] An attempted manipulation is "simply a manipulation that has not succeeded, that is, the conduct engaged in has failed to create an artificial price."[56]

In *Indiana Farm Bureau*, the CFTC addressed the intent requirement for price manipulation in great depth in considering and ultimately dismissing charges that the Indiana Farm Bureau manipulated the price of a corn future contract through a squeeze. According to the CFTC enforcement staff, Indiana Farm Bureau conducted a squeeze in corn prices by standing for delivery on corn futures contracts that allegedly amounted to four times the amount of available deliverable supplies. Over the course of a 39-page opinion, the CFTC considered a variety of policy and economic issues with a particular emphasis on the purposes and operations of the market it regulates and concluded that the "specific intent to create an 'artificial' or 'distorted' price is a *sine qua non* of price manipulation."[57] In particular, it recognized that, "since the self-interest of every market participant plays a legitimate part in the price setting process, it is not enough to prove simply that the accused intended to influence price." In coming to this decision, the CFTC expressed particular concern that a "weakening of the manipulative intent standard" would "wreak havoc with the market place," as a "clear line between lawful and unlawful activity is required in order to ensure that innocent trading activity not be regarded with the advantage of hindsight as unlawful manipulation."[58]

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52 *Volkart Bros., Inc. v. Freeman*, 311 F.2d 52, 58 (5th Cir. 1962) (internal quotation marks omitted).

53 452 F.2d 1154, 1163 (8th Cir. 1971).

54 *In re Ind. Farm Bureau*, 1982 WL 30249.

55 *Id*. at *4.

56 *CFTC v. Enron Corp.*, Civil Action No. H-03-909, 2004 WL 594752, at *7 (S.D. Tex. Mar. 4, 2004) (internal quotation marks omitted).

57 *Id.*

58 *Id.*

With respect to "artificial price," which is not a statutory term, the relevant legal authorities only vaguely define it as a price "clearly outside the 'legitimate' forces of supply and demand."[59] As a practical matter, courts typically look to economic analyses of conduct to determine whether a price was "artificial."

The CFTC had long chafed under this standard and maintained that its enforcement efforts were hampered by the need to establish specific intent and artificiality, neither of which is required under the SEC's principal anti-fraud statute – Exchange Act § 10(b).[60] As discussed further below, the CFTC has attempted to change this standard through rulemaking under Section 6(c) of the CEA, which was added by the DFA. [61] Similarly, in recent enforcement actions, the CFTC's Division of Enforcement claimed that it needs to prove only an intent to "influence price," instead of the intent to cause an "artificial price," to establish that a trader engaging in otherwise lawful open market transactions committed or attempted to commit price manipulation. [62]

Case Study: U.S. Commodity Futures Trading Comm'n v. Donald R. Wilson and DRW Investments LLC

Despite the precedent set by *Indiana Farm Bureau*, the CFTC took a different stance on the intent requirement for price manipulation in *U.S. Commodity Futures Trading Comm'n v. Wilson*.[63] In the enforcement action filed in a New York federal court , the CFTC advocated a theory of price manipulation that turns on the intent of the trader to influence price, rather than the specific intent to create an artificial price.[64]

In November 2013, the CFTC filed an action against DRW Investments, a proprietary trading firm, and its founder and CEO, Donald R. Wilson, alleging that DRW had attempted to manipulate and manipulated an exchange-traded interest rate swap futures contract by placing bids for the purpose of influencing the price of the contract in violation of CEA Sections 6(c) and 9a.[65] Instead of denying that its bids were intended to influence the price of the contract, DRW stated that, after further review and study by its management, the contract was undervalued as a result of the pricing methodology and that DRW traded in a manner to bring the price in line with the fair value. Although it did not allege fraud or deceit, the CFTC claimed that DRW's placement of bids in the

[59] *United States v. Radley*, 659 F. Supp. 2d 803, 814 (S.D. Tex. 2009), *aff'd*, 632 F.3d 177 (5th Cir. 2011); *see also In re Cox*, CFTC Docket No. 75-16, 1987 CFTC LEXIS 325, at *25 (CFTC July 15, 1987) ("An artificial price is one that does not reflect the market or economic forces of supply and demand").

[60] *See, e.g.*, Bart Chilton, Comm'r, CFTC, Speech before the Institutional Investors Carbon Forum: Moment of Inertia (Sept. 15, 2009), www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-26.

[61] *See infra* at Section II(C)(1).

[62] Pl.'s Resp. in Opp'n to Defs.' Mot. for Summ. J., at 29, *CFTC v. Wilson*, No. 13-CV-7884 (S.D.N.Y. filed Sept. 30, 2016), ECF No. 119 (citing *CFTC v. Wilson*, 27 F. Supp. 3d 517, 531-32 (S.D.N.Y. 2014)); Pl.'s Resp. in Opp'n to Defs.' Mot. to Dismiss, at 21, *CFTC v. Kraft Foods Grp., Inc.*, No. 15-CV-2881 (N.D. Ill. filed July 13, 2015), ECF No. 64 (citing *CFTC v. Parnon Energy*, 875 F. Supp. 2d 233, 244 (S.D.N.Y. 2012)).

[63] *CFTC v. Wilson*, 27 F. Supp. 3d 517 (S.D.N.Y. 2014).

[64] *Id.*; *see also CFTC v. Wilson*, No. 13-CV-7884 (S.D.N.Y. filed Nov. 5, 2013); *CFTC v. Kraft Foods Grp., Inc.*, No. 15-CV-2881 (N.D. Ill. filed Apr. 1, 2015).

[65] *Wilson*, 27 F. Supp. 3d at 524-26.

open market to affect price is proof of specific intent to manipulate prices, a position which stands in contrast to *Indiana Farm Bureau*.

In rejecting DRW's motion to dismiss in 2014, the trial court held that DRW's argument, which was that the bids based on subjective belief as to the value of the contract were not intended to cause an artificial price, was factually-disputable.[66] The court applied a short-hand version of the *Indiana Farm Bureau*'s four-part test which requires the CFTC to "allege '(1) that the accused had the ability to influence market prices; (2) that [he] specifically intended to do so; (3) that artificial prices existed; and (4) that the accused caused the artificial prices'" to support a price manipulation claim.[67] In its cross-motion for summary judgment, the CFTC argued that, under the shorthand version, it need only show DRW's intent to influence price[68] and that it has satisfied the intent requirement for price manipulation. DRW challenged the CFTC's requisite intent argument and other various arguments in the CFTC's motion.

The district court accepted an *amicus curiae* brief filed by five key participants in the futures market, which included futures exchanges, clearinghouses, and trade associations. The brief expressed the concern that, under the CFTC's looser interpretation of the requisite intent, there may be no way "to ensure that innocent trading activity not be regarded with the advantage of hindsight as unlawful manipulation," the exact issue that led the CFTC to require a showing of specific intent to create artificial prices in *Indiana Farm Bureau*. Because the CFTC sought to punish *all* attempted price influences, even ones that would result in more accurate prices, the *amici* feared that traders may "abstain from legitimate trading to avoid the risk of being branded an attempted manipulator."

In September 2016, the court agreed with the defendant and the *amici* and held that the "CFTC's interpretation is incorrect" and that the CFTC must prove specific intent to cause artificial prices.[69] It rejected the CFTC's argument that a trader can be guilty of attempted price manipulation based on futures contract orders entered with the intent to merely influence prices. The trial concluded in December 2016 and a decision remains pending.

In December 2018, Judge Sullivan rejected the CFTC's manipulation and attempted manipulation claims in a strongly-worded decision. The Judge characterized the CFTC's posiiton as "little more than an 'earth is flat'-style conviction."[70] Concluding instead that DRW committed no offence because "[i]t is not illegal to be smarter than your counterparties in a swap transaction, nor is it improper to understand a financial product better than the people who invented that product."[71]

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66 *Id*. at 533.

67 *Id.* at 532 (quoting Parnon Energy, 875 F. Supp. 2d at 244, 249).

68 Pl.'s Resp. in Opp'n to Defs.' Mot. for Summ. J., at 29, *CFTC v. Wilson*, 13-CV-7884 (S.D.N.Y. Sept. 30, 2016), ECF No. 119 (citing *Wilson*, 27 F. Supp. 3d at 531-32).

69 *Wilson*, 27 F. Supp. 3d at 533.

70 *U.S. Commodity Futures Trading Comm'n v. Wilson*, 2018 WL 6322024, *21 (S.D.N.Y. Nov. 30, 2018).

71 *Id.* at *21.

Ruling on the CFTC's manipulation claim, the court rejected the CFTC's expert's opinion that DRW's bids were necessarily illegitimate because DRW was the only participant placing bids on the contract, which necessarily "created artificial settlement prices" as "absurd."[72] Instead, the Court found that DRW placed bids based on its understanding of the contract, which "actually contributed to price discovery."[73] The Court went on to describe the CFTC's argument that any price that was influenced by DRW's conduct was necessarily artificial as a "tautological fallback" before rejecting it for effectively eliminating the artificial price requirement and "collapsing it into the subjective intent requirement."[74] According to the Court, such a rule would "effectively bar market participants with open positions from ever making additional bids."[75]

The Court also made short-shrift of the CFTC's attempted manipulation allegations. According to Judge Sullivan, "trial testimony and exhibits prove[d] beyond the shadow of a doubt that Defendants sincerely believed the value of the [exchange traded-contract] was higher than the bids they submitted."[76] Based on this belief, the Court concluded that DRW "made bids with an honest desire to transact at those prices, and that they fully believed the resulting settlement prices to be reflective of the forces of supply and demand."[77] As Judge Sullivan put it, because the "trading pattern is supported by a legitimate economic rationale, it 'cannot be the basis for liability under the CEA.'"[78] "Any other conclusion would be akin to finding manipulation by hindsight."[79]

The court's rejection of the CFTC's new stance on intent, should provide some comfort to market participants concerned with the CFTC's more aggressive recent approach to price manipulation, as the CFTC must now provide evidence that there was an actual intent to create an artificial price rather than an intent to influence price. This will undoubtedly also make it more difficult for the CFTC successfully prosecute Rule 180.2 price manipulation cases, which are likely to turn on expert evidence. As a result, we expect that the CFTC will appeal this ruling, as well as, the court's earlier summary judgment ruling to reassert its authority to bring Rule 180.2 cases based on this theory.

Following the decision, on December 3, 2018, CFTC Chair Christopher Giancarlo released a statement noting that the CFTC was "reviewing the decision and will analyze it carefully in considering next steps." That review concluded on February 27, 2019, when the CFTC announced that Chair "Giancarlo has decided that the agency will not appeal the district court's decision." This announcement may signal that the CFTC may attempt to avoid this precedent by pursuing similar theories of liability under its Rule 180.1 authority added pursuant to certain Dodd-Frank Act related statutory amendments. In particular, the CFTC's pending case against Kraft Foods in

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72 *Id.* at *13.

73 *Id.* at *14.

74 *Id.* at *14.

75 *Wilson*, 2018 WL 6322024 at *14-15.

76 *Id.* at *15.

77 *Id.* at *20.

78 *Id.* at *20 (quoting *In re Amaranth*, 587 F. Supp. 2d 523, 527 (S.D.N.Y. 2008).

79 *Id.* at *20.

Chicago federal court suggests that the CFTC will seek to prosecute market participants for conduct when it can be established that the purpose was to influence price or even that the market participant was reckless in regard to price impact, irrespective of whether any fraudulent or deceptive statement was made.[80] Nevertheless, while we expect that the CFTC may try to allege a Rule 180.1 violation when bringing future cases, rather than relying upon the now-limited Rule 180.2, the Court's rationale in requiring both the existence of an artificial price and the trader's intent to create an artificial price is likely to be persuasive in such cases, given the well-established requirement that the specific intent to create an artificial or distorted price is essential for finding price manipulation in cases premised on open market transactions.[81]

Example Case: *In re Statoil ASA*, CFTC Docket No. 18-04 (Nov. 14, 2017)

In November 2017, the CFTC settled attempted manipulation charges in violation of CEA § 9(a)(2)with Statoil ASA, an international energy company headquartered in Norway, alleging that Statoil attempted to manipulate the Argus Far East Index in order to benefit its physical and financial positions, including its NYMEX-cleared over-the-counter swaps which settled to that index, from October through November of 2011. According to the CFTC, Statoil violated CEA Section 9a by allegedly making efforts to prop up the Index by purposefully purchasing propane cargoes during the November Index propane price-setting window, hoping to signal that the demand was high and put upward pressure on the November Index propane price. The CFTC found Statoil's intent to manipulate the Index in contemporaneous communications, which allegedly discussed Statoil's "strong position" and "good insight" in the "direction of the November quote in Argus" and the likelihood of making "a good impact on the Argus quote" to "move it quite a bit up as [it kept] buying (during the time period in which a monthly price was calculated)." While the Order of Settlement recognizes that, the attempted manipulation was not successful due to the depth of the propane market.

Without admitting to or denying the allegations, Statoil agreed to pay a $4 million civil monetary penalty, which is relatively small for manipulation or attempted manipulation by an entity over several years. Despite the order's issuance following the rollout of the CFTC's new cooperation standards, the order did not reference the respondent's cooperation.

(b) Fraud-Based Manipulation ("Reckless" Manipulation)

The DFA significantly expanded the scope of the CFTC's jurisdiction under CEA § 6(c) (which historically has been interpreted as prohibiting the intentional creation of artificial prices) to cover

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[80] For further discussion of this topic, please review Anthony Candido, *Freedom to Trade in the Age of Heightened Market Protection*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (April 3, 2016), *available at* https://corpgov.law.harvard.edu/2016/04/03/freedom-to-trade-in-the-age-of-heightened-market-protection/.

[81] For further information on this topic, please review *U.S. Market Manipulation: Has Congress Given the CFTC Greater Latitude than the SEC to Prosecute Open Market Trading as Unlawful Manipulation? It's Doubtful*, 38 Futures and Derivatives Law Report 38 (June 2018), *available at* https:/www.cliffordchance.com/content/dam/cliffordchance/PDFDocuments/FDLR_6_Art_1.pdf.

(1) "fraud-based" manipulation, including (a) reckless manipulation and (b) insider trading, and (2) manipulation by false reports. The new § 6(c)(1) states:

> It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate.[82]

The DFA also expanded the CEA section that criminalizes manipulation to apply to swaps, prohibiting "[a]ny person [from] manipulat[ing] or attempt[ing] to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or of any swap."[83]

Based on the DFA amendments, the CFTC finalized its new rules for manipulation – Rules 180.1 and 180.2 – in July 2011.[84] According to the CFTC, Rule 180.1 broadly prohibits "intentionally or recklessly" using or attempting to use any manipulative device, scheme, or artifice to defraud. It also prohibits intentionally or recklessly (1) making or attempting to make any untrue or misleading statement of a material fact or omitting to state a material fact necessary in order to make the statement made not untrue or misleading, and (2) engaging or attempting to engage in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person.[85]

Where no material misrepresentations or omissions exist, to establish a fraud-based manipulation claim, the CFTC takes that position that it may merely show that the defendant acted at least recklessly to create an artificial price – i.e., the defendant recognized the danger of or was willfully blind to the creation of artificial prices and exhibited indifference to price consequences.

According to the CFTC, it may charge manipulation under Rule 180.1 by pointing to the "recklessness" scienter standard rather than specific intent, which is required for traditional manipulation as established in *Indian Farm Bureau*. [86] Thus the CFTC has stated that "a showing of recklessness is, at a minimum, necessary to prove the scienter element of final Rule 180.1," and recklessness is defined as "an act or omission that 'departs so far from the standards of ordinary care that it is very difficult to believe the actor was not aware of what he or she was doing.'"[87]

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82 7 U.S.C. § 9(1).

83 7 U.S.C. § 13.

84 CFTC Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 17 C.F.R. §§ 180.1-180.2 (2011).

85 *Indiana Farm Bureau*, 1982 WL 30249, at *4-6.

86 *Id.*

87 CFTC Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 17 C.F.R. §§ 180.1-180.2 (2011).

As discussed further below, the CFTC's position on recklessness is open to question. The CFTC has previously stated that, because the "language of CEA section 6(c)(1), particularly the operative phrase 'manipulative or deceptive device or contrivance,' is virtually identical to the terms used in section 10(b) of the Securities Exchange Act of 1934,"[88] it "deems it appropriate and in the public interest to model final Rule 180.1 on SEC Rule 10b-5," and to " be guided, but not controlled, by the substantial body of judicial precedent applying the comparable language of SEC Rule 10b-5."[89] Relevant case law in the Rule 10b-5 context recognizes that § 10(b) and Rule 10b-5 target both deception *and* manipulation in the securities markets, and courts only apply a scienter of recklessness to claims of "deception" in the securities markets (i.e. cases concerning misrepresentations or omissions of material information capable of influencing security prices) and not manipulation, which requires specific intent. [90] To date, courts have neither clearly delineated the lower boundary of the intent standard nor reconciled the differences in the two standards with respect to Rule 180.1.

However, the CFTC has recently taken the view that, because CEA section 6(c)(1) prohibits manipulative devices in addition to deception, it is a market manipulation provision as opposed to simply an anti-fraud provision.[91] Based on this theory, the CFTC argued in at least one recent case that it did not need to meet the heightened pleading standard requiring claims of fraud to be plead with particularity provided in Federal Rule of Civil Procedure 9(b) because its self-described prohibition on "fraud and fraud-based manipulation"[92] prohibits both fraud and any other form of manipulation.

The court in that case rejected this argument, holding that "based upon the plain language of the Act and [Rule] 180.1" and comparisons to "the well-established reading of the Securities Exchange Act of 1934," Rule 180.1 "prohibits only fraudulent conduct."[93] Thus, to establish manipulative conduct under Rule 180.1, a plaintiff must show "what manipulative acts were performed, which defendants performed them, when the manipulative acts were performed, and what effect the scheme had on the market for the commodities at issue."[94]

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88 *Id.*

89 *Id.* (emphasis added).

90 *See, e.g.*, *Cent. Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 178 (1994) (Section 10(b) prohibits "the making of a material misstatement (or omission) *or* the commission of a manipulative act." (emphasis added)); *see also Santa Fe Indus. v. Green*, 430 U.S. 462, 474 (1977) (holding that conduct at issue did not violate section 10(b) because it "was neither deceptive *nor* manipulative" (emphasis added)). *See, e.g.*, *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (finding a violation of 10(b) where defendants recklessly omitted material facts about the performance and financial condition of a company that was part of a possible merger deal); *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 704 (7th Cir. 2008) (scienter of recklessness sufficient when defendants issued six fraudulent press releases in violation of 10(b) and Rule 10b-5).

91 Codified at 7 U.S.C. § 9(1).

92 CFTC Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 17 C.F.R. §§ 180.1-180.2 (2011).

93 Complaint, *CFTC v. Kraft Foods Grp., Inc.*, No. 15-CV-2881 (N.D. Ill. filed July 13, 2015).

94 *CFTC v. Kraft Foods Grp.*, 153 F. Supp. 3d 996, 1012 (N.D. Ill. 2015).

Analysis: Judicial Interpretation of Rule 180.1.

Although not discussed in the CFTC's CEA section 6(c)(1) implementing rulemaking process, for decades, courts have extensively interpreted Exchange Act section 10(b), upon which CEA section 6(c)(1) is patterned, and have long recognized that the statute separately prohibits two distinct types of misconduct: "manipulative devices" and "deceptive devices." Accordingly, courts have applied appropriately-tailored standards for establishing a violation for these distinct species of wrongdoing, including variations on what level of scienter is required for each form of section 10(b)-prohibited misconduct. Congress is presumed to have known of these court decisions when it imported section 10(b) language into the CEA.[95]

As the Supreme Court first explained in its 1977 *Santa Fe Industries, Inc. v. Green* decision, section 10(b) prohibits two distinct types of misconduct in the securities markets (deception or manipulation). Building upon the Supreme Court's guidance, the several federal appellate courts examining this issue have required different standards of proof for intent as to each type of misconduct. These courts only apply a scienter of recklessness to claims based upon deception, and not to manipulation claims premised on open market transactions. Conversely, these courts have unanimously confirmed the applicability of a specific intent requirement in cases concerning alleged open market securities manipulations accomplished through otherwise bona fide open market transactions. For example, in *Markowski v. S.E.C.*, the D.C. Circuit Court of Appeals affirmed an SEC finding of manipulation under section 10(b) based on an underwriter's over-bidding and buying up of undersubscribed securities it had underwritten. The *Markowski* court acknowledged that, absent "fictitious transactions," liability for manipulation under section 10(b) depends "entirely on whether the investor's intent was 'solely to affect the price of [the] security.'" In *ATSI Communications, Inc. v. Shaar Fund, Ltd.*, the Second Circuit recognized that, in some circumstances, a trader's intent "is the only factor distinguishing legitimate trading from manipulation." And in *Sullivan & Long, Inc. v. Scattered Corp.*, the Seventh Circuit held that a defendant's "massive short selling" of stock in a bankrupt company—including naked short-selling of more shares than existed—was not "manipulative" under section 10(b) because it was not done for the purpose of "fool[ing] the market" into believing there was "a lot of buying interest in the stock." These well-established principles inform the "manipulative or deceptive device" term of art that Congress intended to embed in CEA section 6(c)(1), and demonstrate that specific intent is required to establish a violation under the manipulation prong.

In May 2018, a California federal district court rejected the CFTC's proffered interpretation of section 6(c)(1) that would have permitted the CFTC to pursue fraud in the absence of market manipulation under that provision.[96] In so doing, the court looked to the legislative history of section 6(c)(1) and courts' treatment of Exchange Act section 10(b) in an attempt to interpret section 6(c)(1) in a "holistic manner." [97] The court interpreted the phrase "manipulative or deceptive" to require the presence of both manipulative and deceptive conduct and concluded that

[95] *Morissette v. United States*, 342 U.S. 246, 263 (1952) ("[W]here Congress borrows terms of art it …presumably knows and adopts the cluster of ideas that were attached to each borrowed word.").

[96] *U.S. Commodity Futures Trading Comm'n v. Monex Credit Co.*, No. 8:17-cv-1868 at *15 (C.D. Cal. May 1, 2018), ECF 191.

[97] *Id.* at *15. (internal citation and quotation omitted).

section 6(c)(1) only prohibits "fraudulent manipulation." While the California federal court's interpretation and conclusion do not go directly to the scienter requirements for bona fide open market based manipulation, and furthermore may be of questionable durability, the decision makes clear that federal courts are not bound to follow the CFTC's interpretation of its section 6(c)(1) anti-manipulation authority, including the intent required to sustain a violation.[98]

Case Study: *In re JPMorgan Chase Bank, N.A.*, CFTC No. 14-01 (Oct. 16, 2013)

In *In re JPMorgan Chase Bank, N.A.*,[99] also known as the "London Whale" matter, the CFTC used Rule 180.1 for the first time to penalize JPMorgan for reckless manipulation.

The CFTC found that JPMorgan recklessly employed manipulative devices in connection with a particular type of credit default swap ("CDX") by selling large volumes of the CDX (roughly 15% of the net market volume that month) on the last day of the month. The sales caused the price of the CDX to fall, thereby increasing the value of JPMorgan's short protection position. The CFTC found that such conduct constituted a manipulative device.

As to scienter, because it was "very difficult to believe that the JPMorgan traders were not aware of the possible consequences of selling enormous volumes of [the CDX] in a concentrated period at month end," the CFTC found that the traders acted "with reckless disregard to obvious dangers to legitimate market forces from their trading." Thus, it concluded that, regardless of whether JPMorgan "intended to create or did create an artificial price," its trading conduct nevertheless "interfered with the free and open markets to which every participant is entitled."

The London Whale settlement was the CFTC's first enforcement action utilizing Rule 180.1(which had not yet been interpreted or applied in any court previously). The settlement order represented an expansive reading of the CFTC's power to control market conduct, seemingly placing traders at risk of liability whenever they have reason to believe an otherwise legitimate transaction may have some impact on price (as all transactions have the potential to do). JPMorgan agreed to pay a $100 million civil monetary penalty.

It is worth noting that the CFTC used Rule 180.1 to target trading to defend price rather than to police trading conduct intended to deceive a market. Indeed, the JPMorgan swap transactions at issue were conducted not on a centralized exchange, but rather on a bilateral, over-the-counter basis, in a market where other traders (such as hedge funds) became aware of JPMorgan's large position and took aggressive, opposite positions to put pressure on price (arguably itself a Rule 180.1 violation given CFTC's broad reading).[100] The CFTC's approach in penalizing JPMorgan for defending itself against such predatory trading seems to stand in stark contrast to the SEC's recognition that, in some circumstances, defense of price is a legitimate goal.

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98 *See id.* at *14.

99 CFTC Docket No. 14-01 (Oct. 16, 2013).

100 *See, e.g.*, Azam Ahmed, *The Hunch, the Pounce and the Kill: How Boaz Weinstein and Hedge Funds Outsmarted JPMorgan*, N.Y. TIMES (May 26, 2012), http://www.nytimes.com/2012/05/27/business/how-boaz-weinstein-and-hedge-funds-outsmarted-jpmorgan.html?ref=economy.

The London Whale settlement also emphasized the differences between Rule 180.1 and Rule 10b-5. The SEC has recognized certain limited circumstances in which it is appropriate for particular market participants to trade for the purpose of influencing the market price of a security – conduct which would otherwise be considered fraudulent or manipulative under the Exchange Act. For example, underwriters, brokers, and dealers participating in some types of securities offerings are permitted, under certain conditions, to execute transactions in order to "stabilize" (that is, to stop or slow the decline of) the market price of the security to facilitate the offering.[101] The SEC acknowledged that stabilizing "is price-influencing activity intended to induce others to purchase the offered security," but the agency permits such trading as a means of "fostering an orderly distribution," a goal that the SEC deems sufficiently worthy to merit some exception to liability for trading intended to impact price.[102] In contrast, as shown by the London Whale settlement, the CFTC has not identified analogous "defense of price" exceptions to the anti-fraud or anti-manipulation provisions of the CEA.

(c) False Reporting-Based Manipulation

False reporting has long been recognized as a means of accomplishing traditional manipulation[103] and pursuant to CEA Section 6b it was an offense under the CEA.[104] The DFA, however, created a new provision for "manipulation by false reporting," which treats a false report made while "knowing or acting in reckless disregard" of the fact that the report is false as manipulation. Section 6(c)(1)(A) of the CEA states:

> SPECIAL PROVISION FOR MANIPULATION BY FALSE REPORTING.— Unlawful manipulation for purposes of this paragraph shall include, but not be limited to, delivering, or causing to be delivered for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate.[105]

This provision has been implemented through the CFTC's new manipulation rule, Rule 180.1, which provides an exception to liability if one "mistakenly transmits, in good faith, false or misleading information to a price reporting service."[106]

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[101] Stabilizing and Other Activities in Connection with an Offering, 17 C.F.R. § 242.104 (2013).

[102] Final Rules: Anti-manipulation Rules Concerning Securities Offerings, 62 Fed. Reg. 520, 535 (Jan. 3, 1997) (codified at 17 C.F.R. pts. 200, 228, 229, 230, 240, and 242).

[103] *See, e.g., Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971) ("[O]ne of the most common manipulative devices [is] the floating of false rumors which affect futures prices.").

[104] 7 U.S.C. § 13(a)(3).

[105] 7 U.S.C. § 9(1)(A).

[106] U.S. Commodity Futures Trading Comm'n, Rule 180.1(a)(4).

Under the CEA, the elements for a claim of false reporting are: "(1) that a defendant knowingly delivered market reports or market information through interstate commerce; (2) that the information was knowingly false or misleading; and (3) that the information affected or tended to affect the price of a commodity in interstate commerce."[107]

As written, false reporting under this section requires a *knowing* violation. "[T]he knowledge requirement of the reporting prong of [9(a)(2)] applies to the false or misleading character of the reports, as well as to delivery and inaccuracy."[108]

Although the text of the new provision does not vary greatly from the preexisting provision, false reporting is now classified as manipulation, and the CFTC may therefore seek the higher penalties. Moreover, this change may have also rendered the preexisting false reporting provision obsolete. In particular, because the new provision can be enforced criminally by making the same showing of willfulness that is required under the preexisting provision and because false reporting is now classified as manipulation, there is now also a broader private right of action for false reporting.[109]

Example Case: *U.S. Commodity Futures Trading Comm'n v. Atha*, 420 F. Supp. 2d 1373 (N.D. Ga. 2006)

Paul Atha was a natural gas trader for Mirant America's Energy Marketing, L.P., which bought and sold natural gas for profit and employed traders who engage in transactions for the physical delivery of natural gas. The CFTC alleged that Atha and others violated CEA Sections 6(c), 6(d), and 9(a)(2) by knowingly submitting false transaction information for natural-gas transactions to companies that calculate natural gas price indexes, including *Inside FERC*, *Gas Daily*, and *Natural Gas Intelligence*. The reported information allegedly included fabricated price and volume information for natural gas transactions entered into for delivery at a specific location or hub. The CFTC further alleged that, had it been successful, the attempted manipulation could have affected the price of natural gas and the price of natural gas futures and options contracts traded on the New York Mercantile Exchange. Without admitting or denying, Atha agreed to a settlement based on charges of attempted manipulation, false reporting, and aiding and abetting, pursuant to which it paid a civil monetary penalty of $200,000 and was barred from trading on commodity markets.[110]

(d) New CFTC Rule for Traditional Manipulation

The CFTC's Rule 180.2 mirrors the text of the CFTC's traditional manipulation provision, as now stated in new CEA § 6(c)(3), and provides that "[i]t shall be unlawful for any person, directly or

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[107] *CFTC v. Atha*, 420 F. Supp. 2d 1373, 1380 (N.D. Ga. 2006) (citing *United States v. Valencia*, 394 F.3d 352, 356 (5th Cir. 2004), *cert denied*, 544 U.S. 1034 (2005)); 7 U.S.C. § 13(a)(2).

[108] *United States v. Valencia*, 394 F.3d at 357; 7 U.S.C. § 9(a)(2).

[109] *See infra* § II(E)(3).

[110] *See also CFTC v. Reed*, 481 F. Supp. 2d 1190 (D. Colo. 2007) (false natural-gas transaction data submitted to industry reporting firm); *United States v. Futch*, 278 F. App'x 378 (5th Cir. 2008) (false report of natural-gas trade submitted to *Inside FERC*).

indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity."[111]

In its adopting release, the CFTC stated that it will be guided by the traditional four-part test for manipulation developed in cases arising under CEA §§ 6(c) and 9(a)(2) when applying Rule 180.2.[112]

As discussed above, the artificial price element of this test had stymied the CFTC in previous prosecutions because of the difficulty in proving that an artificial price existed.[113] However, at least one decision applying Rule 180.2 suggests that this long-standing test, which turned on an objective analysis of overall supply and demand factors to determine if artificial price has been created, is being condensed into a three-part test in practice, turning principally on the defendant's state of mind.

Case Study: U.S. Commodity Futures Trading Comm'n v. Kraft Foods Grp., Inc., 2015 WL 9259885 (N.D. Ill. Dec. 18, 2015)

In *Kraft*, the CFTC's principal allegation was that Kraft used its position as a large commercial user of wheat to manipulate cash wheat prices and wheat futures prices, which are related but separate markets, for its financial benefit in violation of Rule 180.2.

The CFTC alleged that Kraft's scheme was related to the wheat supply for its mill in Toledo, Ohio which required purchase of wheat that met the FDA milling requirements for baking and human consumption. Due to the FDA requirements, Kraft would typically purchase cash market wheat from sources in the Toledo region and typically could not use wheat procured from the CBOT which was typically from locations south of Toledo, where it needed to be barged before it could be transferred to rail. Due to these constraints, Kraft had last taken delivery of CBOT wheat in 2002 prior to Fall 2011.

However, in 2011, Kraft allegedly engaged in a strategy whereby it would purchase long wheat futures contracts in excess of its immediate supply needs to induce sellers to believe that Kraft would take delivery of large amounts of wheat through the futures market. According to the CFTC complaint, Kraft reacted to escalating prices in the high-quality cash wheat market it normally used to supply its commercial operations by uneconomically purchasing an "enormous" quantity of lower quality wheat futures and taking delivery of the related warehouse receipts. In October 2011, Kraft procurement staff allegedly recommended buying $90 million of CBOT wheat futures to depress the cash-market wheat price and increase the futures price, while a Kraft executive acknowledged that the conduct was intended to affect price. Kraft executives approved the request to purchase $90 million in wheat futures but required that the position could not exceed $50 million by the end of December.

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[111] 17 C.F.R. § 180.2.

[112] 7 U.S.C. §§ 9(1)(A), 13(a)(2).

[113] Because of this difficultly, although the CFTC has settled a number of cases, it did not have a successful prosecution for market manipulation until 2009. *See* Chilton, *supra* note 60.

The complaint further alleged that Kraft never intended – and did not actually – load out and use most of this futures market wheat. Instead, Kraft allegedly intended for other market participants to react to the enormous size of the futures position, resulting in reduced cash market prices that allowed Kraft to purchase its favored cash market wheat at lower prices while profiting from certain pre-existing wheat futures spread positions at the same time. According to the CFTC, Kraft did not have a *bona fide* need for $90 million in wheat, which would constitute a six-month supply; ultimately procured a long position of $93.5 million or 15.75 million bushels, which constituted 87% of the open interest in December wheat futures on December 7, 2011; and took delivery of only 660,000 bushels of wheat, less than 5% of the wheat position it carried in early December. On December 2, 2011, a Kraft executive confirmed that the strategy had worked as planned, having narrowed the December–March future spread and reduced the cash wheat price by 30 cents. The CFTC estimated that Kraft was set to make a profit of $5.4 million, including decreased costs of wheat near its Ohio plant.

In applying the four-part test at the motion to dismiss stage, the court focused on the following allegations: (i) Kraft had the ability to influence price because it was a large wheat consumer holding a large position and intentionally sent false signals to the market;[114] (ii) "the prices created by those actions were artificial because Kraft's actions were not taken due to a legitimate demand," but rather due to its desire to influence price; [115] (iii) the CFTC adequately alleged causation through circumstantial evidence, price changes in the markets, and Kraft's internal communications regarding the purpose and effectiveness of its strategy;[116] and (iv) the internal strategy e-mails and Kraft's uneconomic market behavior showed Kraft's intent to influence price.[117] In doing so, Judge Blakey's decision looked at Kraft's intent as key in determining whether the CFTC had met its pleading burden for each element.

Accordingly, the *Kraft* decision suggests that a Rule 180.2 manipulation action can, in practice, be supported by allegations that a trader: (1) possessed the ability to influence price; (2) intended to influence price; and (3) did influence price. This formulation rests on the theory that an action intended to influence price is not a legitimate factor of supply and demand and that any resulting price is *ipso facto* an artificial price.[118] Thus, the need to prove by extrinsic economic analysis, as well as potentially complex and conflicting expert views, that prices were artificial is essentially replaced by mere proof of a trader's intent to influence prices. In other words, because the CFTC adequately pleaded that Kraft intended to and did affect price, it adequately pleaded a violation of Rule 180.2.

In July 2016, Judge Blakey denied Kraft's motion for interlocutory appeal. Trial in this case is scheduled for March 2019.

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[114] *U.S. Commodity Futures Trading Comm'n v. Kraft Foods Group, Inc., et al.*, No. 1:15-CV-02881, 2015 WL 9259885 at *16 (N.D. Ill. Dec. 18, 2015).

[115] *Id.* at *19.

[116] *Id.*

[117] *Id.* at *17.

[118] *Id.* at *19.

In a parallel private litigation in a separate Chicago federal court, in June 2016 the judge rejected Kraft's motion to dismiss, finding the allegations that Kraft used its market power to "intentionally and knowingly deceive[] the market" to be sufficient to state a claim for manipulation.[119] But because the court found that the plaintiff's allegations contained "more than enough concrete facts to support his contention that Kraft intentionally and knowingly deceived the market," the court did not analyze the distinction in requisite intent standards for violations stemming from inherently deceptive conduct that affects price, as opposed to bona fide market actions that, may constitute manipulation due to the actor's intent to affect price.[120] Confusing the matter more, while the court acknowledged that "fraud . . . requires intent to manipulate or deceive," which appears "incongruous" with a recklessness scienter requirement under section 6(c)(1), the court then cited to non-manipulation securities cases in finding that "reckless disregard of the truth counts as intent under" section 10(b) and Rule 10b-5.[121]

2. Disruptive Trading Practices on Exchanges

The DFA added § 4c(a)(5) to the CEA, which creates an explicit prohibition on any trading, practice, or conduct (including trading, practice, or conduct related to swaps) on or subject to the rules of a registered entity (that is a CEA registered exchange or swap execution facility) that:

1. Violates bids or offers;
2. Demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
3. Is of the character of, or is commonly known to the trade as, "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution).[122]

Prior to the DFA, each of the above trading practices may have been actionable as a manipulation violation, but manipulation has historically been difficult for the CFTC to prove. The new DFA section, however, allows the CFTC to sanction the same conduct without having to satisfy the four-part test for proving manipulation.

(a) Exchange Reactions: CME, CBOT, NYMEX, and COMEX Rules

In August 2014, the CME, CBOT, NYMEX, and COMEX adopted a new rule, Rule 575, which was derived, in part, from the above section of the CEA. Under the Rule, all orders "must be entered for the purpose of executing bona fide transactions." The following conduct is prohibited:

1. Orders entered with the intent, at the time of entry, of cancelling the order.

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[119] *Ploss v. Kraft Foods Group, Inc.*, 197 F. Supp. 3d 1037, 1056 (N.D. Ill. 2016).

[120] *Id.* at 1059.

[121] *Id.* at n.10 (citations and quotations omitted).

[122] 7 U.S.C. § 6c(a)(5).

2. Entering actionable or non-actionable messages with the intent to: (i) mislead other market participants; or (ii) overload, delay or disrupt the Exchange or other market participants.

3. Entering actionable or non-actionable messages with the intent to disrupt orderly conduct of trading or the fair executions of transactions. Entering messages with reckless disregard for the adverse impact on orderly trading or execution is also sufficient to show a violation of this Rule.

(b) ICE Rules

In December 2014, ICE adopted Rule 4.01, which also prohibits disruptive trading practices. The Rule prohibits the same conduct as Rule 575 but also prohibits knowingly entering bids or offers "for the purpose of making a market price which does not reflect the true state of the market."

(c) Interpretative Guidance: The Reach of § 4c(a)(5)

The CFTC published an Interpretive Statement regarding disruptive trading practices in May 2013.[123] The Interpretive Statement clarified that 4c(a)(5) applies to any trading, practices, or conduct on a registered entity (including designated contract markets and swap execution facilities), except for block trades or exchanges for related positions.

(d) Interpretative Guidance: Violations of Bids or Offers

Violating a bid means buying a contract at a price that is higher than the lowest available price offered in the market. Violating an offer means selling a contract for a price that is lower than the highest available price bid in the market.[124]

The CFTC interprets § 4c(a)(5)(A) as a *per se* offense, and thus, it is not required to show that a person violating bids or offers did so with any intent to disrupt fair and equitable trading. However, the CFTC does not intend to exercise its discretion to bring an enforcement action against a person who, purely by accident, makes a one-off trade in violation of § 4c(a)(5)(A).

The CFTC has stated that § 4c(a)(5)(A) does not apply where a person is unable to violate a bid or offer (*i.e.*, when a person is utilizing an electronic trading system in which algorithms automatically match the best bid and offer). With respect to the SEFs, the CFTC interprets § 4c(a)(5)(A) as:

1. Inapplicable, unless a person is using an SEF's "order book," and particularly inapplicable when using other execution methods such as the RFQ system. The CFTC noted that market participants may consider a number of factors in addition to price when trading less liquid swaps, which are more likely to be traded on an SEF's RFQ system. However, the Commission noted it may revisit these issues as the SEFs and swaps markets evolve.

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[123] *See* Antidisruptive Practices Authority, 78 Fed. Reg. 31,890 (May 28, 2013).

[124] 7 U.S.C. § 6c(a)(5)(A); Antidisruptive Practices Authority, 78 Fed. Reg. 31,890 (May 28, 2013).

2. Inapplicable to non-cleared swap transactions, even if they are transacted through a registered entity. This is because in such swap transactions, the parties may consider considerations other than price (including counterparty risk) when determining how to best execute their trades.

3. Inapplicable to bids or offers on swaps that would be cleared at different clearing houses because each clearing house may have different cost, risk, and material clearing features.

4. Inapplicable to creating any sort of best execution standard across multiple trading platforms and markets; rather, a person's obligation to not violate bids or offers is confined to the specific trading venue which he or she is utilizing at a particular time.

5. Inapplicable where an individual is "buying the board"—that is, executing a sequence of trades to buy all available bids or offers on that order book in accordance with the rules of the facility on which the trades were executed.

6. But applicable and prohibiting any person from buying a contract at a price that is higher than the lowest available offer price and/or selling a contract at a price that is lower than the highest available bid price.

(e) Interpretive Guidance: Reckless Disregard for Orderly Execution During the Closing Period

In the view of the CFTC, Congress's inclusion of a scienter requirement means that accidental, or even negligent, trading conduct and practices will not suffice for a claim under § 4c(a)(5)(B); rather, a market participant must at least act recklessly. The CFTC has declined to interpret § 4c(a)(5)(B) as requiring either "extreme recklessness" or "specific intent" and instead interprets "recklessness" as conduct that "departs so far from the standards of ordinary care that it is difficult to believe the actor was not aware of what he or she was doing."[125]

The CFTC interprets the closing period to include the time period in which a daily settlement price is determined; the expiration day for a futures contract; and any period of time in which the cash-market transaction prices for a physical commodity are used in establishing a settlement price for a futures contract, option, or swap. In addition, the CFTC's policy is that conduct outside the closing period may disrupt orderly execution of transactions during the closing period and thus may form the basis of a § 4c(a)(5)(B) violation when a market participant accumulates a large position in a product or contract in the period immediately preceding the closing period with the intent (or reckless disregard) to disrupt the orderly execution of transactions during the closing period.

With respect to swaps executed on a SEF, a swap will be subject to the provisions of § 4c(a)(5)(B) if a closing period or daily settlement price exists for the particular swap.

[125] 7 U.S.C. § 6c(a)(5)(B); *see* Antidisruptive Practices Authority, 78 Fed. Reg. 31,890 (May 28, 2013).

Section 4c(a)(5)(B) violations will include executed orders as well as any bids and offers submitted by individuals for the purposes of disrupting fair and equitable trading.

The CFTC will consider all of the relevant facts and circumstances in determining whether a person violated § 4c(a)(5)(B). The CFTC will evaluate the facts and circumstances as of the time the person engaged in the relevant trading, practices, or conduct (*i.e.*, the CFTC will consider what the person knew, or should have known, at the time he or she was engaging in the conduct at issue).

The CFTC will use existing concepts of orderliness of markets when assessing whether trades are executed, or orders are submitted, in an orderly fashion in the time periods prior to and during the closing period. In the view of the CFTC, an orderly market may be characterized by, among other things, parameters such as a rational relationship between consecutive prices, a strong correlation between price changes and the volume of trades, levels of volatility that do not materially reduce liquidity, accurate relationships between the price of a derivative and the underlying physical commodity or financial instrument, and reasonable spreads between contracts for near months and for remote months.

The CFTC recommends that market participants assess market conditions before placing a bid or offer or executing an order and consider how their trading practices and conduct affect the orderly execution of transactions during the closing period.

3. Intentional Spoofing

The CEA's anti-spoofing provision, § 4c(a)(5)(C), prohibits conduct that is "commonly known" as "spoofing" on any CEA-registered trading facility (that is, any designated contract market or swap execution facility).[126] The statute defines "spoofing" as "bidding or offering with the intent to cancel the bid or offer before execution." When prosecuted as a civil action by the CFTC, the anti-spoofing prohibition carries a civil penalty of up to $165,227 per violation, or triple the gain.[127] The CFTC may also seek a range of other penalties, including a temporary or permanent trading ban.[128] If the spoofing was for the purpose of affecting market prices, a separate price manipulation charge is possible, carrying a civil penalty of up to $1,191,842 per violation, or triple the gain.[129] Both spoofing and price manipulation are also criminal violations.[130]

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[126] *Id*. The CEA disruptive practices provision makes it "unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that—(A) violates bids or offers; (B) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or (C) is of the character of, or is commonly known to the trade as, "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution).

[127] 7 U.S.C. § 9.

[128] *Id.*

[129] *Id*.

[130] 7 U.S.C. § 13(a).

The first criminal conviction for spoofing futures markets occurred in Chicago in late 2015.[131] Since that time both the CFTC and the DOJ have made spoofing prosecutions a priority. In November 2018, the CFTC established a Spoofing Task Force "to preserve the integrity of [the listed derivatives] markets."[132] At that time, Enforcement Director James McDonald described spoofing as "a particularly pernicious example of bad actors seeking to manipulate the market through the abuse of technology."[133] The DOJ has similarly made spoofing a priority as it "has charged over a dozen individuals with spoofing-related crimes, and has obtained convictions of several traders affiliated with both large financial institutions and medium-sized proprietary trading companies."[134]

Recognizing that the boundaries of the new spoofing offense were not fully clear, the CFTC published interpretive guidance in 2013 when it issued rules in relation to the anti-spoofing provision. In that guidance, the CFTC provided four non-exclusive examples of spoofing behavior:

1. submitting or cancelling bids or offers to overload the quotation system of a registered entity;

2. submitting or cancelling bids or offers to delay another person's execution of trades;

3. submitting or cancelling bids or offers with intent to create artificial price movements; and

4. submitting or cancelling multiple bids or offers to create an appearance of false market depth.[135]

Notably, these behaviors are not limited to efforts to mislead the market as to price or liquidity and do not require a manipulative intent. Further, these behaviors can extend to orders which are made at market prices. Given the scope of prohibited behaviors, the intent element becomes critical if legitimate activity is to be distinguished from unlawful and potentially criminal acts.

The CFTC's guidance seeks to address the intent issue by explaining both what is and what is not the prohibited intent. It explains that the CFTC:

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[131] *See* David Yeres et al., *Spoofing: The First Criminal Conviction Comes in the U.S.*, 36 Futures & Derivatives L. Rep. 1 (2016).

[132] James M. McDonald, Speech of CFTC Enforcement Director James M. McDonald Regarding Enforcement trends at the CFTC, NYU School of Law: Program on Corporate Compliance & Enforcement (Nov. 14, 2018), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald1.

[133] *Id.*

[134] U.S. Dep't of Justice, Criminal Division, Fraud Section, *Fraud Section Year in Review 2018*, at 17, (2018) https://www.justice.gov/criminal-fraud/file/ 1123566.

[135] *See* Yeres, *supra* note 131.

- considers that a market participant must act with some degree of intent beyond recklessness to engage in the spoofing trading practices prohibited by the CEA;[136]

- considers that a spoofing violation will not occur where the person's intent when cancelling a bid or offer before execution was to cancel such bid or offer as part of a legitimate, good faith attempt to consummate a trade;[137]

- does not consider that a pattern of trading is necessary for a violation to occur: spoofing may be committed with a single order. However, in determining whether spoofing has occurred, the CFTC will look at all the facts and circumstances of a case including an individual's trading practices and patterns where applicable.[138]

The CFTC guidance has left significant uncertainty about the requirements of proof. In particular, it provides that the trader's state of mind must be "beyond reckless" but leaves open whether specific intent is required for a CEA civil spoofing violation.[139] Thus, the CFTC may take the view that a trader could be "beyond reckless" in placing an order, even if it is unable to establish specific intent to cancel the order when it was placed. In contrast the standard in criminal prosecutions is clearer. The CEA expressly states that a willful violation of that statute or CFTC rules are felonies prosecutable by the DOJ.[140] Unlike the CFTC's mere preponderance of evidence standard, the DOJ, which is required to prove beyond a reasonable doubt, will need to establish that the trader acted with the purpose of cancelling an order to avoid trade consummation at the time the order was placed.[141]

Nevertheless, the CFTC guidance and CFTC cases suggests that the CFTC has prioritized cases where specific intent is present, as reflected by trading that appears to be motivated by a desire to

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136 Antidisruptive Practices Authority, 78 Fed. Reg. 31890, 31896 (May 28, 2013).

137 *Id*. The CFTC lists partially filled orders and properly placed stop-loss orders as examples where cancelling a bid or offer before execution can be part of a legitimate, good-faith attempt to consummate a trade. *Id.*

138 *Id.*

139 The CFTC guidance does not define "beyond reckless," but courts have consistently defined "recklessness" as conduct that "departs so far from the standards of ordinary care that it is very difficult to believe the actor was not aware of what he or she was doing." *See, e.g.*, *Drexel Burnham Lambert, Inc. v. CFTC*, 850 F.2d 742, 748 (D.C. Cir. 1988) (quoting *First Commodity Corp. v. CFTC*, 676 F.2d 1, 7 (1st Cir. 1982)). Other courts have even defined "reckless" in the securities context to be "the functional equivalent of intent." *See Sundstrand Corp. v. Sun Chem. Corp*., 553 F.2d 1033, 1045 (7th Cir. 1977) (interpreting "recklessness" under Rule 10b-5). Under this heightened standard, recklessness "may serve as a surrogate concept for willful fraud." *See Rolf v. Blyth, Eastman Dillon & Co., Inc*., 570 F.2d 38, 46 (2d Cir. 1978).

140 The DFA amendments added criminal sanctions for "knowing" violations of the statute of up to 10 years imprisonment and a fine of not more than $1 million. 7 U.S.C. § 13(a)(2).

141 While the amendments allow criminal sanctions for spoofing in the futures and derivatives markets, there is no parallel provision under the securities statutes. Regardless, the Securities and Exchange Commission has attacked spoofing in the past by characterizing it as a manipulative practice in violation of the antifraud and antimanipulation provisions of Section 10(b) of the Exchange Act, as well as Rule 10b-5 and 17(a) of the Securities Act. *See, e.g.*, Visionary Trading LLC, et al., Exchange Act Release No. 71871, Investment Company Act Release No. 31,007 (Apr. 4, 2014); Briargate Trading, LLC, et al., Securities Act Release No. 9959, Exchange Act Release No. 76,104 (Oct. 8, 2015).

mislead, given that the examples in the guidance appear to involve such activity (*e.g.* "submitting or cancelling bids or offers *with intent to create artificial price movements*").[142] However, these are non-exhaustive examples, and the CFTC could conceivably bring an enforcement action alleging spoofing conduct outside the context of market deception.

"Spoofing" covers bid and offer activity on all registered entities, including all regulated futures, options, and swap execution facilities, including all bids and offers in pre-open periods or during other exchange-controlled trading halts.

In the view of the CFTC, a § 4c(a)(5)(C) violation does not require a pattern of activity; rather, a single instance of trading activity can violate § 4c(a)(5)(C), [143] provided that the activity is conducted with the prohibited intent.

The CFTC has said that it will evaluate "relevant facts and circumstances of each particular case" when distinguishing legitimate trading activity from spoofing, including "market context" and "the person's trading activity (including fill characteristics)," although the agency has explained that a pattern of trading is not a necessary element of spoofing.[144] To date, the CFTC has sought to establish contemporaneous intent to cancel through circumstantial evidence of (a) near-simultaneous orders and cancellations that generated, and produced profits based on, artificial market interest;[145] (b) high volumes of cancelled trades (both in absolute terms and relative to other market participants),[146] and (c) impact on price.[147]

In August 2016, an Illinois federal court denied a constitutional challenge brought against the CEA anti-spoofing provision.[148] Defendants Igor Oystacher and 3Red Trading, LLC ("3Red") moved the court to dismiss on the pleadings a civil enforcement action brought by the CFTC, arguing that the anti-spoofing prohibition, as applied to their case, was unconstitutionally vague.[149] The court disagreed, holding that the statute was not unconstitutionally vague as applied to defendants' case because it includes an intent element: in order to violate the statute, one must enter an order with the intent to withdraw it rather than to trade. The court found that the CFTC had met its burden on the intent element by alleging circumstantial evidence, including "a detailed description of Defendant Oystacher's trading patterns, relevant market data, and examples of his trading . . . ."

Of particular note, the court held that the CFTC's complaint need not allege direct evidence of intent to spoof in order for the complaint to pass constitutional muster. The court found instead

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142 Antidisruptive Practices Authority, 78 Fed. Reg. 31896 (May 28, 2013).

143 7 U.S.C. § 6c(a)(5)(C).

144 Antidisruptive Practices Authority, 78 Fed. Reg. 31896 (May 28, 2013).

145 *In re Panther Energy Trading LLC*, CFTC No. 13-26, 2013 WL 3817473, at *2–3 (July 22, 2013).

146 Complaint at 48, *CFTC v. Nav Sarao Futures Ltd. plc*, No. 15-CV-3398 (N.D. Ill. filed Nov. 9, 2016).

147 Complaint at 17–19, 29, 32, *CFTC v. Khara*, No. 15-CV-3497, (S.D.N.Y. filed May 5, 2015).

148 7 U.S.C. § 1 *et seq.*

149 *CFTC v. Oystacher*, 203 F. Supp. 3d 934 (N.D. Ill. 2016). The court also rejected defendants' arguments that the CFTC's Rule 180.1, a broad anti-fraud rule, is unconstitutionally vague and that the anti-spoofing provision represents an unconstitutional delegation of legislative authority from Congress to the CFTC.

that allegations that defendants routinely placed and very rapidly cancelled orders on one side of the market just before placing and filling orders on the opposite side, if true, would constitute circumstantial evidence of an intent to spoof. On December 20, 2016, the U.S. District Court for the Northern District of Illinois entered by consent order a permanent injunction against Igor B. Oystacher and his proprietary trading company, 3Red, finding that Oystacher and 3Red engaged in a manipulative and deceptive spoofing scheme while trading at least five different futures contracts on four exchanges for more than two years, thereby violating certain provisions of the CEA and CFTC Regulations on anti-spoofing, anti-fraud, and anti-manipulation.

The court order required (1) Oystacher and 3Red to pay, jointly and severally, a $2.5 million civil monetary penalty; (2) the appointment of an independent monitor to assess and monitor all 3Red's and Oystacher's futures trading for three years; (3) Oystacher and 3Red to employ certain compliance tools with respect to all of Oystacher's futures trading on U.S. exchanges for a period of 18 months; and (4) Oystacher and 3Red to be permanently prohibited from spoofing and employing manipulative or deceptive devices while trading futures contracts, including entering bids or offers with the intent to cancel the bids or offers before execution.

Case Study: Citi Spoofing Case – *In re Citigroup Global Markets Inc.*, CFTC Docket No. 17-06 (Jan. 19, 2017); *In re Stephen Gola*, CFTC Docket No. 17-12 (Mar. 30, 2017); *In re Jonathan Brims*, CFTC Docket No. 17-13 (Mar. 30, 2017)

On January 19, 2017, Citigroup Global Markets Inc. ("Citi") agreed to pay $25 million in civil penalties to settle allegations that it had over a nearly 18-month period repeatedly violated CEA Section 4c(a)(5)(C) by "spoofing" the U.S. Treasury futures market and violated CEA Section 6c(a)(5)(C) by failing to diligently supervise its traders. This was the first CFTC-spoofing enforcement action against a major firm. It is also the largest fine levied by the CFTC for a spoofing violation.

As a registered futures commission merchant and a provisionally registered swap dealer, Citi was also subject to the duty of each registrant to supervise its employees. Through this enforcement action, the CFTC signaled that it places high expectations on registrants to bolster their training programs as well as internal systems with respect to identifying potential spoofing activities on their trading desks.

Spoofing by U.S. Treasuries and Swap Desk

According to the CFTC order, traders on Citi's U.S. Treasury and U.S. Swaps desks engaged in spoofing from July 16, 2011 through December 3, 2012 by entering more than 2,500 orders on the Chicago Mercantile Exchange ("CME") with the intent to cancel them before execution. As such, these orders violated the CEA's anti-spoofing provisions,[150] which prohibit any trading practice by a registered entity that is "of the character of, or is commonly known to the trade, as 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution)."

The CFTC found that the orders at issue were placed to "create or exacerbate an imbalance in the order book." A strategy, which according to the order, "created the impression of greater buying

[150] Commodities Exchange Act § 4c(a)(5)(C), 7 U.S.C. § 6c(a)(5)(C).

or selling interest than would have existed absent the spoofing orders and was done to induce other market participants to fill the Traders' smaller resting orders on the opposite side of the market from the Traders' spoofing orders in advance of anticipated price changes." The spoofing orders were cancelled "after either the smaller resting orders had been filled or the Traders believed that the spoofing orders were at too great a risk of being executed."

These activities became known to the Citi management when it was alerted by the CME that suspicious orders had been placed by two Citi traders. Citi then investigated and identified additional spoofed orders that were placed during the 18-month period.

Registrants Training Systems and Policing

The CFTC found that Citi also violated Commission Regulation § 166.3[151] and failed to diligently supervise its traders on the U.S. Treasury and U.S. Swaps desks. As a registered futures commission merchant and a provisionally registered swap dealer, Citi had a duty to diligently supervise its trading desks. According to the settlement, during the period that the trades at issue took place, Citi did not provide sufficient training on the CEA anti-spoofing provisions to traders, did not have adequate systems in place to detect spoofing or analyze trading activity for patterns of potential spoofing, and did not detect spoofing orders placed by its traders.

The CFTC also found that Citi supervisors failed to comply with Citi policies regarding reporting of potential anti-spoofing violations. Even when Citi supervisors were alerted to a failed spoofing order placed by one of their traders in Tokyo, they failed to report and investigate the incident. In addition to expecting firms to have internal systems to monitor and identify signs of spoofing, the Citi settlement underscores the importance of having a strong compliance culture at trading firms even when there is no violation of the anti-spoofing provision.

Credit for Self-Reporting, Cooperation, and Corrective Measures[152]**.**

The CFTC credited Citi with self-reporting and cooperation in the investigation of additional instances of spoofing upon notification by the CME. Initially, the CME alerted Citi to a limited number of suspicious orders placed on its exchange by Citi traders. Citi then conducted its own investigation and, upon identifying additional instances of spoofing, self-reported these activities to the CFTC. The CFTC also recognized Citi's corrective measures, including enhanced compliance training and improvement in supervisory systems and internal controls designed to detect spoofing. The order makes clear, however, that the CFTC expects registrants to have robust systems in place to internally monitor trading desks for potential spoofing violations or intent to execute trades that can run afoul of the anti-spoofing provisions.

The Citi settlement underscores spoofing as the CFTC's major enforcement area of focus as well as the CFTC's expectations of registrants to diligently supervise their traders, as required by Commission Regulations.

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[151] 17 C.F.R. § 166.3.

[152] For more on the CFTC's cooperation policies please see the discussions at pages 143-49.

Claims Against Individuals

Subsequently, in March 2017, the CFTC settled charges with Stephen Gola and Jonathan Brims, alleging that they violated CEA Section 4c(a)(5) by spoofing the U.S. Treasury futures markets while trading for Citi between July 2011 and December 2012. Gola's and Brims's alleged spoofing strategy involved placing bids or offers of 1,000 lots or more with the intent to cancel those orders before execution. The spoofing orders were allegedly placed in the U.S. Treasury futures markets after another smaller bid or offer was placed on the opposite side of the same or a correlated futures or cash market. Gola and Brims allegedly placed their spoofing orders to create or exacerbate an imbalance in the order book and cancelled their spoofing orders after either the smaller resting orders had been filled or the traders believed that the spoofing orders were at too great a risk of being executed. Additionally, Gola and Brims allegedly coordinated with one or more Citigroup traders on the U.S. Treasury Desk to implement the spoofing strategy by, in some instances, placing one or more spoofing orders after another trader had placed one or more smaller resting orders in the same or a correlated futures or cash market. In other instances, another trader allegedly placed spoofing orders to benefit smaller resting orders of Gola and Brims. As part of the settlement, Gola agreed to pay $350,000, and Brim agreed to pay $200,000. Both agreed to be banned from trading in the futures markets until 6 months after each trader has made full payment of his respective penalty, as well as to cease and desist from violating the CEA's prohibition against spoofing, as charged.

Example Case: *In re Yingdi Liu*, COMEX 15-0143-BC (July 22, 2016)

A panel of the CME Business Conduct Committee found that on several dates in April 2015, Liu engaged in a pattern of activity in which he entered layered manual orders in Gold, Copper, and Silver contracts without the intent to trade. Specifically, Liu entered these layered orders to encourage market participants to trade opposite his smaller orders that were resting on the opposite side of the book. After receiving a fill on his resting smaller orders, Liu would then cancel the layered orders he had entered on the opposite side of the order book. Liu settled the allegations, which he neither admitted nor denied, agreeing to pay a $20,000 fine and serve a suspension of 20 business days.

Example Case: *In re Edward Buonopane*, CME 13-9382-BC (Aug. 29, 2016)

A panel of the CME Business Conduct Committee found that from December 2012 through February 2013, Buonopane engaged in a pattern of activity in the Euro FX and Japanese Yen futures markets wherein he entered larger-sized orders on one side of the market and smaller-sized orders on the other, which created the appearance of an imbalance in buy/sell pressure in violation of CME Rules 432.B.2., 432.Q., and 432.T. Once the small orders began trading, Buonopane cancelled the large orders resting on the other side of the order book. Buonopane's purpose in creating this imbalance included encouraging market participants to trade with his smaller-sized orders and in many cases his orders had that effect. Buonopane settled the allegations, which he neither admitted nor denied, agreeing to pay a $90,000 fine and serve a two-week suspension.

Example Case: *In re Fredrik Nielsen*, CME 14-9869-BC (Aug. 29, 2016)

A panel of the CME Business Conduct Committee found that between February 2013 and February 2014, Nielsen engaged in a pattern of activity wherein he entered multiple, layered orders for E-mini NASDAQ 100 Futures contracts without the intent to trade in violation of CBOT Rules 432.B.2, 432.Q., and 432.T. Specifically, Nielsen entered the layered orders to encourage market participants to trade opposite his smaller orders that were resting on the opposite side of the book. Once the smaller orders began trading, Nielsen would then cancel the resting layered orders that he had entered on the opposite side of the order book. Nielsen settled the allegations, which he neither admitted nor denied, agreeing to pay a $65,000 fine and serve a three-week suspension.

Example Case: *CFTC v. James Vorley*, 18-cv-00603 (Jan 26, 2017)

Related to the above spoofing of precious metals futures, actions have also been brought against individual traders, including James Vorley and Cedric Chanu. The civil case against both is currently pending. The complaint charged James Vorley and Cedric Chanu with spoofing and manipulative conduct in violation of CEA §§ 4c(a)(5) and 6(c)(1)..

Both are subject to a related criminal action. Notably however, they have only been charged with wire fraud in violation of 18 U.S.C. 1343 and not commodities fraud (18 U.S.C. 1348). In their motions to dismiss the criminal indictment, Vorley and Chanu claim that this is an attempt by the government to inappropriately stretch the understanding of wire fraud to a commodities fraud action. They explain that this is necessary because in December 2011, Deutsche Bank had established an internal compliance mechanism to monitor for spoofing, and it had, in fact, flagged and cleared numerous trades that the Government alleges were part of the spoofing scheme. As a result, the government theory is now that they were engaged in a scheme prior to November 2011. This, however, falls outside of the statute of limitations for commodifies fraud and the anti-spoofing regulations in Dodd-Frank. Thus, the government's only recourse may be to pursue a wire fraud action.

Example Case: *CFTC v. Krishna Mohan*, No. 4:18-CV-00260 (S.D. Tx. filed Jan. 28, 2018).

Mohan was a trader focusing on the E-mini Dow and E-mini Nasdaq 100 futures contracts. The CFTC complaint alleges that Mohan entered into a manipulative spoofing scheme in violation of CEA §§ 4c(a)(5)(C) and 6(c)(1) with the following pattern. He would first place a genuine iceberg order on one side of the market. At the same time, Mohan would place one or more fully visible spoof orders on the other side of the market. These large orders were at least nine times the size of the visible portion of the genuine iceberg order. This order book would create a false impression of market depth that would shift the price of the futures and allow his genuine orders to be filled at favorable prices. He would further this scheme by trading during overnight sessions, where volume was low and volatility was higher. And to further the impact of his spoof orders, he used an order splitting tool which split the orders into multiple orders of various sizes, creating the appearance that they were coming from multiple traders. Mohan had no intention of these large spoof orders being filled, and they were often quickly cancelled. His genuine orders were open on average 7.3 to 7.5 seconds while his spoof orders were only available for 1.7 to 1.9 seconds on average. Accordingly, his genuine orders were filled 39% of the time while his spoof orders were

only filled 1% of the time. Over the course of his scheme, he engaged in this pattern of trading 1500 times, with 2400 genuine orders and 36,000 spoof orders.

In March 2019, the CFTC dismissed the civil case and instituted an enforcement action as part of a settlement with Mohan. The CFTC order, which recognized that Mohan had entered into a cooperation agreement with the CFTC in October 2018, barred Mohan from directly or indirectly trading on any registered entity for a period of three years, but reserved the CFTC's determination of monetary penalties based upon his cooperation.

In a related criminal proceeding, Mohan plead guilty to: wire fraud, 18 U.S.C. §1343; commodities fraud, 18 U.S.C. §1348; and spoofing, CEA §§ 6c(a)(5)(C),13(a)(2). Mohan is awaiting sentencing.

Example Case: *CFTC v. Jiongsheng Zhao*, No. 1:18-CV-00620 (N.D. Ill. filed Jan. 28, 2018).

In January 2018, the CFTC filed a civil complaint against Zhao, an Australian commodities trader who traded the E-mini S&P 500 Index futures contract on the CME.

The CFTC complaint charged Zhao with spoofing and manipulative conduct in violation of CEA §§ 4c(a)(5)(C) and 6(c)(1). The CFTC alleged that while trading these futures, Zhao placed large spoof orders on one side of the market while placing a small genuine order on the other side of the market. This scheme encouraged market participants to react to a false impression of market depth on one side of the market and drive the price in a direction favorable to his genuine orders. These spoof orders were at least five times as numerous as his genuine orders and were canceled on average within 0.737 seconds. Zhao entered 2300 genuine orders and 3100 spoof orders in this predictable pattern and seemingly without regard for any external market circumstance. And he rarely placed large orders of the magnitude of his spoof orders outside of this established trading pattern.

He compounded this effort by almost exclusively participating during overnight sessions when trading volume was low. While this overnight session was, admittedly, during the day in Australia, the complaint explains that Zhao also often traded overnight in Australia in order to participate in the CME's daytime sessions. Accordingly, his trading pattern was unlikely to be driven by the time zone difference in Australia and instead focused on assisting his scheme.

The CFTC's civil case has been stayed pending the resolution of a related criminal case. In that case, Zhao plead guilty to violating CEA §§ 6c(a)(5)(C) and l3(a)(2) in December 2018 and is awaiting sentencing.

Example Case: *In re* Michael D. Franko, CFTC Docket No.: 18-35 (Sept 19, 2018) and *In re Victory Asset, Inc.*, CFTC Docket No. 18-36 (Sept. 19, 2018).

In September 2018, the CFTC entered into settlement agreements with Franko and Victory Asset. Franko was a director of commodities trading at Victory and focused on gold, crude oil, and copper futures. In the scheme, Franko would place small genuine orders for these futures on one side of the market and then place large spoof order on the other side of the market. Franko's goal was not to execute these large spoof orders, and he would quickly cancel them within seconds. Instead, Franko intended to create a false impression of market depth in order to shift the price of these

contracts and fill his genuine orders at favorable prices. Notably, he not only did this with within a single exchange but also conducted spoofing across exchanges. He did so by placing genuine orders for copper futures on the LME and then placing large spoof orders on COMEX. He relied on a general understanding that traders are aware of a price correlation between copper futures prices on COMEX and the LME, and thus, his spoof orders on COMEX would be beneficial to his open positions on the LME

Without admitting or denying any of the allegations, Franko and Victory agreed to pay a total civil penalty of $2,300,000 and take additional remedial measures for this alleged violation of the anti-spoofing and anti-manipulation provisions in Sections 4(c)(5)(C) and 6(c)(1) of the CEA and CFTC regulation 180.1(a)(1).

Example Case: *In re Mizuho Bank, Ltd.*, CFTC Docket No.: 18-35 (Sept 21, 2018).

Mizuho entered into a settlement agreement with the CFTC regarding spoofing of Treasury and Eurodollar futures contracts by one of its traders. The trader's job was to hedge Mizuho's swap positions in these futures contracts. To facilitate these hedges, the trader attempted to test how the market would react by placing futures orders that he quickly canceled. His goal was to be able to anticipate how the market would react when the hedges were actually executed at a later date. Notably, unlike a traditional spoofing case, the trader's goal was not to manipulate the market to fill orders at a favorable price and no order was filled while the spoofing was occurring.

Upon learning of this behavior, Mizuho suspended the trader and conducted an internal investigation while also overhauling its systems and controls. Without admitting or denying any of the allegations, Mizuho agreed to pay a $250,000 penalty for violating CEA § 4(c)(5)(C) =, and cease and desist from violating the relevant provision. r

Example Case: *In re David Liew*, CFTC Docket No. 17-14 (June 2, 2017).

In June 2017, the CFTC settled charges with David Liew, who admitted to the facts of engaging in numerous acts of spoofing, attempted manipulation, and manipulation of CEA registered U.S. gold and silver futures markets for more than two years while employed as a junior trader on the Singapore precious metals desk for a large financial institution in violation of CEA §§ 4c(a)(5), 6(c), 6(d) and 9(a)(2). The CFTC order found that Liew acted individually and in coordination with traders at the financial institution and with a trader at another large financial institution. Specifically, the CFTC found that Liew, acting individually and in coordination with other traders on the precious metals trading desk, placed orders to buy or sell gold or silver futures contracts that he did not intend to execute at the time the orders were placed on numerous occasions from December 2009 through February 2012. Liew's spoof orders were placed in the futures market after another bid or offer was placed on the opposite side of the same market with the intent to create the false appearance that the market interest in buying or selling was greater than the actual market interest, to induce other market participants to fill Liew's resting orders on the opposite side of the market from his spoof orders, and to manipulate the price of the relevant futures contract. Separately, Liew placed orders and executed trades on certain occasions with the intent of manipulating the market price of gold and silver futures contracts for the purpose of triggering customers' stop-loss orders to allow the traders to buy precious metals futures contracts at artificially low prices or sell precious metals futures contracts at artificially high prices. As part

of the settlement, Liew agreed to be permanently banned from trading commodity interests and to never engage in other commodity-interest related activities, including seeking registration, acting in a capacity requiring registration, or acting as a principal, agent, officer, or employee of any person registered, required to be registered, or exempt from registration.

Liew agreed to cease and desist from violating the relevant provisions.

4. Trade Practice Violations

(a) Wash Trades, Accommodation Trades, Fictitious Trades & Non-Bona Fide Price Sales

The CEA prohibits anticompetitive trading practices such as fictitious trades, wash sales, accommodation trades, and non-bona fide price sales of futures, options, and swaps. Section 4c(a) of the CEA states:

> It shall be unlawful for any person to offer to enter into, enter into or confirm the execution of a transaction described [below] involving the purchase or sale of any commodity for future delivery (or any option on such a transaction or option on a commodity) or swap, if the transaction is used or may be used to—
>
> (A)hedge any transaction in interstate commerce in the commodity or the product or byproduct of the commodity;
>
> (B)determine the price basis of any such transaction in interstate commerce in the commodity; or
>
> (C)deliver any such commodity sold, shipped, or received in interstate commerce for the execution of the transaction.
>
> A transaction referred to above is any transaction that:
>
> (1)is of the character of, or is commonly known to the trade as, a "wash sale" or "accommodation trade";
>
> (2) is a fictitious sale; or
>
> (3)is used to cause any price to be reported, registered, or recorded which is not a true and bona fide price.[153]

(1) Wash Sales

A "wash sale" has been further defined by courts as a transaction made "without an intent to take a genuine, bona fide position in the market, such as a simultaneous purchase and sale designed to

[153] 7 U.S.C. § 6c(a) (2012).

negate each other so that there is no change in financial position."[154] It is "designed to give the appearance of submitting trades to the open market, while negating risk or price competition incident to the market . . . [and] produce a virtual financial nullity because the resulting net financial position is near or equal to zero."[155]

To establish that a wash sale has occurred, the CFTC must demonstrate (1) the purchase and sale (2) of the same delivery month of the same futures contract (3) at the same (or a similar) price.[156] Also, the CFTC must prove intent[157] and have provided advance notice to the market that it views a specific practice as constituting a wash sale.[158] The DFA amended § 4c(a) of the CEA[159] to apply specifically to swaps.

Example Case: *Wilson v. U.S. Commodity Futures Trading Comm'n*, 322 F.3d 555, 557 (8th Cir. 2003)

Wilson, a commodities futures broker, made 22 intramarket wheat futures spread orders at the Minneapolis Grain Exchange. For those trades, Wilson received instructions to place simultaneous orders to buy and sell 500 wheat spread positions with instructions that the result of the purchase and sale should not be a loss that exceeded a certain amount. When Wilson made the bids, he bid and offered the spread within seconds of each other. Because of the structure and execution of the 11 paired transactions, the customer began and ended each of the transactions with the same net position in the wheat spread market but was able to create an apparent profit in the nearby month. The CFTC concluded that Wilson violated CEA Section 4c(a)(A) by knowingly participating in wash sales because the evidence sufficiently demonstrated that Wilson knew that the orders underlying the transactions were designed to negate risk. The CFTC imposed a cease and desist order, a six-month registration sanction, and a civil monetary penalty.

Example Case: *In re JSC VTB Bank*, CFTC No. 16-27 (Sept. 19, 2016)

JSC VTB Bank ("VTB") and its UK subsidiary settled claims that it had violated CEA Section 4c through noncompetitive block trades. The CFTC alleged that VTB, the second largest bank in the Russian Federation, and its U.K.-based subsidiary, VTB Capital, engaged in fictitious and noncompetitive block trades in Russian Ruble/U.S. Dollars futures contracts. According to the CFTC, VTB and VTB Capital entered into 100 block trades over two-and-a-half years for the purpose of transferring JSC VTB's cross-currency risk to its subsidiary at prices more favorable

[154] *Reddy v. CFTC*, 191 F.3d 109, 115 (2d Cir. 1999).

[155] *Wilson v. CFTC*, 322 F.3d 555, 559 (8th Cir. 2003).

[156] *Id.* (citing *In re Gilchrist*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,993 at 37,653 (CFTC Jan. 25, 1991)).

[157] *Reddy*, 191 F.3d at 115; *CFTC v. Savage*, 611 F.2d 270, 284 (9th Cir. 1979) ("The essential and identifying characteristic of a 'wash sale' seems to be the intent not to make genuine, bona fide trading transactions in stocks or commodities." (internal quotation marks omitted)).

[158] *Stoller v. CFTC*, 834 F.2d 262, 267 (2d Cir. 1987) ("Because we find that the public was not adequately apprised that the Commission views 'roll forward' trading to be encompassed within the 'wash sale' prohibition, we conclude that Stoller may not be held liable under that interpretation for his alleged violations with respect to the Contracts at issue herein.").

[159] 7 U.S.C. § 6c.

than it could have obtained from third parties. These trades effectively transferred cross-currency risk from VTB to VTB Capital. According to the CFTC, VTB Capital then offset the risk by entering into OTC cross-currency swaps with various international banks. Although the relevant contract "is predominantly [traded] off-exchange through block trades which are allowable by CME Rule 526 as long as executed in accordance with exchange requirements," the CFTC alleged that the trades violated regulations against non-competitive trades because CME Rule 526 requires that block trades be transacted at prices that are "fair and reasonable." The order concluded that the block trades at issue "were not fair or reasonable" because "VTB did not seek price quotes from unrelated third parties because such prices would not be as favorable as those offered by VTB Capital and … merely seeking a price could cause unfavorable pricing to VTB." Pursuant to a settlement, the VTB entities agreed to pay a $5 million penalty, conduct staff training, and strengthen policies and procedures to deter non-competitive training while neither admitting nor denying the allegations. The entities also agreed not to enter into privately negotiated futures, options, or combination transactions with one another on or through a U.S.-based futures exchange for two years.

(2) Accommodation trading

"'[A]ccommodation trading' [i]s '[w]ash trading entered into by a trader, usually to assist another with illegal trades.'"[160]

Example Case: *Sundheimer v. U.S. Commodity Futures Trading Comm'n*, 688 F.2d 150 (2d Cir. 1982)

In *Sundheimer*, a vice-president of Pressner Trading Corporation ("Pressner") agreed that Pressner would take the other side of certain prearranged contracts in crude oil futures so that an oil company could obtain illegal tax benefits by claiming fraudulent losses. The court found that Pressner's prearranged transactions in the oil company's stock were accommodations for the oil company, and the artificial character of the arrangement was consistent with a finding of an accommodation trade in violation of CEA Section 4c.

(3) Fictitious sales

"[T]he central characteristic of the general category of fictitious sales, is the use of trading techniques that give the appearance of submitting trades to the open market while negating the risk or price competition incident to such a market."[161]

Example Case: *In re Shell US Trading Co.*, CFTC Docket No. 06-02 (CFTC Jan. 4, 2006)

The CFTC alleged that the respondents had violated CEA Section 4c by engaging in fictitious sales by executing non-competitive transactions in NYMEX crude-oil futures. According to the CFTC, the traders prearranged trades by agreeing on the quantity and agreeing to take opposite positions, although they did not prearrange price. The CFTC alleged that Shell traders then placed the trades with a NYMEX floor brokerage company, which executed the trades. The CFTC alleged that

[160] *Sundheimer v. CFTC*, 688 F.2d 150, 152 (2d Cir. 1982) (citation omitted).

[161] *Transnor (Bermuda) Ltd. v. BP N. Am. Petroleum*, 738 F. Supp. 1472, 1495 (S.D.N.Y. 1990) (citation omitted).

various telephone conversations between the traders about the specific quantity and delivery month of the contracts to be traded prior to the submission of the orders and the execution of the trades and the agreement to take the opposite positions in the trades, established that the resulting trades were prearranged, and thus fictitious sales. Pursuant to a settlement, Shell and one of its traders agreed to pay a total of $300,000 in civil monetary penalties.

(4) Non-Bona Fide Price Sales

Example Case: *In re Reddy*, 1995 WL 646200, at *61 (CFTC Nov. 2, 1995)

Traders on the Coffee, Sugar & Cocoa Exchange submitted trade cards that showed irregularities in the sequence of trades. For example, for one trading sequence, the cards showed that both the broker and trader altered the quantities they first recorded by identical amounts. The administrative law judge found that Reddy violated CEA Section 4c(a)(B) [162] of the CEA by entering into and confirming transactions which were used for the "reporting, registering, or recording of prices which were not true and bona fide prices."

(5) Private Right of Action

Although a private plaintiff will generally need to establish privity to bring a claim for wash trading or other CEA Section 4c(a) violations, class action plaintiffs may allege that a defendant engaged in wash trading as means of manipulation in order to benefit from the broader private right of action available for manipulation violations.[163]

(b) Block Trade Exceptions[164]

Certain larger ("block") trades by large traders are permitted to be executed in off-exchange, privately negotiated transactions, apart and away from the otherwise required electronic or open outcry markets. Each relevant market's rules identify the types of contracts and minimum quantity requirements for a block trade. Each party to a block trade qualify as an "eligible contract participant" as defined in CEA Section 1a(18) of the CEA.

Block trades must be executed at prices that are fair and reasonable in light of their size and various market factors. As a rule, block trades may be executed at any time and may be used for "trades at settlement."

Companies must also apply with certain recordkeeping, audit track, and timely reporting requirements set forth for block trades, which are set by market rules.

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[162] 7 U.S.C. § 6c(a)(B).

[163] *See, e.g.*, *In re Natural Gas Commodity Litig.*, 337 F. Supp. 2d 498, 510–11 (S.D.N.Y. 2004) (finding that plaintiffs did not allege a claim for wash trading separate and distinct from their manipulation claim); *see also infra* § II(E).

[164] Chicago Mercantile Exch. & Chicago Bd. of Trade, Block Trades – Rule 526 (2013); Intercontinental Exch. Swap Trade, LLC, Swap Execution Facility Rulebook 64 (2017) (ICE Rule 407 – Certain Acknowledgements of Market Participants).

In general, however, a block trade executed between affiliated accounts will not be considered a prohibited wash sale if each party has a separate bona fide purpose for trading and each party's decision to trade is made by a separate and independent person.

(c) Violating position limits

DFA amended the CEA to allow the CFTC to establish regulations fixing limits on the amounts of trading which may be done, or positions which may be held, by any person in swaps.[165]

The DFA also amended the CEA to include swaps.[166] CEA Section 4a(b) makes it unlawful for any person to:

> (1)directly or indirectly to buy or sell, or agree to buy or sell, under contracts of sale of such commodity for future delivery on or subject to the rules of the contract market or markets or swap execution facility or facilities with respect to a significant price discovery contract, . . . any amount of such commodity during any one business day in excess of [the CFTC's position limits]; or
>
> (2)directly or indirectly to hold or control a net long or a net short position in any commodity for future delivery on or subject to the rules of any contract market or swap execution facility with respect to a significant price discovery contract in excess of [the CFTC's position limits] for or with respect to such commodity.[167]

A federal court has ruled that the CFTC's rule fixing limits for swaps is flawed due to the failure to make a factual finding of necessity.[168] The CFTC is appealing that decision.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Hunt*, 591 F.2d 1211, 1214 (7th Cir. 1979)

In *Hunt*, the CFTC alleged that Nelson Bunker Hunt and William Herbert Hunt, along with their children and a corporation under their control, violated CEA Section 4a(b) by exceeding the CFTC's three-million-bushel position limit for soybean futures contracts. By January 1977, the Hunt brothers held a three-million-bushel position in March 1977 soybeans. On February 25, with both Hunt brothers at the personal position limit, N. B. Hunt purchased 750,000 bushels of May soybeans in the name of his son, Houston Hunt. Similarly, on March 3, he ordered the purchase of 750,000 May bushels to be allocated equally among accounts that he had opened for his three daughters. The transactions were made possible by a short-term transfer of interest-free funds from N.B. Hunt's account. The Hunt family's collective position eventually reached over 23 million bushels of soybeans. The court found that, based on this evidence, the individual positions of the family members should be aggregated, and therefore, the Hunt family soybean transactions constituted a violation of the CFTC's position limit for soybean futures.

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165 7 U.S.C. § 6a.

166 *Id.*

167 *Id*.

168 *See ISDA Ass'n v. CFTC*, 887 F. Supp. 2d 259 (D.D.C. 2012).

5. Fraud Violations

(a) General Antifraud

Unlike the securities laws, the CEA's fraud prohibition is not limited to purchases and sales but may be applicable to all aspects of a transaction, including performance and settlement.

Section 4b(a) of the CEA makes it unlawful:

> for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce or for future delivery that is made, or to be made, on or subject to the rules of a designated contract market, for or on behalf of any other person; or
>
> for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, or swap, that is made, or to be made, for or on behalf of, or with, any other person, other than on or subject to the rules of a designated contract market . . .
>
> > (1) to cheat or defraud or attempt to cheat or defraud the other person;
> >
> > (2)willfully to make or cause to be made to the other person any false report or statement or willfully enter or cause to be entered for the other person any false record; [or]
> >
> > (3)willfully to deceive or attempt to deceive the other person by any means whatsoever in regard to any order or contract or the disposition or execution of any order or contract, or in regard to any act of agency performed, with respect to any order or contract for or in the case of paragraph 2, with the other person.[169]

The DFA expanded the CEA's broad prohibition on fraud to include swaps, including fraud on any counterparty or any person.

Prior to the DFA, to prove that a respondent had violated the CEA by misrepresentations or omissions, the CFTC needed to show only that: (1) the respondent misrepresented or deceptively omitted certain information regarding commodity futures trading; (2) the misrepresentation or omission was "material;" and (3) the respondent knew that the information was false and calculated to cause harm or recklessly disregarded the truth or falsity of the information.[170]

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[169] 7 U.S.C. § 6b.

[170] *Hammond v. Smith Barney, Harris Upham & Co*., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617, at 36,659 (CFTC Mar. 1, 1990).

Example Case: *U.S. Commodity Futures Trading Comm'n v. Daniel Winston LaMarco*, et al., No. 17-CV-4087 (E.D.N.Y. 2017)

The CFTC filed a complaint against Daniel Winston LaMarco and his company, GDLogix Inc. ("GDLogix"), alleging that LaMarco violated CEA Sections 4b and 4o by engaging in off-exchange foreign currency derivatives (Forex) fraud and by committing commodity pool fraud, and that they violated CEA Sections 4m and 4k by failing to register with the CFTC. In the complaint, the CFTC alleges that LaMarco fraudulently solicited and accepted money from individuals to trade off-exchange leveraged or margined retail derivatives Forex contracts in a commodity pool from January 2011 through March 2016, and he concealed and perpetuated his fraud by fabricating monthly statements and misappropriating pool funds. The CFTC is seeking full restitution for defrauded customers, disgorgement of ill-gotten gains, civil monetary penalties, permanent registration and trading bans, and a permanent injunction against future violations of federal commodities laws, as charged. The case is currently pending, although LaMarco has already pled guilty to criminal commodities fraud and wire fraud charges related to the same scheme.

Case Study: In re Forex Capital Markets, LLC, FXCM Holdings, LLC, Dror Niv, and William Ahdout, CFTC Docket No. 17-09 (Feb. 6, 2017)

In February 2017, the CFTC settled charges that Forex Capital Markets, LLC ("FXCM"), a registered Futures Commission Merchant and Retail Foreign Exchange Dealer; FXCM Holdings, LLC ("FXCM Holdings"), FXCM's parent company; and the two founding partners – Dror Niv and William Ahdout – who were the Chief Executive Officer of FXCM and Managing Director of FXCM, respectively violated CEA Section 4g and CFTC Regulation 1.35. FXCM provided retail customers with access to over-the-counter Forex markets through a proprietary technology platform and acted as counterparty in transactions with its retail customers who could buy one currency and simultaneously sell another.

In the order, the CFTC alleged that (1) FXCM engaged in false and misleading solicitations of FXCM's retail foreign exchange customers by concealing its relationship with its most important market maker and by misrepresenting that its "No Dealing Desk" platform had no conflicts of interest with its customers between September 2009 and 2014; and (2) FXCM, FXCM Holdings, Niv, and Ahdout were responsible for FXCM's fraud and false statements made to the National Futures Association ("NFA") about its relationship with the market maker.

Under Niv's and Ahdout's direction and control, FXCM allegedly misrepresented to its retail Forex customers that (1) FXCM would have no conflict of interest when they traded Forex on FXCM's No Dealing Desk platform; (2) retail customers' profits or losses would have no impact on FXCM's bottom line; and (3) the risk would be borne by banks and other independent "market makers" that provided liquidity to the platform. The CFTC also alleged that FXCM had an undisclosed interest in the market maker which consistently "won" the largest share of FXCM's trading volume, and thus was taking positions opposite FXCM's retail customers, by using an algorithmic trading system based on an FXCM computer program which could make markets to FXCM's customers, and thereby either replace or compete with the independent market makers on FXCM's "No Dealing Desk" platform.

Additionally, the CFTC alleged that FXCM willfully made false statements to NFA in an attempt to conceal FXCM's role in the creation of its principal market maker and the market maker's owner being an FXCM employee and managing director. During a meeting between NFA compliance staff and FXCM executives, Niv allegedly omitted to mention to NFA the details of FXCM's relationship with the market maker.

As part of the settlement, FXCM, FXCM Holdings, Niv, and Ahdout agreed to pay $7 million and to cease and desist from further violations of the CEA and CFTC Regulations, as charged. FXCM, Niv, and Ahdout agreed to withdraw from CFTC registration; never to seek to register with the CFTC; and never to act in any capacity requiring registration or exemption from registration, or act as a principal, agent, officer, or employee of any person that is registered, required to be registered, or exempted from registration with the CFTC.

(b) Insider Trading and the CFTC's Insider Trading Task Force

The securities laws contain well-known prohibitions on the trading of a company's (an "issuer") securities on the basis of material non-public information ("MNPI") in breach of an insider's duty to the issuer's shareholders (the "classical theory") or, as the Supreme Court recognized more recently, in breach of a duty of loyalty owed to the source of the information (the "misappropriation theory." [171] In contrast, the CEA historically viewed the "classical" theory of insider trading inapplicable due to the absence of any issuer of securities in connection with the commodities market and contained only limited prohibitions on trading on the basis of MNPI by settlement or exchange officials.[172] As recently as 2009, the CFTC asserted that it "has no jurisdiction over insider trading in any way."

This changed with the passage of the DFA, which gave the CFTC a new anti-fraud authority similar to the Securities Exchange Act's § 10(b). As a result, the CFTC's new "fraud-based" manipulation rule (Rule 180.1) was modeled on SEC Rule 10b-5, which prohibits what is known in the securities context as insider trading.

When issuing its final rule, the CFTC acknowledged that "unlike securities markets, derivatives markets have long operated in a way that allows for market participants to trade on the basis of lawfully obtained material nonpublic information."[173] Therefore, Rule 180.1 generally "does not prohibit trading on the basis of material nonpublic information."

But, the CFTC's authority to police market conduct, has nonetheless, been expanded to include trading on the basis of MNPI "in breach of a pre-existing duty" or when "obtained through fraud

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[171] *See United States v. O'Hagen*, 521 U.S. 642 (1997) (adopting the "misappropriation theory" of insider trading); *Chiarella v. United States*, 445 U.S. 222 (1980) (articulating the "classical theory" of insider trading).

[172] 7 U.S.C. §§ 6c(a)(4), 13(c)–(e) (prohibiting disclosure of, or trading on the basis of, non-public information, by CFTC employees or agents, other government employees, and employees of registered exchanges, boards of trade, and similar industry personnel, as well as by people who knowingly receive such information from government employees).

[173] Prohibition Against Manipulation, 17 C.F.R. 180 (2011).

or deception."[174] With this language, the CFTC has embraced the "misappropriation" theory of insider trading.

In September 2018, the CFTC the CFTC's Division of Enforcement announced the formation of an Insider Trading and Information Protection Task Force (the "Insider Trading Task Force"). The Insider Trading Task Force is tasked with identifying and bringing charges related to insider trading or the improper use confidential information in connection with commodity and derivatives markets.

Case Study: *CFTC v. EOX Holdings LLC*, No. 1:18-cv-08890 (S.D.N.Y. filed Sept. 28, 2018).

In September 2018, simultaneously with the creation of the Insider Trading Task Force, the CFTC filed charges against EOX Holdings LLC ("EOX"), an introducing broker and Andrew Gizienski ("Gizienski"). The CFTC alleged that the defendants misused material, nonpublic customer information in connection with block trades of energy futures contracts. According to the CFTC, EOX permitted Gizienski to violate company policy by exercising discretionary trading authority over the account of one customer, who was a personal friend and one of his long-standing clients. In exercising this discretionary trading authority, Gizienski shared material, nonpublic information relating to other customers, such as their identities, trading activity, and positions.

According to the complaint, Gizienski's conduct constituted the misuse of material, nonpublic customer information in breach of a pre-existing duty, in violation of CFTC Rule 180.1(a) and CFTC Rule 155.4(b), which governs disclosures by introducing brokers of customer orders. The CFTC has alleged that EOX is vicariously liable for this conduct. The CFTC further alleged that EOX violated recordkeeping rules and failed to supervise Gizienski as a result of EOX's alleged failure (i) to establish, implement, and enforce policies or procedures to detect or prevent Gizienski's misuse of confidential customer information; (ii) to review Gizienski's discretionary trading, his communications, or the brokerage services he provided; and (iii) to establish, implement, or enforce policies or procedures governing its brokers' handling of customer.

The *EOX* case is noteworthy as the first contested use of the CFTC's insider trading authority, and when coupled with the creation of the Insider Trading Task Force signal that insider trading is likely to remain an area of focus for the CFTC. *EOX* also provides valuable guidance regarding what the CFTC considers to be material information. Specifically, the CFTC alleged that the material nonpublic information that Gizienski disclosed included the potential counterparties' identities, the prices at which they had bought or sold particular contracts, the prices at which they were interested in buying or selling particular contracts, their trading positions, and their trading patterns, information that the complaint asserts could affect other traders' decisions.

[174] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices, 17 C.F.R. §§ 180.1–180.2 (2011).

Case Study: *In re Arya Motazedi*, CFTC Docket No. 16-02 (Dec. 2, 2015)

In 2015, the CFTC brought and settled its first insider trading case in *In re Arya Motazedi*.[175] According to the settlement, Arya Motazedi, a gasoline trader, misappropriated non-public information from his employer concerning "times, accounts, and prices at which the company intended to trade energy commodity futures."[176] Motazedi violated CEA Sections 4b(a)(l)(A),(C), 4c(a), and 6(c)(l) and CFTC Regulations 1.38(a) and 180.1by using the information to trade in personal accounts at prices favorable to him, as well as to place trades ahead of orders for the company's account, in breach of a duty of confidentiality owed to his employer. These facts present a fairly straightforward application of the "misappropriation" theory of insider trading.

The CFTC's *Motazedi* order unmistakably adopted the language of *securities* insider trading law, rather than charting a new path. In particular, the order stated: (i) that Motzedi shared a relationship of trust and confidence with his employer; (ii) which gave rise to a duty of confidentiality; and (iii) which was breached by his using information to trade in personal trading accounts. By incorporating the key elements from a securities insider trading claim, the CFTC appears to have endorsed the view that securities and commodities markets are enough alike that the logic of one can rationally apply to the other.

However, as some commentators have observed, the *Motazedi* settlement suggests that the CFTC may look to apply a different—and potentially broader—standard for "materiality" than is the case under the Exchange Act. Exchange Act Rule 10b-5 applies an objective materiality standard focusing on what a "reasonable investor" would view as "significantly alter[ing] the 'total mix'" of available information.[177] When proposing Rule 180.1, the CFTC suggested it would apply the objective definition of "materiality" utilized in the securities context.[178] However, the CFTC did not apply such a standard in the *Motazedi* case. Instead of asserting that the information Motazedi traded on had the potential to move the market, or that a "reasonable person" would have considered it important, the CFTC simply concluded without explanation that the information Motazedi misappropriated was material and non-public.[179] It remains to be seen whether the CFTC will pursue insider trading cases on the basis of conduct not actionable under the Exchange Act.

Motazedi is interesting because the CFTC *chose* to brandish its new authority, even though it could have achieved the same result more conservatively. Motazedi's insider trading behavior could easily have been punished as mere front-running, a form of market abuse long prohibited as fraud. Moreover, Motazedi had also caused his employer to make dozens of unnecessary trades on unfair terms against dummy accounts he himself secretly owned. This conduct could have been sufficient to execute a tough settlement without mentioning insider trading. Therefore, by including insider

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175 *In re Arya Motazedi*, CFTC No. 16-02 (Dec. 2, 2015) [hereinafter Motazedi Order].

176 *Id*. at 3.

177 *Carpenters Pension Tr. Fund of St. Louis v. Barclays PLC*, 750 F.3d 227, 235 (2d Cir. 2014) (quoting Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988)).

178 17 C.F.R. §§ 180.1–180.2.

179 *See* Motazedi Order, *supra* note 175, at 2.

trading charges, the CFTC put traders on notice of its expanded authority and its willingness to use it.

Without admitting or denying the allegations, Motazedi agreed to pay $216,955.80 in restitution , a $100,000 civil monetary penalty, and cease and desist from violating the relevant provisions.

In October 2015, *The Wall Street Journal* also reported that the CFTC and the U.S. Attorney's Office for the Southern District of New York were investigating Medley Global Advisors' public disclosure of details about the Federal Reserve's plans for further economic stimulus.[180]

Case Study: *U.S. Commodity Futures Trading Comm'n v. William Byrnes, et al.*, No. 13-CV-1174 (S.D.N.Y. 2013)

In February 2013, the CFTC filed a complaint against CME NYMEX and two former NYMEX employees, William Byrnes and Christopher Curtin, alleging that the employees violated Rule 1.59(d) by disclosing to a commodities broker material non-public information regarding orders made on the CME ClearPort Facilitation Desk from February 2008 to September 2010.

While working as employees on the CME ClearPort Facilitation Desk, Byrnes and Curtin were responsible for facilitating customer transactions reported for clearing through the CME ClearPort System and had lawful access to material nonpublic information that they received from brokers and/or principals in transactions which were required to be kept confidential by law. The two allegedly disclosed nonpublic customer information which included details of recent trades, the identities of the parties to specific trades, the brokers involved, the number of contracts traded, the prices paid, the structure of particular transactions, and the trading strategies of market participants. Through these alleged disclosures, the CME NYMEX and the two former employees allegedly violated CEA Section 9(e)(l) and CFTC Regulation 1.59(d)(l)(ii).

In July 2009, a market participant allegedly complained to CME NYMEX, believing that nonpublic information about trades cleared through CME ClearPort had been disclosed by a CME NYMEX employee named "Billy," who was allegedly identified as William Byrnes following an investigation conducted by a CME NYMEX Managing Director. However, CME NYMEX allegedly did not question Byrnes at that time, and Byrnes's illegal disclosures allegedly continued for over a year, until at least September 2010. CME NYMEX ultimately terminated Byrnes in December 2010 after another market participant allegedly complained about disclosures of nonpublic customer information, while Curtin had left CME NYMEX voluntarily prior to Byrnes's termination.

The CFTC seeks civil monetary penalties, trading and registration bans, and a permanent injunction. Plaintiff's motion for summary judgment is currently pending.

Practice Note: As discussed in more detail below in Section VI, the FCA takes a broader view of who is prohibited from trading on the basis of insider information.

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[180] Aruna Viswanatha et al., *Questions About Leak at Federal Reserve Escalate to Insider-Trading Probe*, WALL ST. J. (Oct. 1, 2015), http://www.wsj.com/articles/questions-about-leak-at-federal-reserve-escalate-to-insider-trading-probe-1443650303.

(c) Front Running and Insider Trading of Block Trades

In general, it is a violation for any person to engage in the front running of a block trade when acting on material non-public information regarding an impending transaction by another person, acting on non-public information obtained through a confidential employee/employer relationship, broker/customer relationship, or in breach of a fiduciary responsibility.

However, under market rules a party to a block trade may engage in pre-hedging or anticipatory hedging of its expected block position with certain exceptions. These exceptions include instances in which the party: (i) has a legal regulatory or fiduciary duty not to disclose or act upon any confidential non-public information concerning the anticipated block trade; or (ii) is a market intermediary (a broker) that is to take the opposite side of its customer order in which case it may not offset the position to be taken until after the block has been consummated.

There is no clear prohibition against hedging during the period post-block consummation but pre-reporting of the block to the relevant market (which must be done within a number of minutes specified by the rules of each market).

(d) Misappropriation and Theft of Government Information

Sections 9(c), (d), and (e) of the CEA prohibit the misuse of nonpublic information by government or exchange officials. CEA §§ 9(c) and 9(d) prohibit Commissioners and CFTC employees from (1) participating in investment transactions in commodities if nonpublic information is used in the investment transactions and (2) imparting nonpublic information that may affect the price of a commodity with the intent to assist another person to participate in a commodity transaction. Section 9(d) also prohibits any person who acquires such information from a Commissioner or a CFTC employee from using the information in a commodity transaction.[181]

Section 9(e) of the CEA prohibits employees and members of boards of trade, registered entities, swap data repositories, and registered futures associations from willfully and knowingly trading based on material nonpublic information obtained through special access related to the performance of the employees' and members' duties. Section 9(e)(2) also prohibits any person who acquires such information from an employee or member of a board of trade, registered futures entity, or registered futures association from willfully and knowingly trading based on the information if the person knows the information was obtained in violation of § 9(e)(1).[182]

The DFA adds § 4c(a)(4)(C) to the CEA, which prohibits the misappropriation or theft of federal government information that may affect the price of a swap and trading on it while knowing or acting in reckless disregard of the fact that such information has not been made public.[183]

The DFA also expanded the CEA's prohibition on the use of material non-public information.

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[181] 7 U.S.C. § 13(d).

[182] 7 U.S.C. § 13(e).

[183] 7 U.S.C. § 6c(a)(4)(C).

The CEA's new § 6(c)(1) antifraud provision makes it unlawful for any person to "use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce . . . any manipulative or deceptive device or contrivance."[184]

CEA § 6(c)(1) specifically states "that no rule or regulation promulgated by the Commission shall require any person to disclose . . . nonpublic information that may be material . . . except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect."[185] In keeping with this Congressional direction, the final rule adopted by the CFTC does not impose a new duty to disclose information but requires disclosure if necessary to make a statement not misleading.[186]

(e) Front Running

Front running is a species of fraud that occurs in the commodity context when an agent "intentionally buys or sells for his own account while holding an executable customer order on the same side of the market."[187] Under the CEA, front-running is a kind of insider trading and only occurs when the trading activity (1) violates a duty and (2) causes harm to the customer or the market (if in violation of a disclosure requirement).

Several duties could be implicated by pre-hedging activity, including (1) any fiduciary duty that Futures Commission Merchants owe their customers, (2) any duty to report trades away from the market (such as a block trade, trade-at-settlement, or EFRP) within a particular time, and (3) obligations undertaken by contract or by assurances made to a counterparty.

In November 2016, CME, ICE, CBOT and NASDAQ Futures, Inc. published identical guidance on pre-hedging of block trades, which the CFTC reviewed prior to publication. The guidance makes clear that pre-hedging is allowed as long as it does not violate a fiduciary duty. If a market participant executes a block trade through an intermediary, the intermediary cannot pre-hedge because doing so violates the fiduciary duty that intermediaries owe their customers, but the market participant can pre-hedge. If two arms-length counterparties directly agree to conduct a block trade, both can pre-hedge. If an intermediary tells a market participant about a block trade that others are executing, the market participant cannot "pre-hedge" (or front-run) that trade because the intermediary violated its fiduciary duty to a customer in divulging the information.

Case Study: Best Practices for FX and Other Dealer Businesses

While front-running has traditionally been a fraud-based concept, the New York Department of Financial Services ("DFS") and the FX Global Committee (comprising multiple central banks) have taken a broader view of front-running in the context of dealers' trades with customers. Regulatory actions have thus far been limited to FX dealers, but all dealers who are regulated by the DFS or other banking regulators—whether FX dealers or dealers of energy, metals,

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[184] 7 U.S.C. § 9(1).

[185] 7 U.S.C. § 9(1).

[186] 17 C.F.R. § 180.1 (2013).

[187] *In re Coppola*, No. 01-06, 2001 CFTC LEXIS 104, at *10 (Jan. 10, 2001).

cryptocurrencies, etc.—should be prepared to have their customer-facing activities scrutinized against this broader fair-dealing standard and should also be prepared for increased examination of their disclosures. Dealers who are not regulated by banking regulators should also prepare for potential fair-dealing challenges from their customers or from their regulators.

As discussed above, in exchange trading, traditional fraud-based front-running regimes continue to apply, but in the OTC market, such an approach may not be feasible. Dealers occupy a middle position in OTC trading, as they often know the identities and intentions of their customers prior to those customers executing trades, but they take the opposite side of those customers' trades as arms-length counterparties, and they do not necessarily owe those counterparties any duties in connection with this trading. In many OTC contexts, dealers intentionally trade ahead of actual or potential customers as a matter of course. For example, a dealer might adjust her bid-ask spread on the basis of order flow information. A dealer might also execute a covering trade in advance of executing a trade with his customer, to ensure that he can cover his position at a good price.

Both DFS and the FX Global Code have applied what appears to be a customer fair-dealing standard in order to address dealer front-running. DFS has not published any guidance regarding front-running by dealers or other DFS regulates but has recently cited a broad business-conduct provision of the New York Banking Law in a consent order settling allegations of customer front-running. On November 13, 2017, DFS entered a consent order against Credit Suisse settling alleged violations of Section 10 of the New York Banking Law, a broad provision that gives DFS the authority to bring penalties that "insure the safe and sound conduct" of markets and "maintain public confidence" in banking.[188] Among other things, the allegedly improper conduct involved front-running on Credit Suisse's spot FX dealer platform. Credit Suisse allegedly employed an algorithm that predicted the likelihood that a customer's limit or stop-loss order held by Credit Suisse would be triggered by market price movements. If the algorithm detected a sufficiently high likelihood of triggering, the algorithm would trade in anticipation of the market impact, ahead of the potential customer trade (which might or might not occur).

Notably absent from the Consent Order is any allegation that Credit Suisse's trading harmed any customers, violated any duties, or was contrary to any assurances given to any actual or potential customers. In one instance cited in the Consent Order, the alleged front-run even appears to have benefited both Credit Suisse and its counterparty. A trader noted that a trade with a customer would "show as a loss," so by the trader's admission, Credit Suisse took a loss on the trade while the customer made a profit. [189] But Credit Suisse more than recouped its loss because the algorithm traded ahead. The counterparty therefore arguably received a better execution than likely would have been available absent the algorithm. This alleged front-running trade appears not to have harmed the counterparty and may even have provided a benefit (since Credit Suisse might not have been willing to execute at the counterparty's preferred price absent the algorithm), but it was still considered improper by DFS. Nevertheless, the Consent Order concedes without explanation that

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[188] S*ee* Consent Order Under New York Banking Law §§ 39, 44, and 44-a *In the Matter of Credit Suisse AG* (N.Y. Dep't. of Fin. Servs., Nov. 13, 2017), http://www.dfs.ny.gov/about/ea/ea171113.pdf.

[189] *See id.* ¶ 48.

"it may be proper for a bank's market making electronic trading system to engage in the hedging of customer orders to limit risk and provide liquidity, sometimes called 'pre-hedging.'"[190]

The Consent Order does not explain what exactly the DFS believes constitutes improper front-running, particularly in the absence of any violation of a fiduciary duty, the traditional hallmark of front-running. But given the conduct that the Consent Order discusses as front-running, it appears likely that DFS is imposing a version of a fair-dealing standard on Credit Suisse's trading with customers on its FX dealer platform. The DFS appears to consider Credit Suisse's trading improper because a customer relationship exists between Credit Suisse and users of its dealer platform, even though DFS acknowledges that "Credit Suisse and [users of the dealer platform] transact as counterparties."[191] Under this apparent standard, it would be improper for a dealer to trade in a manner that runs contrary to the expectations of its customer, even though such trading might not violate any duty that the dealer owes its customer. While the Consent Order involved an FX spot dealer business, the DFS may well apply the same logic to other dealer businesses, including spot dealers of energy, metals, or cryptocurrencies. It should be noted, however, that DFS's rule would only apply to DFS regulates, namely, banking institutions operating under a New York charter.[192]

The FX Global Committee has taken a position in the FX Global Code that somewhat aligns with DFS's position as to treatment of customer information.[193] Principle 11 of the FX Global Code, which offers FX industry best practices, states that "Client" orders should only be pre-hedged by market participants who are acting as principals.[194] The FX Global Code defines "Client" to mean, essentially, a customer.[195] Principle 11 therefore applies to dealer trades with customers but would likely be inapplicable to interdealer trades or to other purely arms-length trades that occur outside the context of a customer relationship.

In a December 2017 revision to the FX Global Code, the FX Global Committee took the position that market participants should not enter covering trades during the "last look" window and should not adjust their spreads on the basis of a Client trade during the last-look window.[196] This means, essentially, that FX dealers should not trade ahead of executable customer orders. The FX Global Committee therefore also appears to be utilizing a version of a fair-dealing standard: there is a broad disclosure requirement ensuring that parties do not use customer information in a manner that runs contrary to the customer's expectations, and the last-look position ensures that a dealer will not risk negatively impacting a customer's execution by trading ahead of an executable order.

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190 *Id.* ¶ 43, n.8.

191 *Id.* ¶ 39.

192 N.Y. BANKING L. § 10 (2011).

193 The FX Global Committee is comprised of 16 central banks as well as various market participants. In May 2017, the FX Global Committee promulgated the FX Global Code, which is a set of best-practice principles meant to be followed by FX traders. The first revision to the FX Global Code was published in December 2017. FX Global Committee, *FX Global Code* (2017), https://www.globalfxc.org/docs/fx_global.pdf.

194 *Id.* at 17.

195 *See id.* at 69.

196 *See id.* at 21.

In light of the apparent regulatory interest in dealer front-running and the CFTC's disclosure requirement, dealer businesses would be well advised to scrutinize several areas. In addition to the specific advice below, dealers should understand that even though regulators may seek to impose a higher standard on arms-length trades with customers than they impose on arms-length trades with non-customers (such as interdealer trades), their treatment of non-customers could still constitute front-running if they violate some contractual or non-contractual assurance. None of the suggestions below should be considered a complete defense to a front-running investigation. Until the law is more settled, there cannot be a complete assurance that any particular practice will avoid regulatory scrutiny. However, these steps are likely to put dealers in the best position possible to respond to any regulatory inquiry, while recognizing that trading ahead, in certain circumstances, is a fundamental part of the dealer's business.

First, dealers should enact policies limiting trading ahead of executable customer orders to trading that is necessary to hedge or cover those orders. While the holding of an executable order does not appear to be a necessary component of a dealer front-running charge, regulators are likely to scrutinize most closely any trading that occurs ahead of an executable order, because such trading poses a risk of moving the market adversely to the counterparty and in favor of the dealer. The FX Global Code, for example, recommends a complete prohibition on such trading during the "last look" window. A dealer will likely find it difficult to justify its trading to a regulator if it is found to have profited from trading ahead of an executable customer order, especially if that trading appears to have caused a movement in price that is detrimental to the customer. Trading ahead of executable customer orders should therefore be limited to trading necessary for hedging or covering of that order.

Second, dealers other than swap dealers should review the standard disclosures that they provide to actual and potential customers to ensure that the disclosures describe the ways in which the dealer might trade ahead. Disclosure is the norm set by Principle 11 of the FX Global Code. And while DFS has not directly addressed disclosure in the Credit Suisse Consent Order or elsewhere, it seems unlikely that DFS could have found a front-running violation by Credit Suisse, on the facts alleged in the Consent Order, had Credit Suisse's trading ahead been fully disclosed to the customers who used its FX dealer platform. In light of the CFTC's requirement that swap dealers and major swap participants adhere to a standard of fair dealing in communications and in light of various CFTC anti-fraud rules, swap dealers should review their disclosures both to customers and to arms-length counterparties. Swap dealers should ensure that these disclosures describe the ways in which the swap dealer might use counterparty information to trade ahead.

Finally, dealers should ensure that any trading ahead that they undertake is in line with the contractual and non-contractual assurances that they give to customers and to other counterparties. In particular, dealers should ensure that their trading does not run counter to any assurances in their master agreements or other standard terms of business. Dealers should also be aware that other business units within the dealer's organization might have made assurances to a customer that would be violated by trading ahead. For example, in the Bogucki indictment, discussed above, Barclays' M&A advisory business entered into a confidentiality agreement with a customer, which was allegedly violated by Bogucki's trading.

When dealers respond to formal requests for quotes from counterparties, they should ensure that they abide by any limits on the use of counterparty information contained in the RFQ. Dealers

should also ensure that their marketing materials to customers cannot be construed as contradicting the manner in which they may trade ahead of customers. For example, best-execution assurances and assurances regarding limitations on the use of counterparty information in marketing materials could both be seen as inconsistent with any practice of trading ahead.

Example Case: *In re Coppola*, No. 01-06, 2001 CFTC LEXIS 104, *10 (Jan. 10, 2001)

The CFTC found, by consent, that Coppola violated CEA Section 6c by trading ahead of customers. Coppola, a floor broker who traded on the COMEX, was a dual trader who executed customer orders during trading sessions in the same contract market in which he executed trades for his account. The CFTC found that, in seven instances, Coppola bought or sold gold call options for his personal account at better premiums than his customers paid or received while he held executable orders from those customers to buy or sell gold call options for the same contract month and strike price. Thus, Coppola had executed trades for himself ahead of executable orders for his customers.

Example Case: *In re Jon Ruggles*, NYMEX 12-9153-BC-1 (June 13, 2016); *In re Ivonne Ruggles*, NYMEX 12-9153-BC-2 (June 13, 2016)

A panel of the NYMEX Business Conduct Committee found that from April 18, 2012 through December 10, 2012, Jon Ruggles repeatedly abused his trading discretion given to him by his employer for personal gain by intentionally trading his employer's account opposite two personal accounts owned by his wife, Ivonne Ruggles. While trading for his wife's accounts, Ruggles would either initiate a position opposite his employer's account, offset a position opposite his employer's account, or front-run orders subsequently entered for his employer's account. Ruggles violated NYMEX Rules 432.B.1., 432.B.2., 432.C., 432.L.1., 530, 532,576 and was ordered to pay a $300,000 fine and disgorge profits of $2,812,126.20. Both Jon and Ivonne Ruggles, who declined to be interviewed, were permanently barred from CME Group.

Example Case: *United States v. Mark Johnson & Stuart Scott*, No 16-cr-00457 (E.D.N.Y. filed July 19, 2016)

In July 2016, Mark Johnson, a citizen of the United Kingdom and the global head of FX trading at HSBC, was arrested at New York's John F. Kennedy airport while attempting to board a flight to London. Following his arrest, the DOJ unsealed a criminal complaint that had previously been filed in secret against Johnson and one of his colleagues in the U.K., Stuart Scott, charging them with wire fraud, attempted wire fraud, and conspiracy to commit wire fraud in violation of 18 U.S.C§§ 1343 and 1349.

According to the complaint, in November and December 2011, Mark Johnson and Stuart Scott, who were employed by HSBC at the time, misused information provided to them by a client that hired HSBC to execute a foreign exchange transaction related to a planned sale of one of the client's foreign subsidiaries, which was going to require converting approximately $3.5 billion in sales proceeds into British Pound Sterling. Johnson and Scott allegedly misused confidential information they received about the client's transaction by purchasing Pound Sterling for HSBC's "proprietary" accounts, which they held until the client's planned transaction was executed. The complaint further alleges that both Johnson and Scott made misrepresentations to the client about

the planned foreign exchange transaction that concealed the self-serving nature of their actions. Specifically, the complaint alleges that Johnson and Scott caused the $3.5 billion foreign exchange transaction to be executed in a manner that was designed to spike the price of the Pound Sterling, to the benefit of HSBC and at the expense of their client. In total, HSBC allegedly generated profits of roughly $8 million from the conduct.

After a month-long trial, Johnson was convicted in October 2017 on nine of 10 fraud and conspiracy counts. Scott is still contesting extradition and in August 2018, an intermediate appeals court in England ruled that Scott should not be extradited to the United States because "most of the harm took place" in the UK and extradition was not in the interests of justice."

Example case: *In re Zhiyu Wang*, NYMEX 15-0139-BC (July 27, 2016)

A panel of the NYMEX Business Conduct Committee found that Wang, while trading for his employer, executed multiple transactions between his personal trading account and the account he traded for his employer in violation of NYMEX Rules 432.B.1., 432.B.2., 432.C., 432.L.1., 530 and 532.Specifically, Wang traded ahead of his employer's account by entering orders and executing trades for his personal account and subsequently offsetting those trades opposite the employer's account. Wang, who declined to be interviewed, settled the allegations, which he neither admitted nor denied, agreeing to pay a fine of $100,000, disgorge profits of $236,530, and serve a three-year suspension from CME Group.

(f) Swap Dealer Business Conduct Standards

The DFA provided the CFTC with authority to impose business conduct standards for swap dealers ("SDs") and major swap participants ("MSPs"), including rules relating to fraud, manipulation, and other abusive trading practices involving swaps.[197]

Pursuant to this authority, the CFTC proposed Rule 23.410(c), which included a provision making it unlawful for an SD or MSP to enter into a transaction for its own benefit "ahead of (1) an executable order for a swap received from a counterparty, or (2) a swap that is the subject of negotiation with a counterparty, unless the counterparty specifically consents to the prior execution of such swap transaction."[198] However, the final rule did not include a free-standing prohibition against front running or trading ahead of counterparty transactions as proposed. The CFTC determined that such trading, depending on the facts and circumstances, would violate the prohibitions against fraudulent, deceptive, or manipulative practices, including §§ 4b, 4s(h)(4)(A), and 6(c)(1) of the CEA and Regulations §§ 23.410 and 180.1.[199]

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[197] 7 U.S.C. § 6s(h)(1).

[198] Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 75 Fed. Reg. 80638, 80658 (Dec. 22, 2010) (to be codified at pts. 4, 23).

[199] Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 Fed. Reg. 9734, 9736 n.21 (Feb. 17, 2012) (to be codified at pts. 4, 23).

Case Study: *In re Cargill, Inc.*, CFTC Docket No. 18-03 (Nov. 06, 2017)

In November 2017, the CFTC settled charges with Cargill, Inc. ("Cargill"), a provisionally registered swap dealer, alleging that Cargill violated CEA Section 4s(h) by providing mid-market marks (marks) which concealed its full mark-up on certain swaps from its counterparties and swap data repository ("SDR") from 2013 to 2017 and that Cargill failed to diligently supervise its employees with respect to the inaccurate marks and inaccurate statements made to swap counterparties, all in violation of the CEA and Commission Regulations.

Under the CEA § 4s(h) and Regulation 23.431, swap dealers must disclose to counterparties (1) information about the material characteristics of the swap, (2) the swap dealer's material incentives and conflicts of interest related to the swap, and (3) a daily mark of each uncleared swap transaction. [200] Regulation 23.431 also requires swap dealers to disclose to counterparties "[a]t a reasonably sufficient time prior to entering into a swap" (1) the material characteristics of the particular swap, "which shall include the material economic terms of the swap, the terms relating to the operation of the swap, and the rights and obligations of the parties during the term of the swap"; and (2) the material incentives and conflicts of interest the swap dealer may have in connection with the swap, which shall include "[w]ith respect to disclosure of the price of the swap, the price of the swap and the mid-market mark of the swap."[201] In addition, swap dealers must disclose "methodology and assumptions used to prepare the daily mark" and any additional information necessary "to ensure a fair and balanced communication." [202] Under Regulation 23.431, both the pre-trade and daily mid-market marks disclosed by the swap dealer "shall not include amounts for profit, credit reserve, hedging, funding, liquidity, or any other costs or adjustments." [203] Regulation 23.402(a)(1) requires swap dealers to have written policies and procedures reasonably designed to ensure compliance with swap dealer business conduct standards. [204]

In the order, the CFTC alleged that Cargill violated § 4s(h) and Regulation 23.431 because Cargill (1) provided counterparties with both pre-trade and daily mid-market marks that had the effect of concealing Cargill's full mark-up from counterparties; (2) did not disclose to counterparties that it was employing this methodology until June 2016 to make prior communications not "fair and balanced"; and (3) did not disclose prior to June 2016 that counterparties who terminated complex swaps within the first sixty calendar days would not be charged Cargill's full estimated revenue, and thus failed to disclose information about a material characteristic of its complex swaps. The CFTC further alleged that Cargill violated Regulation 23.402(a)(1) because it did not act in "good faith compliance with policies and procedures reasonably designed to comply with the business conduct standards rules."

More specifically, the CFTC alleged that Cargill provided hundreds of counterparties and its SDR with inaccurate marks, which had the effect of concealing up to ninety percent of Cargill's mark-

[200] 7 U.S.C. § 6s(h).

[201] Disclosures of Material Information, 17 C.F.R. § 23.431 (2012).

[202] *Id*. at §23.431(d).

[203] *Id.* at § 23.431(d)(2).

[204] *Id.* at § 23.402(a)(1).

up, on thousands of complex swaps. Instead of disclosing its full mark-up, Cargill allegedly provided only ten percent of its mark-up on the first day of the swap and amortized the remaining mark-up equally over the next sixty days. Cargill allegedly used this non-compliant mark methodology despite internal concerns that this mark methodology did not comply with requirements and regulations, and it deliberately avoided raising questions about the mid-market mark with the CFTC to avoid "tip[ing Cargill's] hand." Also, the CFTC alleged that Cargill inaccurately reported certain hedging information to swap counterparties on certain occasions for certain swaps executed, based on prices derived by Cargill's ProPricing grain marketing program. On a number of occasions since 2013, the accounts for particular commodities were allegedly over 100% hedged (i.e., short more than the amount of the particular enrolled commodity for that account) or less than zero percent hedged (i.e., long the particular enrolled commodity). In those instances, rather than reporting to counterparties the actual percentage, Cargill employees allegedly reported inaccurately to swap counterparties that the account was exactly 100% hedged or exactly zero percent hedged, respectively. Despite the inaccurate communications, Cargill allegedly failed to develop systems or procedures to prevent inaccurate communications with swap counterparties. Finally, the CFTC alleged that Cargill failed to diligently supervise its officers, employees, and agents and to have and maintain systems or procedures that could have prevented or corrected its inaccurate communications about ProPricing-related swaps with counterparties.

As part of the settlement, Cargill agreed to pay a $10 million civil monetary penalty; cease and desist from violating § 4s(h)(1) of the CEA and Commission Regulations 23.431(a) and (d), 45.4(d)(2), and 166.3; and comply with certain remedial undertakings.

(g) False Reporting to a Registered Entity and False Statements to the CFTC

The CEA has a longstanding prohibition on making false statements in documents required by the CEA, as well as documents relating to membership or participation in any registered entity or futures association.

Section 9(a)(3) states:

> It shall be a felony . . . [for any] person knowingly to make, or cause to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement required under this chapter, or by any registered entity or registered futures association in connection with an application for membership or participation therein or to become associated with a member thereof, which statement was false or misleading with respect to any material fact, or knowingly to omit any material fact required to be stated therein or necessary to make the statements therein not misleading.[205]

To state a claim under this provision, the CFTC must establish "(1) that the subject knowingly made or caused to be made a statement; (2) in a report or a document required to be filed under

[205] 7 U.S.C. § 13(a)(2).

the Act or regulations; (3) concerning a material fact; (4) that was false or misleading or knowingly omitted information required to be reported or necessary to make the statements made not misleading."[206]

The DFA also extended the CEA's prohibitions on making false or misleading statements of material fact to particular regulating entities, to include information that relates to a swap.

Section 9(a)(4) of the CEA prohibits making willfully false statements to particular regulating entities. It states:

> It shall be a felony . . . [for any] person willfully to falsify, conceal, or cover up by any trick, scheme, or artifice a material fact, make any false, fictitious, or fraudulent statements or representations, or make or use any false writing or document knowing the same to contain any false, fictitious, or fraudulent statement or entry to a registered entity, board of trade, swap data repository, or futures association designated or registered under [the CEA] acting in furtherance of its official duties under [the CEA].[207]

To state a claim under this provision, the CFTC 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."[208]

The DFA finally created a new prohibition on making a false or misleading statement of material fact to the CFTC.

Section 6(c)(2) of the CEA prohibits making material false statements to the CFTC if the person knew, or reasonably should have known, the statement to be false or misleading. It states:

It shall be unlawful for any person to make any false or misleading statement of a material fact to the Commission, including in any registration application or any report filed with the Commission under this chapter, or any other information relating to a swap, or a contract of sale of a commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or to omit to state in any such statement any material fact that is necessary to make any statement of a material fact made not misleading in any material respect, if the person knew, or reasonably should have known, the statement to be false or misleading.[209]

Case Study: *In re Susan Butterfield*, CFTC Docket No. 13-33 (Sep. 16, 2013)

In September 2013, the CFTC settled charges with Susan Butterfield who allegedly made false statements of material fact in testimony to CFTC staff during a CFTC Division of Enforcement investigation in violation of § 6(c)(2) of the CEA.

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206 *In re Rockland P. McMahan*, CFTC Docket No. 08-07 (Nov. 5, 2010).

207 7 U.S.C. § 13(a)(4).

208 *CFTC v. Amaranth Advisors, LLC*, 554 F. Supp. 2d 523, 535 (S.D.N.Y. 2008).

209 7 U.S.C. § 9(c)(2).

As an employee of an introducing broker, Butterfield handled various clerical and administrative tasks concerning trading on the floor of the Chicago Board of Trade ("CBOT"). She was responsible for accepting and recording customer orders of commodity futures or options, including time-stamping paper order tickets to accurately record the time. In January 2013, during an investigation in connection with an inquiry into the IB's procedures for documenting customer orders, Butterfield gave sworn testimony to the CFTC, claiming that she "never prestamped any [order] tickets." However, the CFTC had evidence that Butterfield had told her supervisor several months earlier that "we prestamp orders and it's something that is – that we should not be doing." After being presented with this evidence, Butterfield admitted that it was in fact her practice to prestamp order tickets. As a result, the CFTC found that Butterfield knowingly made false and misleading statements regarding improperly pre-stamping order tickets in violation of the CEA. The CFTC also found that her testimony was significant because the use of pre-stamped order tickets may violate CFTC Regulations and CBOT rules and may facilitate unlawful trade allocation schemes in which brokers decide who will receive trades only after they are executed, potentially allowing them to profit at their customers' expense.

As part of the settlement, Butterfield agreed to (1) pay a $50,000 civil monetary penalty, (2) cease and desist from violating the relevant provision of the CEA, (3) never apply for or claim exemption from registration with the CFTC or engage in any activity requiring such registration or exemption, and (4) never act as a principal or officer of any entity registered or required to be registered with the CFTC.

(h) Bucketing an Order Which Was to Be Executed on a Regulated Market

A broker "buckets a customer's order by trading opposite the order for the broker's own account or for an account in which the broker has an interest." "Indirect bucketing" occurs when a broker, aided by an accommodating trader, trades opposite his own customer while appearing to trade opposite the accommodator."[210]

The DFA amended § 4b(a) of the CEA to include swaps:

> It shall be unlawful—
>
> > (1)for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce or for future delivery that is made, or to be made, on or subject to the rules of a designated contract market, for or on behalf of any other person; or
> >
> > (2)for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, or swap, that is made, or to be made, for or on behalf of, or with, any other person, other than on or subject to the rules of a designated contract market

[210] *Reddy*, 191 F.3d at 115.

. . .

> (i) to bucket an order if the order is either represented by the person as an order to be executed, or is required to be executed, on or subject to the rules of a designated contract market.[211]

Example Case: *In re Reddy*, 1995 WL 646200, at *3–4 (CFTC Nov. 2, 1995)

Reddy, a trader in the sugar pit of the Coffee, Sugar & Cocoa Exchange, received a customer order to sell 200 sugar contracts at a rate of 11.77 or higher. Reddy reported that he had executed the customer order to sell all 200 contracts at 11.77, but there were irregularities on the trading cards and discrepancies with the order ticket between Reddy and another trader, Bergamo. Reddy's trading card showed six sales made to Bergamo at a price of 11.78, as well as forty-six contracts to his own account at 11.80 and 11.81. The administrative law judge found that Reddy's purchase of the forty-six contracts for his own account was executed off the market and was part of an arrangement to "indirectly bucket his customer's order."

(i) Cross Trading With Customers

Cross-trading is "where one broker represents both the buyer and the seller of a security and executes both the purchase and the sell side of the transaction, and receives a commission for both."[212] It is "a commodity futures transaction where one floor member offsets a sell order in his hand against a buy order also in his hand."[213]

The DFA amended § 4b(a) of the CEA to include swaps to be executed on a regulated entity. It states:

> It shall be unlawful . . .
>
> > (1)for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce or for future delivery that is made, or to be made, on or subject to the rules of a designated contract market, for or on behalf of any other person; or
> >
> > (2)for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, or swap, that is made, or to be made, for or on behalf of, or with, any other person, other than on or subject to the rules of a designated contract market
> >
> > . . .

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[211] 7 U.S.C. § 6b(a).

[212] *Curley v. Brignoli Curley & Roberts Assocs.,* 746 F. Supp. 1208, 1219 n.5 (S.D.N.Y. 1989); *see also In re Kuhlik*, 1986 CFTC LEXIS 765; Comm. Fut. L. Rep. (CCH) ¶ 22,926 (February 21, 1986) ("A cross trade is a commodity futures transaction where one floor member offsets a sell order in his hand against a buy order also in his hand.").

[213] *Id*.

> (ii) to fill an order by offset against the order or orders of any other person, or willfully and knowingly and without the prior consent of the other person to become the buyer in respect to any selling order of the other person, or become the seller in respect to any buying order of the other person, if the order is either represented by the person as an order to be executed, or is required to be executed, on or subject to the rules of a designated contract market unless the order is executed in accordance with the rules of the designated contract market.[214]

In addition, the CFTC has a regulation for Futures Commission Merchants ("FCM") regarding cross trading. It states:

> No futures commission merchant or any of its affiliate persons shall . . .
>
> > knowingly take, directly or indirectly, the other side of any order of another person revealed to the futures commission merchant or any of its affiliate persons by reason of their relationship to such other person, except with such other person's prior consent and in conformity with contract market rules approved by or certified to the Commission.[215]

Example Case: *In re Lui*, CFTC No. 07-06 (Apr. 25, 2007)

By consent, the CFTC found that Lui had crossed customer orders in violation of § 4c of the CEA. Lui controlled and traded twenty-seven customer accounts. In November and December 2005, Lui traded at least fifteen customer accounts opposite each other in CME Globex E-mini Russell 2000 futures contracts during thinly traded overnight hours. The CFTC found that, as the person entering orders for these customer accounts to Globex and getting the resulting trade results, Lui knew that entering the various buy and sell orders during hours of low trading liquidity would almost certainly result in his customers' accounts trading against each other. Moreover, eleven of the fifteen customer accounts that Lui traded during this period lost an aggregate of $55,505 in trading, while the other four accounts realized trading profits of roughly the same aggregate amount. The CFTC found that the prearrangement of the specific quantity and price of the orders to be traded prior to the submission of the orders, and knowledge that the orders would likely cross each other on the Globex trading platform, established that the resulting trades were prearranged and fictitious and violated § 4c of the CEA.[216]

(j) Disclosing Customer Orders or Positions

The CFTC has long-standing regulations prohibiting the disclosure of customer orders or positions.

17 C.F.R. § 155.3 states:

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[214] 7 U.S.C. § 6b(a).

[215] Trading Standards for Futures Commission Merchants, 17 C.F.R. § 155.3 (2018).

[216] 7 U.S.C. § 6c.

> No futures commission merchant or any of its affiliated persons shall . . . [d]isclose that an order of another person is being held by the futures commission merchant or any of its affiliated persons, unless such disclosure is necessary to the effective execution of such order or is made at the request of an authorized representative of the Commission, the contract market on which such order is to be executed, or a futures association registered with the Commission pursuant to section 17 of the Act.

17 C.F.R. § 155.4 states:

> No introducing broker or any of its affiliated persons shall . . . [d]isclose that an order of another person is being held by the introducing broker or any of its affiliated persons, unless such disclosure is necessary to the effective execution of such order or is made at the request of an authorized representative of the Commission, the contract market on which such order is to be executed, or a futures association registered with the Commission pursuant to Section 17 of the Act.

The DFA amended the CEA by adding § 4s(h), which provides the CFTC with authority to impose business conduct requirements on swap dealers and major swap participants.[217] Pursuant to this authority, the CFTC implemented Rule 23.410(c), which makes it unlawful for any swap dealer or major swap participant ("MSP") to:

> Disclose to any other person any material confidential information provided by or on behalf of a counterparty to the swap dealer or MSP; or
>
> Use for its own purposes in any way that would tend to be materially adverse to the interests of a counterparty, any material confidential information provided by or on behalf of a counterparty to the swap dealer or major swap participant.[218]

(k) Reckless Disregard for a Counterparty's Fraudulent Use of a Swap

The DFA created a new provision, CEA § 4c(a)(7), that prohibits a party from entering into a swap knowing, or acting in reckless disregard of the fact, that its counterparty will use the swap as part of a device, scheme, or artifice to defraud any third party. "Reckless disregard" satisfies the scienter element.[219]

This provision was meant to address, *inter alia*, instances in which a derivative is used to achieve impermissible and potentially unlawful accounting or tax outcomes. This subject was extensively reviewed in the aftermath of the Enron bankruptcy, which led several banking and securities regulators to issue the 2007 Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities (the "Interagency Statement") that described internal

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[217] 7 U.S.C. § 6s(h).

[218] Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 Fed. Reg. 9734, 9746 (Feb. 17, 2012) (codified at 17 C.F.R. pts. 4, 23).

[219] 7 U.S.C. § 6c(a)(7) (2012).

controls and risk management procedures concerning complex structured finance transactions ("CSFTs"), including certain swaps.

The CFTC has provided little guidance on new CEA § 4c(a)(7),[220] although it has noted that its new "know your counterparty" rule (17 C.F.R. § 23.402(b)) "would assist swap dealers and major swap participants in avoiding violations of § 4c(a)(7)."[221] The rule states:

> Know your counterparty. Each swap dealer shall implement policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning each counterparty whose identity is known to the swap dealer prior to the execution of the transaction that are necessary for conducting business with such counterparty. For purposes of this section, the essential facts concerning a counterparty are: (1) facts required to comply with applicable laws, regulations and rules; (2) facts required to implement the swap dealer's credit and operational risk management policies in connection with transactions entered into with such counterparty; and (3) information regarding the authority of any person acting for such counterparty.

In the absence of other guidance, adhering to principles stated in the 2007 Interagency Statement may provide a defense to a claim of "reckless disregard" of a counterparty's fraudulent use of a swap. The Interagency Statement recommended certain principles that banks should follow, including:

> Maintaining policies, procedures, and systems that are designed to identify elevated risk CSFTs and subject them to a heightened due diligence and approval processes;
>
> Focusing particularly on transactions that appear to lack economic substance, or that can be used for questionable accounting, regulatory or tax objectives;
>
> Conducting thorough due diligence in connection with CSFTs and requiring more onerous internal approval standards; and
>
> Creating and maintaining adequate documentation in connection with CSFTs.[222]

6. Organizational Violations

(a) Recordkeeping

All CFTC registrants have recordkeeping requirements. Although specific recordkeeping requirements may vary depending on the type of registrant, all CFTC-registered futures

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[220] 7 U.S.C. § 6c(a)(7).

[221] Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 Fed. Reg. 9734, 9746 (Feb. 17, 2012) (codified at 17 C.F.R. pts. 4, 23).

[222] *See* Exchange Act Release No. 34-55043, 89 S.E.C. Docket 2179 (Jan. 5, 2007).

commission merchants, commodity pool operators, commodity trading advisors, swap dealers, and major swap participants are generally required to keep books and records for a period of five years.

The DFA expanded recordkeeping requirements for swap transactions. Both cleared and uncleared swaps need to be reported to a registered SDR and that swap data must be reported in real time.[223] The CFTC requires that parties report a publicly reportable swap transaction to an SDR as soon as technologically practicable after the swap transaction is executed.[224]

These records must also be available for inspection by the CFTC or the DOJ.[225] Registrants are required to keep books and records "readily accessible" for the first two years of the five-year period.[226] The CFTC has interpreted "readily accessible" to mean retrieval in real-time or at least on the same day as the request.[227]

Case Study: *In re Deutsche Bank AG*, CFTC Docket No. 15-40 (Sept. 30, 2015) and *U.S. Commodity Futures Trading Comm'n v. Deutsche Bank AG*, 16-CV-6544 (S.D.N.Y. filed Aug. 18, 2016)

In September 2015, the CFTC enforced the new DFA requirements, which require real-time public reporting of swap transactions and reporting of swap data to swap data repositories, for the first time in *In re Deutsche Bank AG*. The CFTC settled charges with Deutsche Bank AG ("Deutsche Bank"), a global banking and financial services company and provisionally registered Swap Dealer, alleging that Deutsche Bank failed to properly report its swap transactions from January 2013 to July 2015, that Deutsche Bank did not diligently address and correct the reporting errors until it was notified of the CFTC's investigation, and that it failed to have an adequate swaps supervisory system governing its swaps reporting requirements in violation of Regulations 43.3(a), (e), 45.4(a), 45.14(a) and 23.602.

As a provisionally registered Swap Dealer, Deutsche Bank was required to comply with certain disclosure, recordkeeping, and reporting requirements related to its swap transactions. The regulations at issue were Parts 43 and 45 of the CFTC's Regulations, which specify requirements for real-time public reporting, public availability of swap transaction and pricing data, and reporting of creation and continuation data. They also include requirements for a reporting counterparty to report and correct errors and omissions in its swaps reporting, including cancellations, to the registered SDR to which the reporting counterparty originally reported the swap. The reporting requirements seek to enhance transparency, promote standardization, and reduce systemic risk in swaps trading because accurate swap data is key to the CFTC's regulatory functions, such as meaningful surveillance and enforcement programs, and real-time public

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223 7 U.S.C. § 2(a)(13)(G).

224 Method and Timing for Real-Time Public Reporting, 17 C.F.R. § 43.3(a)(1) (2016).

225 Regulatory Records; Retention and Production, 17 C.F.R. § 1.31 (2017).

226 *Id.*

227 Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136, 2142 (Jan. 13, 2012) (to be codified at 17 C.F.R. pt. 45).

dissemination of swap transaction and pricing data supports the fairness and efficiency of markets and increases transparency, which in turn improves price discovery and decreases risk.

The CFTC alleged that Deutsche Bank failed to properly report cancellations of swap transactions in all asset classes, which in the aggregate included between tens of thousands and hundreds of thousands of reporting violations and errors and omissions in its swap reporting. Although it was aware of the problems related to cancellation messages, Deutsche Bank allegedly failed to provide timely notice to its SDR and did not diligently investigate, address, and remediate the problems until it was notified of the CFTC's investigation. Due to the reporting failures, misinformation was allegedly disseminated to the market through the real time public tape and to the CFTC. Furthermore, the CFTC alleged that Deutsche Bank's reporting failures resulted, in part, due to deficiencies with its swaps supervisory system, which was allegedly inadequate to supervise all activities related to compliance with the swap reporting requirements.

As part of the settlement, Deutsche Bank agreed to pay $2.5 million and comply with undertakings to improve its internal controls to ensure the accuracy and integrity of its swap reporting.

Following the September 2015 settlement, on April 16, 2016, Deutsche Bank's swap data reporting system experienced a systems outage that prevented Deutsche Bank from reporting any swap data for multiple asset classes for approximately five days. As a result of this outage, the CFTC filed a complaint against Deutsche Bank in federal court in August 2016.

According to the CFTC complaint, Deutsche Bank's subsequent efforts to solve the systems outage repeatedly exacerbated existing reporting problems and often led to the discovery or creation of new reporting problems. The CFTC also alleges that the problems were caused, at least in part, by Deutsche Bank's failure to have an adequate Business Continuity and Disaster Recovery Plan and other appropriate supervisory systems in place.

Simultaneously with the filing of the complaint, the CFTC and Deutsche Bank filed a joint motion seeking the appointment of a monitor to ensure Deutsche Bank's compliance with its reporting responsibilities under the CEA and CFTC Regulations. In response, the court requested that the CFTC file a memorandum explaining why the order should be granted, explaining that a district judge's "duty extends beyond that of a rubber stamp" and that the CFTC's application was "bereft of any authorities explaining why the proposed consent order was 'fair, reasonable, adequate, and in the public interest.'"

Example Case: *In re ABN Amro Clearing Chicago LLC*, CFTC Docket No. 18-31 (Sept. 14, 2018).

In September 2018, the CFTC settled charges alleging that ABN AMRO Clearing Chicago LLC ("ABN") failed to maintain certain required records and failed to supervise its employees and agents in violation of Section 4g(a) of the CEA to ensure that ABN fulfilled its statutory and regulatory obligation to keep and promptly produce such records.

The settlement alleged that from January 24, 2014 through August 28, 2015 ABN failed to maintain electronic audit trail information relating to the trading of derivatives for a total of sixty-five clients. The settlement also alleged that ABN had no system in place to confirm that no anomalies existed in its data collection and preservation. Thus, while ABN had a recordkeeping

system in place, the settlement alleged that the system did not confirm that it was accurately preserving audit trail data.

According to the settlement, ABN only learned of these issues after the Division of Enforcement requested audit trail data for an ABN client and discovered significant gaps and missing transactions in the audit trail data. The Division of Enforcement then notified ABN of these issues, and ABN made substantial efforts to repair and reconstruct the audit trail data impacted by the recordkeeping failures, and ultimately did reconstruct substantially all affected records.

As part of the settlement, ABN agreed to pay a $160,000 civil monetary penalty.

(b) Failure to Supervise

A CFTC registrant may be held liable for a failure to supervise under CFTC Rule 166.3.[228] The regulation provides:

> Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents . . . relating to its business as a Commission registrant.

In addition, 17 C.F.R. § 23.602, which was recently enacted and specifically applies to swap dealers and major swap participants, notes that:

> Each swap dealer and major swap participant shall establish and maintain a system to supervise, and shall diligently supervise, all activities relating to its business performed by its partners, members, officers, employees, and agents (or persons occupying a similar status or performing a similar function). Such system shall be reasonably designed to achieve compliance with the requirements of the Commodity Exchange Act and Commission regulations.

A failure to supervise is an independent violation of CFTC regulations and liability may attach even absent an underlying violation of the CEA.

A violation of Regulation 166.3 requires a showing that either (1) the registrant's supervisory system was generally inadequate; or (2) the registrant failed to perform its supervisory duties diligently.[229] Further, the CFTC has noted that the scope of Regulation 23.602 largely mirrors that of 166.3.[230]

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228 Supervision, 17 C.F.R. § 166.3 (1983).

229 *In re Murlas Commodities*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,485, at ¶ 42,161 (CFTC Sept. 1, 1995).

230 *In re INTL FCStone Markets, LLC*, CFTC Docket No. 15-27 (Aug. 19, 2015).

Case Study: In re Merrill, Lynch, Pierce, Fenner & Smith Incorporated, CFTC Docket No. 17-25 (Sept. 22, 2017)

On September 22, 2017, Merrill, Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") entered into a $2.5 million settlement with the CFTC to resolve allegations that it violated Rule 166.3 by failing to supervise its employees and CEA § 4g by failing to keep adequate records, and the U.S. Attorney's Office for the Western District of North Carolina ("USAO") publicized a previous settlement, related to certain alleged impermissible "pre-hedging" of futures block trades. Notably, the CFTC settlement focused on the firm's failure to adequately supervise its process of responding to an earlier CME investigation of the pre-hedging. This represents a novel and expansive application of the duty to supervise and suggests that the procedures for internal investigations, including but not limited to any delegation of investigative responsibility to persons outside the legal and compliance department or its outside counsel, may be subject to close scrutiny by the CFTC.

In reaching the settlement, the CFTC deployed a novel application of its Regulation 166.3 authority to oversee registrants' diligent supervision of personnel by applying that provision to Merrill Lynch's response to a CME investigation. In particular, the CFTC alleged that by delegating certain important investigative tasks to an operations support group and by failing to maintain adequate trading records, Merrill Lynch did not properly ensure that its employees and agents provided complete and accurate information to the CME in connection with its investigation into "pre-hedging" of block futures trades. This novel application demonstrates that companies must not only be vigilant in preventing substantive trading violations but must also diligently oversee investigation responses, including responses to exchange investigations.

On the same day, in a somewhat unusual delay, the USAO simultaneously announced its own settlement with Merrill Lynch for the same conduct, which was reached in October 2015. Pursuant to that settlement, Merrill Lynch agreed to pay $2.5 million and the USAO agreed not to bring civil charges against Merrill Lynch based on Merrill Lynch meeting certain conditions for a period of eighteen months.

Background

The settlements related to conduct by traders on a New York-based swaps desk who would occasionally execute principal-to-principal block trades—privately negotiated off-market transactions for large quantities of a particular contract—for certain financial institutions. According to the USAO settlement, three traders would occasionally listen to calls between these financial institutions and Merrill Lynch salespeople about potential block trades. The USAO settlement further alleged that these traders would then begin hedging Merrill Lynch's expected risk.

From 2009 to 2010, the CME investigated this conduct.[231] The CME investigation was focused on whether these traders would execute U.S. Treasury Futures transactions on the CME before entering into block trades with these counterparties. In November 2010, the CME interviewed certain traders about the suspected conduct. The traders allegedly provided "misleading answers"

[231] *In re Merrill, Lynch, Pierce, Fenner & Smith Inc.*, CFTC No. 17-25 (Sept. 22, 2017).

to the CME by suggesting that the trades were unrelated to the block trades or that the trades actually occurred after the block trades and that the reported execution times for the block trades were inaccurate.[232] The traders also claimed that it would have been impossible for them to trade ahead of a counterparty's block trade because the time between receiving the customer's block trade inquiry and executing the block trade was very brief.[233] However, according to the CFTC's Order of Settlement, the traders "did in fact trade futures contracts" in this way and engaged in other questionable conduct such as eavesdropping on calls between counterparties and salespersons about block futures trades without announcing their presence and then using the information learned to hedge expected risk from those block futures trades.[234]

Alleged Failure to Supervise

The CFTC alleged that Merrill Lynch violated CFTC Regulation 166.3, which requires entities registered with the CFTC to "diligently supervise the handling by its partners, officers, employees and agents" of "all commodity interest accounts . . . relating to its business as a Commission registrant."[235] Typically, the CFTC brings Regulation 166.3 claims against firms who failed to prevent their employees from committing misconduct (such as manipulative trading practices). However, the CFTC took an expansive and unprecedented approach in applying this provision to find Merrill Lynch liable for its inadequate response to the CME investigation.

According to the CFTC, Merrill Lynch failed to adequately supervise its employees and agents entrusted with investigating the CME's claims of trading ahead of block trades. Although Merrill Lynch's compliance and legal departments were primarily responsible for responding to the inquiry, they relied on the Bank's operations support group to gather information for Merrill Lynch's response and provided only "minimal oversight." This was problematic because the operations support group primarily handled operational and technical issues.

The CFTC also alleged that Merrill Lynch's operations support group was authorized to speak with the traders but never provided the results of these discussions to the legal and compliance divisions.[236] Additionally, when collecting and analyzing electronic futures trading activity data, the operations support group provided only an "abridged version" to the legal and compliance departments that failed to disclose "a number of occasions" where certain traders traded futures contracts in the five minutes before the execution time of block trades. Rather, in responding to the CME's inquiries, the business unit generated an internal spreadsheet identifying several potential instances of "pre-hedging" but did not share it with legal and compliance personnel. Overall, the CME found that Merrill Lynch's "failure to stay adequately informed" regarding the

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[232] *Id.*

[233] *Id.*

[234] *Id.*

[235] *Id.* (quoting 17 C.F.R. § 166.3).

[236] *In re Merrill, Lynch, Pierce, Fenner & Smith Inc.*, CFTC No. 17-25.

activities of the operations support group contributed to its failure to detect the improper trading activity before the traders misled the CME during the interviews.[237]

Recordkeeping Violations

The CFTC also alleged that Merrill Lynch committed recordkeeping violations in connection with the block trading activity. First, according to the CFTC, Merrill Lynch had inadequate procedures in place (and failed to implement existing procedures) from at least January 2010 to October 2010 for preparing and maintaining the relevant desk's block trade records, including the procedures for recording accurate execution times.[238]

Additionally, the settlement alleged that Merrill Lynch violated § 4g of the CEA as well as Regulations 1.31 and 1.35, which generally require futures commission merchants to "[k]eep full, complete, and systematic records . . . of all transactions relating to its business of dealing commodity interests."[239] The settlement states that from January 2010 through June 2012, Merrill Lynch failed to prepare or maintain trade tickets and other records regarding the execution of block trades, including the execution times for the trades. According to the CFTC, Merrill Lynch's recordkeeping deficiencies "contributed to its failure to detect" the improper "trading ahead of block trades."[240]

The CFTC Settlement and Implications

As part of the settlement, Merrill Lynch agreed to pay a $2.5 million civil monetary penalty and to make certain improvements to its compliance procedures and controls, including clearly specifying that its sales personnel are responsible for recording block trade execution times and reporting the block trades to the relevant exchanges, making certain upgrades to its block trading recording technology, and conducting a periodic audit every three months for two years to ensure that the block trades are being properly recorded and reported.

This case underscores the importance of providing complete and accurate disclosures in response to regulatory inquiries.[241] The CFTC has made clear that it expects companies to comply fully not only with CFTC investigations but also with investigations of exchanges such as the CME or risk incurring substantial penalties. Indeed, while it is essential for companies to maintain robust compliance procedures with regard to their normal operations, they must take extra care to

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[237] *Id.*

[238] *Id.*

[239] *Id.*

[240] *Id.*

[241] Following this settlement, the CFTC entered into a similar settlement with Logista Advisors LLC, which is discussed in more detail in Section II(F)(1). In that settlement, the CFTC alleged that the employee primarily responsible for Logista's crude oil futures trading from approximately September 2013 through September 2014 was given inadequate training, direction, and supervision, which resulted in him repeatedly engaging spoofing, while trading futures on a foreign futures exchange. After the trader's misconduct, which occurred in August 2014, was detected by the exchange's compliance department, the CFTC alleged that Logista provided the exchange with a succession of inaccurate explanations for the trading at issue, and failed to detect the trader's misconduct even after Logista had been contacted by the exchange.

diligently supervise their responses to such investigations. In this way, companies should ensure that they rely on appropriate procedures and personnel to ensure that the relevant authority receives complete and accurate information.

Example Case: *In re Advantage Futures LLC, Joseph Guinan, & William Steele*, CFTC Docket No. 16-29 (Sept. 21, 2016)

In its first action enforcing CFTC Regulations 1.11 and 1.73, which involve risk management program and supervision obligations for FCMs and clearing FCMs' risk management obligations, the CFTC simultaneously filed and settled charges alleging that Advantage Futures failed to diligently supervise the handling of certain customer accounts, deficient risk management and credit risk practices, and knowingly making inaccurate statements to the CFTC through the submission of required risk manuals and the annual CCO's Report. The CFTC order also charged Advantage's CEO Joseph Guinan and former CRO William Steele with failing to supervise Advantage's risk management program in violation of Regulation 166.3 and submission of false documents in violation of Section6(c)(2).

According to the CFTC order, Advantage and Guinan failed to diligently supervise the handling of certain customer accounts, despite being notified between June 2012 and April 2013 by three exchanges about what the exchanges characterized as a problematic pattern of trading that was consistent with spoofing and/or manipulative or deceptive trading. The CFTC alleged that while Advantage eventually blocked the customer from trading in the particular contracts identified by the exchanges, it did not increase scrutiny over the customer's trading in other markets.

The CFTC further alleged that William Steele, in his role as Advantage's CRO, failed to ensure that Advantage followed its risk management, credit, and risk policies. In particular the CFTC found that although Advantage possessed written policies and procedures that appeared to comply with CFTC regulations, Advantage did not in practice follow them.

Finally, the CFTC found that Advantage knowingly made inaccurate statements to the CFTC through the submissions of its required risk manuals and annual CCO's Report that represented that certain policies and procedures were in place and followed when they were not.

Pursuant to the settlement, Advantage, Guinan, and Steele were jointly and severally liable for a $1.5 million civil monetary penalty. Advantage was also required to comply with undertakings to improve the implementation of its policies and procedures.

Example Case: *In re J.P. Morgan Securities LLC*, CFTC Docket No. 17-04 (Jan. 11, 2017)

In January 2017, the CFTC settled charges with J.P. Morgan Securities LLC ("JPMS"), a registered Futures Commission Merchant and a swap dealer, alleging that JPMS violated Section 166.3 by failing to diligently supervise its officers', employees', and agents' processing of exchange and clearing fees it charged customers for trading and clearing CME products and products from certain other exchanges between 2010 and 2014.

Customer transactions executed on exchanges are subject to payment of exchange and clearing fees that are applied to each transaction in the normal course of business. Clearing firms, such as JPMS, receive invoices for these fees from the exchange clearinghouses, which the firms pass on

to their customers. In the order, the CFTC alleged that JPMS failed to implement and maintain adequate systems for reconciling invoices from exchange clearinghouses with the amounts of fees actually charged to its customers. JPMS' fee reconciliation process was allegedly largely manual and carried out by only one employee at the end of the month using three different JPMS systems. In addition to insufficient staff to complete the fee reconciliation process accurately, JPMS allegedly did not have adequate written policies and procedures in place regarding its clearing and exchange fee reconciliations. This allegedly led to instances in which JPMS overcharged some customers in an aggregate amount of approximately $7.8 million. JPMS discovered the problem in 2014, self-reported it to the CFTC, and thereafter took remedial steps, including refunding adversely affected customers.

As part of the settlement, JPMS agreed to pay a $900,000 fine and cease and desist from violating the CFTC regulation governing diligent supervision.

Example Case: *In re AMP Global Clearing LLC*, CFTC Docket No. 18-10 (Feb. 12, 2018)

The CFTC alleged that AMP Global Clearing LLC violated Rule 166.3 by failing to supervise diligently the implementation of critical provisions in its information systems security program. As a result of this failure, customers' records and information were allegedly left unprotected for nearly ten months. According to the CFTC, this allowed a third-party to access approximately 97,000 files, which included customers' records and information, and personally identifiable information. The action was resolved by settlement.

The settlement required AMP to pay a $100,000 civil monetary penalty and cease and desist from violating the CFTC regulation governing diligent supervision. The settlement further required AMP to provide two written follow-up reports, within one-year of the settlement, to the CFTC verifying AMP's ongoing efforts to maintain and strengthen the security of its network and its compliance with its ISSP's requirements.

(c) Aiding and Abetting CEA Violations

Under § 13(a) of the CEA, an aider and abettor is liable for violations of the CEA as a principal. The CEA § 13(a) states: "[a]ny person . . . who willfully aids, abets, counsels, commands, induces, or procures the commission of a violation of any of the provisions of [the CEA] . . . may be held responsible for such violation as a principal."[242]

To state a claim for aiding and abetting under the CEA, "a plaintiff must prove that the defendant (1) had knowledge of the principal's intent to [engage in wrongdoing which would] violate the CEA; (2) intended to further that violation; and (3) committed some act in furtherance of the principal's objective."[243] However, recent actions brought by the CFTC demonstrate that aiding-and-abetting liability is not limited to market participants and instead may extend to individuals

[242] 7 U.S.C. § 13c(a).

[243] *In re Amaranth Natural Gas Commodities Litig*., 587 F. Supp. 2d 513, 531 (S.D.N.Y. 2008).

otherwise involved in the alleged scheme.[244] While a more extensive reach may be available with aiding-and-abetting liability, that expansion may similarly make it difficult for the CFTC to allege the required intent and knowledge needed to establish liability.

To establish aiding-and-abetting liability, the CFTC must demonstrate an underlying CEA violation. "Without proof of an underlying violation, the Court cannot find any liability for aiding and abetting."[245]

The standard for aiding-and-abetting liability under the CEA is the same as that for aiding and abetting under federal criminal law and requires "proof of a specific unlawful intent to further the underlying violation."[246] In the context of commodities manipulation, this aiding-and-abetting standard requires a showing that the defendant intended to cause artificial prices.[247]

Example Case: *CFTC v. Jitesh Thakkar*, No. 1:18-cv-00619 (N.D. Ill. filed Jan. 28, 2018)

The CFTC brought a civil enforcement action against Jitesh Thakkar, a computer programmer, and his company, Edge Financial Technologies, Inc. In 2013, a trader, identified as Trader A, contacted Thakkar for assistance in creating custom software to trade the E-mini S&P 500 futures contract on the CME Globex platform. Specifically Trader A wanted a Back-of-Book Function. This feature would, first, monitor open visible orders, and when a sufficient number of orders at the same price were placed, the software would increase Trader A's order by one lot. This would cause Trader A's order to move to the back of the order queue in the Globex matching system. Second, if Trader A's order was hit, the Back-of-Book Function would immediately cancel the remaining portion of the order. These features would allow Trader A to place large spoofing orders with minimal risk that they would be executed. After the program became operational, Thakkar provided additional software support as requested by Trader A.

The CFTC alleged that by creating this software, Thakkar and Edge aided and abetted Trader A's spoofing and were liable as if they were the principals under Section 13(a) of the CEA. Specifically, Thakkar created the software at the request of Trader A. And the complaint alleges that Thakkar knew, based on both communications with Trader A and the nature of the software itself, that Trader A's goal was that none of these orders be executed. Instead, Thakkar's experience working with other traders meant he knew the influence that large orders placed by Trader A using the Back-of-Book feature would create a false impression in the market and constitute unlawful spoofing. As a result, the CFTC brought a suit for injunctive relief and civil damages.

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[244] Complaint at 1–2, *CFTC v. Jitesh Thakkar*, No. 1:18-cv-00619 (N.D. Ill. filed Jan. 28, 2018) (alleging aiding-and-abetting liability against a computer programmer for designing the program that was used by a trader to engage in manipulative conduct).

[245] *CFTC v. R.J. Fitzgerald & Co., Inc.*, 173 F. Supp. 2d 1295, 1313 (M.D. Fla. 2001), *rev'd in part on other grounds*, 310 F.3d 1321 (11th Cir. 2002).

[246] *In re Amaranth Natural Gas Commodities Litig.*, 730 F.3d 170, 181 (2d Cir. 2013); *see also id.* at 182 ("aiding and abetting requires the defendant to in some sort associate himself with the venture, that he participate in it as something that he wishes to bring about, [and] that he seek by his action to make it succeed" (internal quotation marks omitted)).

[247] *Id.* at 183.

The case is currently stayed pending the resolution of a related criminal proceeding against Thakkar.

(d) Respondeat Superior, Control Person Liability & Personal Liability for Principals

(1) Respondeat Superior

The CFTC may seek to extend the reach of its enforcement actions to hold a corporate parent liable for the CEA violations of one of its subsidiaries when acting as an agent under respondeat superior liability. Section 2(a)(1)(B) of the CEA expressly provides a statutory form of vicarious liability of firms for the acts of their employees within the scope of their employment.[248] Section 2(a)(1)(B) states: "The act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent, or other person."[249]

For example, in *Commodity Futures Trading Comm'n v. MF Global Holdings Ltd.*, MF Global Holdings Ltd. ("MFGH") settled, by consent, allegations that it was liable for the CEA violations of one of its subsidiaries that was an FCM registered with the CFTC, MF Global Inc. ("MF Global"). The CFTC had asserted that MFGH was liable "as a principal of MF Global" because MFGH "was the parent company of MF Global and controlled the operations of MF Global, including the acts constituting the violations."[250] In settling with the Commission, MFGH admitted (for purposes of the consent order only) the allegations in the complaint pertaining to liability against MFGH solely based on acts and omissions of its agents."[251]

Despite potentially broad assertions of corporate parent liability under § 2(a)(1)(B), it may be argued that respondeat superior liability is inappropriate where the subsidiary is an operating company and there is no evidence of guilty awareness at the holding company. Likewise, a coincidence of officers or directors at the parent company and subsidiary entity alone should not create the agency relationship needed to justify charging a holding company.

Federal courts have applied two tests to determine whether agency exists under § 2(a)(1)(B). The 11th Circuit requires "(1) consent to the agency by both principal and agent, and (2) the control of the agent by the principal."[252] The 2nd, 7th, and 9th Circuits use a "totality of the circumstances" test.

Under general principles of agency law, "[t]he fact that a corporation or other entity owns a majority of the voting equity in another entity does not create a relationship of agency between

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[248] 7 U.S.C. § 2(a)(1)(B).

[249] *Id*.

[250] Am. Compl. at ¶ 80, *CFTC v. MF Global Inc.*, No. 11-CV-07866 (S.D.N.Y. 2013).

[251] Final Consent at 10, *CFTC v. MF Global Holdings Ltd*., No. 11-7866 (U.S.CFTC) (Dec. 23, 2014).

[252] *CFTC v. Gibraltar Monetary Corp., Inc.*, 575 F.3d 1180 (11th Cir. 2009).

each entity and the other's agents. Likewise, common ownership of multiple entities does not create relationships of agency among them."[253]

Moreover, "[w]ithin a related group of corporations or other entities the same individuals may serve as officers or directors of more than one entity. An overlapping cast in multiple organizational roles does not in itself create relationships of agency that are not otherwise present."[254]

(2) Control Person Liability

Under § 13(b) of the CEA, an individual who "directly or indirectly[] controls any person who has violated any provision of the CEA or [the rules and regulations issued under the CEA] may be held liable for such violation . . . to the same extent as the controlled person."[255]

To establish that an individual "controls" an entity, it must be shown that such individual (1) actually exercised general control over the operation of the entity principally liable during the period of time when the unlawful act occurred and (2) possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, even if such power was not exercised.[256]

In addition, § 13(b) of the CEA states that to establish personal liability it must be demonstrated that the controlling person acted with a lack of good faith or knowingly induced, directly or indirectly, the acts constituting the violation.[257]

This section of the CEA is limited by its terms to actions brought by the CFTC; there is no private right of action.

(3) Principal Liability

"Principal" is not a separate class of persons required to register under the CEA. Nonetheless, individuals having the status of "principal" as defined under the CEA must be listed with the National Futures Association and must, with certain exceptions for non-U.S. resident principals of swap dealers, provide fingerprints and personal background information as part of the swap dealer registration application. Listing as a principal of a registered entity, such as a swap dealer, under the CEA does not of itself carry with it any supervisory or other responsibilities.

However, irrespective of whether a senior officer or other person is listed as a principal of a registered entity, that person may, under certain circumstances, be personally liable for violations of the CEA and related regulations by the registered entity, its employees, or its agents. The

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253 Restatement (Third) of the Law Agency § 7.03 cmt. d(3).

254 Restatement (Third) of the Law Agency § 7.03 cmt. d(3).

255 7 U.S.C. § 13c(b).

256 *See CFTC v. Baragosh*, 278 F.3d 319, 330 (4th Cir. 2002).

257 7 U.S.C. § 13c(b).

liability could arise under the CEA's aiding-and-abetting, respondeat superior, or control-person provisions described above.

Case Study: U.S. Commodity Futures Trading Comm'n v. MF Global Holdings Ltd., Jon S. Corzine, and Edith O'Brien, 11-CV-7866 (S.D.N.Y. filed Jan. 5, 2017)

In January 2017, the CFTC obtained consent orders against Jon S. Corzine, the former CEO of MF Global Inc. ("MF Global"), a registered FCM, and CEO and Chairman of the Board of Directors of MF Global's parent company, and Edith O'Brien, the former Assistant Treasurer of MF Global who was responsible for directing, approving, and/or causing certain wire transfers and other payments into and out of MF Global's customer accounts. As the CEO, Corzine was found liable for MF Global's violations of the CEA as a controlling person pursuant to § 13(b) of the CEA and for failure to diligently supervise the activities of the officers, employees, and agents who handled customer funds in violation of CFTC Regulation 166.3. [258] The CFTC found controlling person liability as a result of Corzine's role as a CEO, which included among others directly and indirectly controlling employees responsible for making the wire transfers at issue, making management and hiring decisions, influencing how proprietary funds were invested, and directly and indirectly controlling MF Global and its employees in October 2011 when the wire transfers were executed.

The orders found that MF Global, which was experiencing a worsening liquidity crisis, unlawfully commingled and used customer segregated funds to support its own proprietary operations and the operations of its affiliates and to pay broker-dealer securities customers and pay FCM customers for withdrawals of secured customer funds in October 2011. Corzine was found to have been aware of the transfer of funds, MF Global's liquidity crisis, JP Morgan's request for written assurances of compliance with CFTC regulations, and MF Global's policy to maintain a positive amount of FCM excess cash in customer accounts.

As a result, Corzine was ordered to pay a $5 million civil monetary penalty; prohibited from seeking or accepting, directly or indirectly, reimbursement or indemnification from any insurance policy with regard to the penalty amount; and required to undertake that he will never act as a principal, agent, officer, director, or employee of a FCM and that he will never register with the CFTC in any capacity.

As a principal of the organization, Edith O'Brien was found to have herself violated aiding and abetting provisions in § 13(a) of the CEA.[259] O'Brien instructed, approved, and/or caused seven transfers of funds from customer segregated accounts to MF Global's proprietary accounts totaling hundreds of millions of dollars that caused and/or contributed to a deficiency in the customer segregated accounts. As an Assistant Treasurer, O'Brien was a senior officer at MF Global who supervised MF Global's Treasury Department. O'Brien knew that certain funds would be transferred from customer segregated accounts to MF Global's proprietary accounts in October 2011 and by this conduct was found to have aided and abetted MF Global's segregation violations. O'Brien was ordered to pay a civil monetary penalty of $500,000.

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258 CFTC Regulation 166.3 and supervisory liability is discussed at Section II(C)(6)(b) above.

259 Commodities Exchange Act § 13(a) is discussed at Section II(C)(6)(c) above.

Example Case: *In re Apache Trading Corp.*, CFTC No. 87-14, 1992 WL 52596 (Mar. 11, 1992)

Clancy, an individual, appealed to the CFTC from an administrative law judge's ("ALJ") decision that he was liable as a control person for options fraud committed by Apache's associated persons. The CFTC affirmed the ALJ's control-person ruling, finding that (1) Clancy made or approved all of the decisions of Apache and its employees; and (2) Clancy did not act in good faith, as evidenced by his failure to establish any system of supervision for Apache's employees and his deliberate attempts to insulate himself from, rather than prevent, Apache's fraudulent sales efforts.

Example Case: *Monieson v. U.S. Commodity Futures Trading Comm'n*, 996 F.2d 852 (7th Cir. 1993)

Monieson appealed from the CFTC's assessment of monetary penalties and other sanctions against him based on a finding that he was a control person of two futures commission merchant employees (associated persons) who engaged in fraudulent trading practices—namely, bucketing customer futures orders—in violation of the CEA. The Seventh Circuit affirmed the CFTC's decision, rejecting Monieson's arguments that (1) control-person liability is available only where a defendant is the "alter ego" of a dummy corporation; (2) he did not qualify as a control person because he did not dominate the operations of the corporation; and (3) the CFTC did not prove that he acted with a lack of good faith. The court concluded that (1) the control-person provision is broadly written and should be broadly construed to encompass control not only over shell companies but also over individuals; (2) the evidence was sufficient to show that Monieson exercised general control over the activities of both the corporation and its employees, including the rogue employees; and (3) Monieson demonstrated a lack of good faith in recklessly failing to conduct a follow-up investigation after an initial inquiry into the traders' practices was inconclusive, despite repeated warnings and complaints by multiple other employees.

(e) Whistleblower Protection

The DFA added § 23 of the CEA, which provides for whistleblower protections, including a private right of action for retaliation that allows for reinstatement, back pay with interest, and compensation for special damages. Pursuant to the CEA, "[n]o employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower" in reporting misconduct to the CFTC or for assisting in any investigation into misconduct.[260]

Based on a recent reinterpretation of the CFTC's anti-retaliation authority under the CEA, the CFTC or the whistleblower may now bring an action against an employer for retaliation against a whistleblower. [261] In May 2017, the CFTC unanimously approved amendments to the whistleblower rules that will (1) strengthen the CFTC's anti-retaliation protections for

[260] 15 U.S.C. § 78u–6(h)(1)(A).

[261] U.S. Commodity Futures Trading Comm'n, *CFTC Strengthens Anti-Retaliation Protections for Whistleblowers and Enhances the Award Claims Review Process* (May 22, 2017), http://www.cftc.gov/PressRoom/PressReleases/pr7559-17.

whistleblowers; (2) enhance the process for reviewing whistleblower claims; (3) add efficiency and transparency to the process of deciding whistleblower award claims and will, in many respects, harmonize the CFTC's rules with those of the U.S. Securities and Exchange Commission's whistleblower program; and (4) prohibit employers from taking steps to impede a would-be whistleblower from communicating directly with CFTC staff about a possible violation of the CEA by using a confidential, pre-dispute arbitration or similar agreement.[262]

The amended rules establish a claims review process which will utilize a Claims Review Staff, in place of the Whistleblower Award Determination Panel, to consider and issue a Preliminary Determination as to whether an award claim should be granted or denied. A whistleblower will then have an opportunity to request to view the record and may contest the Preliminary Determination before the CFTC issues a Final Determination. The amendments also make changes to other key areas, such as whistleblower eligibility requirements, and make clear that, with limited exceptions, a whistleblower may receive an award in a Covered Action, a Related Action, or both. In addition, the amendments authorize the Whistleblower Office to handle facially ineligible award claims that do not relate to a Notice of Covered Action, a final judgment in a Related Action, or a previously filed Form TCR (Tip, Complaint, or Referral). The amended rules will go into effect sixty days after publication in the Federal Register.

The CFTC's anti-retaliation provision has been used less frequently by employees than the identical provision in the Exchange Act. Nonetheless, it provides any employee who feels that she or he has suffered an adverse employment action with a potent tool to rectify the perceived wrong. Pursuant to the statute, an employer may not "discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment."[263]

Courts have construed the identical language in the Exchange Act as being purposely broad in order to allow courts to make a "factual determination on a case-by-case basis" of whether allegedly retaliatory conduct is in fact retaliatory.[264] As a result, courts have refused to create a bright-line standard for what constitutes adverse employment action and instead "pore over each

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262 *Id*.

263 The CEA anti-retaliation provision is nearly identical to the protection given to whistleblowers under the Sarbanes Oxley Act ("SOX") and the only difference between the two provisions is that the CEA provision specifically prohibits direct or indirect actions against employees. *Compare* 7 U.S.C. § 26(h)(1)(A) (stating that no employer "may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower"), *with* 18 U.S.C.A. § 1514A(a) (stating that identified classes of employers may not "discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee"). As a result, courts will likely apply SOX case law to determine whether actions are retaliatory for purposes of the CEA provision, as they have done with the identical provision added to the Exchange Act. *See e,g.*, *Ott v. Fred Alger Mgmt., Inc*., No. 11 Civ. 4418 LAP, 2012 WL 4767200, at *7 (S.D.N.Y. Sept. 27, 2012) (applying SOX case law to determine what constitutes retaliation under the whistleblower provision added to the Exchange Act by Dodd-Frank).

264 SEC, *Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934* (2011), https://www.sec.gov/rules/final/2011/34-64545.pdf.

case to determine whether the challenged employment action" constitutes an adverse action.[265] Therefore, any adverse action could be construed by an employee as potentially retaliatory. But, in practice, based on precedent from similar whistleblower provisions, we would expect claims to generally be predicated on conduct, such as dismissals, [266] demotions, [267] or decreased compensation.

Based on judicial decisions construing similar anti-retaliation provisions, these cases are likely to be difficult to dismiss and to defeat at the motion for summary judgment stage.[268] Under this framework, the plaintiff carries the initial burden of "proving by the preponderance of the evidence a prima facie case."[269] To establish a prima facie case, a plaintiff must prove: (1) he engaged in protected activity; (2) the employer knew the plaintiff engaged in protected activity; (3) the plaintiff suffered an unfavorable action; and (4) the protected activity was a contributing factor in such action.[270] Courts have stated that this prima facie burden for plaintiffs "is not onerous, and has been frequently described as minimal."[271]

Once a plaintiff makes this minimal showing, it "in effect creates a presumption that the employer unlawfully [retaliated] against the employee."[272] The defendant must then articulate a legitimate, non-retaliatory reason for its employment decision. [273] In making this argument, companies generally try to sever the causal connection between the report and the termination.[274] However, it is difficult to make this showing at summary judgment.

The CEA also contains a whistleblower bounty provision, pursuant to which, whistleblowers are entitled to monetary awards of 10% to 30% of the monetary sanctions imposed in a successful enforcement action based on the whistleblowers disclosure. To date, the CFTC has made four awards pursuant to this authority. The largest award in April 2016 was for more than $10 million.

Both FERC's and the CFTC's enforcement actions against Total Gas, which we discuss below, stemmed from tips received by two whistleblowers, who separately alerted the agencies to Total

[265] *Wanamaker v. Columbian Rope Co.,* 108 F.3d 462, 466 (2d Cir. 1997) (ADEA anti-retaliation claim).

[266] *See e,g.*, *Ott*, 2012 WL 4767200, at *3 (employee alleged that she was terminated for reporting to the SEC that she believed that the hedge fund's trading policy allowed the firm to trade ahead of customer orders).

[267] *See, e.g.*, *In re Paradigm Capital Mgmt., Inc*., S.E.C. No. 3-15930 (2014) (hedge fund settled claims by the SEC that it retaliated against an employee who was relieved of his responsibilities following complaint).

[268] *Cf. Ashmore v. CGI Grp. Inc*., 138 F. Supp. 3d 329, 339–40 (S.D.N.Y. 2015) ("[A]n employer's burden under [SOX] is notably greater than the burden imposed by other federal employee protection statutes, making summary judgment against plaintiffs in [SOX] retaliation cases a more difficult proposition.") (internal citation and quotation marks omitted).

[269] *Tex. Dep't of Cmty. Aff. v. Burdine*, 450 U.S. 248, 252–53 (1981).

[270] *Bechtel v. Admin. Rev. Bd*., 710 F.3d 443, 447 (2d Cir. 2013).

[271] *Scaria v. Rubin*, 117 F.3d 652, 654 (2d Cir. 1997).

[272] *Tex. Dep't of Cmty. Aff*., 450 U.S. at 254.

[273] *Reeves v. Sanderson Plumbing Prods., Inc*., 530 U.S. 133, 142–43 (2000).

[274] *Fraser v. Fiduciary Tr. Co. Int'l*, No. 04-CIV-6958 (PAC), 2009 WL 2601389, at *6 (S.D.N.Y. Aug. 25, 2009), *aff'd*, 396 F. App'x 734 (2d Cir. 2010).

Gas's activities. In October 2011, a former trader filed a whistleblower complaint implicating one of the accused traders and certain officers at Total Gas's parent and affiliate companies. On June 3, 2012, a separate employee sent an email to FERC's Enforcement Hotline, followed by a formal whistleblower complaint to the CFTC one week later.

D. Overlap between Antitrust Violations and Market Manipulation

1. Introduction

The CFTC typically prosecutes two main types of wrongdoing: fraud and market manipulation.[275] CEA market manipulation often involves conduct that is intended to create an artificial price through control of a market either individually or as part of a conspiracy with other market participants. This conduct is remarkably similar to the conduct that is prohibited by the U.S. antitrust laws, which seek to combat anticompetitive activity.

Despite the similarity between antitrust and CEA violations, for many years, the risk of criminal antitrust enforcement in the commodity and derivatives trading markets was largely theoretical, as the Antitrust Division was inactive in respect of those markets. But in the last decade, some of CFTC's most high-profile market manipulation settlements—including the investigations into the setting of the London Interbank Offered Rate ("LIBOR") and pricing of foreign exchange instruments ("FX")—have featured parallel criminal cartel investigations in which the Antitrust Division has secured corporate guilty pleas and imprisonment for employees participating in the manipulative conduct on a concerted basis with competitors.

The Antitrust Division has also made clear that this trend is likely to continue. Senior Antitrust Division officials have said collusion in the trading markets is "no different" than collusion in the markets for sorts of "traditional products and services" that the Antitrust Division routinely prosecutes."[276] And the Antitrust Division affirmed that its strategy for the coming year includes "continu[ing] to uncover and prosecute cartels . . . in many areas including financial services."[277]

2. The Sherman Act

The U.S. antitrust laws regulate and promote marketplace competition. The most important statute is the Sherman Act of 1890 ("Sherman Act"), which prohibits a wide variety of anticompetitive conduct. Section 1 deals with concerted activity that is harmful to competition, prohibiting

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[275] Philip McBride Johnson & Thomas Lee Hazen, Derivatives Regulation §§ 1.15[1] (3d ed. 2004).

[276] *See* Press Release, U.S. Dep't of Justice, Second Foreign Currency Exchange Dealer Pleads Guilty to Antitrust Conspiracy (Jan. 12, 2017), https://www.justice.gov/opa/pr/second-foreign-currency-exchange-dealer-pleads-guilty-antitrust-conspiracy.

[277] *See* U.S. Dep't of Justice, Antitrust Division, *FY 2018 Budget Request at a Glance* 2 (2017), https://www.justice.gov/jmd/page/file/968396/download.

agreements by two or more parties that unreasonably restrain trade.[278] Section 2 addresses single-firm abuses of market power, prohibiting unlawful monopolizations and monopolistic behavior.[279]

Section 1 of the Sherman Act prohibits every contract, combination, or conspiracy "in restraint of trade or commerce among the several States, or with foreign nations."[280] However, any sort of contract or agreement between two parties will restrain trade in some way.[281] Moreover, many forms of market collaboration produce benefits for the economy and the public. For example, a joint venture may help bring new products to market and reduce prices for consumers. Therefore, courts have long concluded that § 1 does not work to prohibit *all* restraints of trade but rather only those that are deemed "unreasonable."[282] To answer this fundamental question of whether certain conduct constitutes an "unreasonable restraint of trade" in violation of § 1, courts have developed two modes of analysis.

Most restraints of trade are analyzed under the "rule of reason."[283] The rule of reason is a general inquiry into whether the relevant conduct constitutes an unreasonable restraint on competition based on all of the circumstances.[284] When applying the rule of reason, courts will engage in an extensive, fact-driven analysis of all relevant factors relating to the restraint, such as information about the market in which the restraint occurred and "the restraint's history, nature, and effect."[285] Ultimately, the goal of the analysis is to determine whether, on balance, the conduct's procompetitive benefits are outweighed by the conduct's harmful effects on competition and is therefore "unreasonable."[286]

Some restraints, however, are so antithetical to the ideals of free and open competition the Sherman Act is meant to protect that they are deemed to violate § 1 without any inquiry into their procompetitive benefits or justifications.[287] Such restraints are referred to as "*per se*" violations of the Sherman Act. Because application of *per se* rules denies the defendant the opportunity to

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278 15 U.S.C. § 1.

279 15 U.S.C. §§ 1-2.

280 15 U.S.C. § 1.

281 *Bd. of Trade of City of Chicago v. United States*, 246 U.S. 231, 244 (1918) ("Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence.").

282 *See Standard Oil Co. v. United States*, 221 U.S. 1, 60 (1911) (holding that reasonableness "was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which [Sherman Act § 1] provided").

283 *See Texaco Inc. v. Dagher*, 547 U.S. 1, 5 (2006) (explainting that the Supreme Court "presumptively applies rule of reason analysis" in determining whether a restraint violates Section 1).

284 *See Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 885 (2007).

285 *Id.*

286 *See id.* ("In its design and function the rule distinguishes between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that in the consumer's best interest.").

287 *See Dagher*, 547 U.S. at 5 ("*Per se* liability is reserved for only those agreements that are 'so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality.'").

articulate any explanations or justifications for the relevant restraint, only certain specific types of conduct will be treated as *per se* violations.

To determine whether an alleged Sherman Act violation calls for rule of reason analysis or *per se* treatment, courts typically look first to the structure of the alleged agreement and whether it involves a "horizontal" or "vertical" restraint. Horizontal restraints are those formed by direct competitors operating at the same level of a supply or distribution chain, such as an agreement among competing steel manufacturers. Vertical restraints are those formed by direct competitors operating at the same level of a supply or distribution chain, such as an agreement among competing steel manufacturers. Vertical restraints are those between entities at different levels of a distribution chain, such as an agreement between a steel manufacturer and a steel distributor.

Courts apply the rule of reason to all vertical restraints of trade, while certain forms of horizontal conduct will be subjected to *per se* treatment.[288] If an agreement among horizontal competitors creates a naked restraint on price or output and facially appears to restrict competition or decrease output, it will be deemed illegal *per se* in violation of § 1. The most obvious example of a *per se* violation is an agreement among competitors to fix prices.[289] Other examples of *per se* illegal conduct include horizontal agreements to allocate markets or customers, rig bids, or engaging in group boycotts.

Section 2 of the Sherman Act prohibits illegal monopolies and monopolizations of "any part of the trade or commerce."[290] Monopoly is the "[c]ontrol or advantage obtained by one supplier or producer over the commercial market within a given region,"[291] and monopoly power is "the power to control prices or exclude competition."[292] Because a monopoly may be "thrust upon" or created by accident due to market changes or by "superior skill, foresight, and industry,"[293] courts find imposition of criminal penalties and civil liabilities to be unfair in such situations under the Sherman Act, and thus one must have both monopoly power and intent to monopolize to violate § 2.[294]

To determine the monopoly power (i.e. market share) of an alleged monopolist, one must define the relevant market and the power to control prices or output and exclude competition. [295] A manufacturer's control of the relevant market depends on the availability of alternative

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[288] *See Leegin*, 551 U.S. at 894-899. Courts may in some cases apply a "quick look" rule of reason applies where an agreement creates a naked restraint on price or output but the application of per se illegality is inappropriate because procompetitive justifications exist. *See NCAA v. Bd. of Regents of the U. of Okla*., 468 U.S. 85 (1984); *United States v. Brown U*., 5 F.3d 658 (3d Cir. 1993).

[289] *United States v. Socony-Vacuum Oil Co*., 310 U.S. 150, 218 (1940).

[290] 15 U.S.C. § 2.

[291] *Monopoly*, Black's Law Dictionary (10th ed. 2014).

[292] *United States v. E. I. du Pont de Nemours & Co*., 351 U.S. 377, 391 (1956) [hereinafter *du Pont*].

[293] *United States v. Aluminum Co. of Am*., 148 F.2d 416, 429-30 (2d Cir. 1945) [hereinafter *Alcoa*].

[294] *Id*. at 430, 432 ("In order to fall within § 2, the monopolist must have both the power to monopolize, and the intent to monopolize.").

[295] *See du Pont*, 351 U.S. at 380-404.

commodities for buyers,[296] meaning monopoly power increases or decreases as the number of substitutes decreases or increases, respectively. The relevant market, then, consists of "commodities reasonably interchangeable by consumers for the same purposes," and substitutability is "largely gauged by the purchase of competing products for similar uses considering the price, characteristics and adaptability."[297] Thus, courts examine how different the goods are in character or use and "how far buyers will go to substitute,"[298] while being cautious not to distort the results[299] by taking note of the geography, interindustry competition, and relevant submarkets.[300] With respect to market harm, courts analyzing potential antitrust violations are concerned with harm to the competitive process or competition, not to the competitors in the market.[301]

Regarding intent, an alleged monopolist must commit some act, or use its monopoly power, in a manner that reflects the actor's intent to monopolize.[302] Generally, relevant "bad acts" consist of exclusion of competitors, unnatural growth, and use of unduly coercive means for market dominance, and the "bad intent" consists of predatory or retaliatory motives. Principal "bad acts" for purposes of § 2 include: refusal to deal, unlawful leveraging, price squeezing, and predatory pricing.

Unilateral refusal to deal satisfies the intent element of the two-prong test for a § 2 violation if the actor impairs opportunities of rivals and either does not further competition on the merits or does so in an unnecessarily restrictive way. Unlawful leveraging is where an actor uses its monopoly power in one market to wrongfully acquire a monopoly in a second market. A price squeeze exists where a vertically integrated firm operating in both the wholesale (upstream) market and the retail (downstream) market exerts market power to raise wholesale prices while cutting down its own retail prices to raise competing nonintegrated firms' costs while lowering its revenues. Predatory pricing is below-cost pricing (i.e. profit sacrifice) with a reasonable probability of recoupment of lost profits in the future.

3. The CEA's General Provisions Regarding Competition

The CEA, which "regulates futures, options on futures, commodity options, and certain other derivatives to establish a comprehensive new regulatory framework for swaps and security-based swaps,"[303] contains numerous provisions that explicitly refer to antitrust law and principles. Under § 3(b), one of the CEA's purpose is "to promote responsible innovation and fair competition among

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[296] *Id*. at 380.

[297] *Id*. at 395, 380.

[298] *Id*. at 393.

[299] *United States v. Grinnell Corp*., 384 U.S. 563, 587 (1966).

[300] *Id*. at 393; *F.T.C. v. Whole Foods Mkt., Inc*., 548 F.3d 1028, 1037-39 (D.C. Cir. 2008).

[301] *NYNEX Corp. v. Discon, Inc*., 525 U.S. 128, 135 (1998).

[302] *Alcoa*, 148 F.2d at 432.

[303] Gregory Scorpino, *Expanding the Reach of the Commodity Exchange Act's Antitrust Considerations*, 45 HOFSTRA L. REV. 573, 587 (2016).

boards of trade, other markets and market participants."[304] Under § 15, the CFTC must consider antitrust laws to protect public interest and "endeavor to take the least anticompetitive means of achieving the objectives" of the CEA.[305] Section 4s(j)(6), labeled "Antitrust Considerations," was added by the DFA to prohibit swap dealers and major swap participants from "adopt[ing] any process or tak[ing] any action that results in any unreasonable restraint of trade; or impos[ing] any material anticompetitive burden on trading or clearing."[306] Additionally, pursuant to § 6c(a), the CFTC has authority to take action against any registered entity or other person who is engaging in any practice that "is restraining trading in any commodity for future delivery or any swap."[307] This language echoes the prohibition on restraint of trade that lies at the heart of the U.S. antitrust laws, which continue to have a major impact on CEA market manipulation jurisprudence.

Section 3(b) of the CEA states:

> It is the purpose of [the CEA] to serve the public interests . . . through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the [CFTC]. To foster these public interests, it is further the purpose of [the CEA] to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions . . . and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.[308]

These stated intentions provide an "intelligible principle" focused on preserving market integrity and protecting market participants by preventing fraudulent and abusive trading practices.[309]

Section 15 (7 U.S.C. § 19) Titled "Consideration of costs and benefits and antitrust laws," § 15 of the CEA directs the CFTC to consider the costs and benefits of its actions, given considerations of, inter alia, protection of market participants and the public as well as efficiency, competitiveness, and financial integrity of futures markets.[310] It also requires the CFTC to "take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives" of the CEA, as well as the policies and purposes of the statute in issuing any order, adopting any rule or regulation, or requiring or approving "any bylaw, rule, or regulation of a contract market or registered futures association."[311]

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[304] 7 U.S.C. § 5(b).

[305] 7 U.S.C. § 19.

[306] 7 U.S.C. § 6s(j)(6).

[307] 7 U.S.C. § 9(1)(A).

[308] 7 U.S.C. § 5(b).

[309] *CFTC v. Oystacher*, 203 F. Supp. 3d 934, 952 (N.D. Ill. 2016) (*citing J.W. Hampton, Jr. & Co. v. United States*, 276 U.S. 394, 409).

[310] 7 U.S.C. § 19(a).

[311] 7 U.S.C. § 19(b).

Thus, § 15 circumscribes the antitrust-relevant considerations of the CFTC's rulemaking and enforcement functions.

Section 4s(j)(6) (7 U.S.C. § 6s(j)(6)) labeled "Antitrust Considerations," states:

> Unless necessary or appropriate to achieve the purposes of this chapter, a swap dealer or major swap participant shall not—
>
> > (A)adopt any process or take any action that results in any unreasonable restraint of trade; or
> >
> > (B) impose any material anticompetitive burden on trading or clearing.

From this statutory language, the CFTC has developed new regulations on anticompetitive conduct in swaps markets. Under 17 CFR § 23.607, the CFTC prohibits any swap dealer or "major swap participant" from adopting any process or taking any action that results in an "unreasonable restraint of trade" or imposes a material "anticompetitive burden on trading or clearing, unless necessary or appropriate to achieve the purposes of the Commodity Exchange Act."

These new provisions contain language borrowed directly from antitrust law jurisprudence. Section 1 of the Sherman Act prohibits agreements and combinations "in restraint of trade." However, as discussed above, courts have interpreted the Sherman Act to only prohibit "unreasonable" restraints of trade. The notion of "reasonableness" in the antitrust context is simple enough to describe. Conduct with legitimate, procompetitive justifications that outweighs their detrimental impact on competition is beyond the scope of prosecution under the antitrust laws. The complexity exists when determining whether the relevant conduct's anticompetitive effect is actually outweighed by its procompetitive benefits in a particular case.

While there are no cases to date interpreting § 4s(j)(6) or the CFTC's rules promulgated pursuant to that provision, use of the term "unreasonable restraint of trade" indicates that Congress and the CFTC intended to introduce the concept of reasonableness as it is understood under the antitrust laws. Thus, the decades of judicial precedent, which distinguish "unreasonable" restraints that are harmful to competition and consumers from "reasonable" restraints that are beneficial to trade, ought to serve as persuasive authority on the proper application of these new provisions.

Finally, under § 6c(a) of the CEA, the CFTC can bring civil actions in federal courts whenever the CFTC believes that an entity or person "has engaged, is engaging, or is about to engage in any act or practice constituting a violation" of the CEA or is "restraining trading in any commodity for future delivery or any swap" to enjoin such act or practice or to enforce compliance. [312] Although the statute lists "restraining trading" to suggest discussions of antitrust laws, all cases deal with issues of injunctions or remedies based on alleged violations of a specific CEA provision, not restraint of trade which is less concrete than a specific statutory violation and which may be better addressed by the antitrust laws.

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[312] 7 U.S.C. § 13a-1(a).

4. Corners and Monopolizations

One form of conduct that could violate both the CEA and the antitrust laws simultaneously is the market "corner" or "squeeze."[313] A corner is an operation where a person or an entity buys all available supply of a commodity to manipulate the price charged to potential purchasers of the commodity.[314] Similarly, a "squeeze" refers to a situation in which a party holds a dominant long position in a commodity but does not have direct control over the entire supply of the commodity in the market. A successful squeeze involves a party acquiring a sufficiently dominant market position to raise the price at which short-positioned parties can settle their holdings.

As discussed more fully below, the act of buying or controlling all or nearly all of the supply of a commodity to establish a position of dominant market power and abusing that power to manipulate prices could potentially violate the anti-manipulation provisions of the CEA [315] and the anti-monopoly provisions of § 2 of the Sherman Act. At least one court has noted that a "corner amounts to nearly a monopoly of a cash commodity, coupled with the ownership of long futures contracts in excess of the amount of that commodity, so that shorts—who because of the monopoly cannot obtain the cash commodity to deliver on their contracts—are forced to offset their contract with the long at a price which he dictates, which of course is as high as he can prudently make it."[316] Moreover, while it is possible for a single party to corner or squeeze a market, in cases where two or more individuals or firms work together to execute a corner or squeeze, such concerted activity may be In fact, before the CEA or Grain Futures Act of 1922 were enacted, corners and squeezes were challenged under the Sherman Act. In *United States v. Patten*, the government charged four individuals with violations of §§ 1 and 2 based on an alleged attempt to corner the cotton market on the New York Cotton Exchange ("NYCE").[317] The indictment alleged that the conspirators purchased cotton futures on the NYCE "greatly in excess of the amount available for delivery when deliveries should become due," and thus created an "abnormal demand" on the part of short sellers who "would pay excessive prices to obtain cotton for delivery upon their contracts." [318] While acknowledging that "corners are illegal," the trial court nevertheless concluded that corners "cannot, strictly speaking, be called a combination in restraint of competition;"[319] that corners, at least temporarily, actually increase competition; and that "it is more than doubtful whether a combination to run a corner restrains competition at all."[320]

On appeal, the Supreme Court reversed, holding that corners do constitute a restraint of trade within the meaning of § 1 of the Sherman Act.[321] The Court explained that corners "thwart the

[313] *See infra* Section V(H)(2).

[314] JERRY W. MARKHAM, LAW ENFORCEMENT AND THE HISTORY OF FINANCIAL MARKET MANIPULATION 3 (2014).

[315] *See Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971).

[316] *Id*. at 1162.

[317] *United States v. Patten*, 187 F. 664 (S.D.N.Y. 1911).

[318] *Id*. at 667.

[319] *Id*. at 668.

[320] *Id*. at 669.

[321] *United States v. Patten*, 226 U.S. 525 (1913).

usual operation of . . . supply and demand," "withdraw the commodity from the normal current of trade," "enhance the [commodity's] price artificially," "hamper users and consumers in satisfying their needs," and "produce practically the same evils as does the suppression of competition."[322] The Court concluded that, because the defendants' conspiracy "would directly and materially impede" the interstate market for cotton, the defendants "inflict[ed] upon the public the injuries which the anti-trust act is designed to prevent."[323]

In *Peto v. Howell*, a grain dealer sued a grain trader on the Chicago Board of Trade for monopolizing the corn market in Chicago in violation of § 2 of the Sherman Act.[324] The defendant purchased large amounts of July 1931 deliverable corn, while also holding futures contracts for "July corn" that "exceeded the supply of corn available for delivery in Chicago in July." The defendant ultimately acquired warehouse receipts for all the July corn available in Chicago, while owning contracts for delivery of an additional 1.5 million bushels. Plaintiff alleged that these purchases were "made with the intention . . . of withholding the commodity from the market and thereby causing a sharp increase in its price."[325] The plaintiff also alleged that the defendant thereby became the "dictator" of the price of corn in Chicago and was able to force those unable to deliver, including the plaintiff, to settle their contracts for "an excessive sum of money."[326]

The Seventh Circuit reversed the trial court's grant of a directed verdict in the defendant's favor based on insufficient proof of monopolization of "interstate commerce." While acknowledging that "only when a monopoly of some part of interstate commerce is involved does jurisdiction attach to the federal government," the Seventh Circuit disagreed that the defendant's purchases of corn futures contracts for corn to be delivered in Chicago was wholly intrastate in nature[327] because corn flowed into the Chicago market, which has influence over the country's broader corn market, from across the country and "necessarily passed to the defendant in satisfaction of his contracts of purchase."[328] The court held that substantial evidence showed the defendant "monopoliz[ing] the part of interstate commerce represented by his contracts for future deliver in July, viz., 90 per cent of the available corn of the commercial visible supply of the entire country."[329]

<u>Case Study: Hunt Brothers Silver Manipulation</u>

In the late-1970s, commodities speculators, Nelson Bunker Hunt and Herbert Hunt (known as the Hunt Brothers), and several other silver futures traders and brokerage houses amassed silver reserves and futures contracts in an effort to corner the silver market. The Hunt Brothers and their co-conspirators built up a massive long position in physical silver, in addition to acquiring at least $3 billion in silvers futures contracts. Between 1979 and 1980, the price of silver rose from less

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322 *Id*. at 542.

323 *Id*. at 543.

324 101 F.2d 353 (7th Cir. 1938).

325 *Id*. at 355.

326 *Id*.

327 *Id*. at 359-60.

328 *Id*. at 359.

329 *Id*.

than $9 an ounce to as high as $50 an ounce before eventually collapsing in March 1980 and triggering a financial emergency referred to as the "Silver Crisis." During this period, the Hunt Brothers demanded delivery of the silver on their contracts while taking care to ensure their holdings were kept in various locations and not re-delivered back to them. The prices fell only after the CBOT implemented emergency rules imposing silver position limits, increased margin requirements, and trading for liquidation only on U.S. silver futures.

The CFTC investigated and charged the Hunt Brothers, as well as several of their conspirators, with manipulation in violation of the Section 9(b) of the CEA for their attempt to squeeze the silver market. As a result of the CFTC's enforcement action, both Hunt Brothers agreed to a $10 million civil penalty and a lifetime ban from trading on CEA-covered commodity exchanges.

The Hunt Brothers' silver manipulation also spawned a number of private civil actions, in which plaintiffs alleged violations of §§ 1 and 2 of the Sherman Act in addition to violations of the CEA.[330] In an action by a Peruvian state-owned mining company, a jury found that the Hunts violated both the CEA and the antitrust laws (as well as committed RICO violations and common law fraud) and awarded the plaintiffs a judgment of $132 million.[331]

Case Study: Sumitomo Copper Manipulation

In 1995-1996, Sumitomo, a Japanese corporation and one of the world's largest refiners, sellers, and traders of copper and copper futures attempted to manipulate the copper market. The CFTC found that Sumitomo, in collaboration with U.S. copper merchant Global Minerals and Metals and others, "established and maintained large and dominating futures positions in copper metal on the London Metal Exchange . . . which directly and predictably caused copper prices . . . to reach artificially high levels."[332] At certain times during the fourth quarter of 2015, Sumitomo and the U.S. copper merchant controlled up to 100% of LME copper stocks, while also maintaining large and controlling LME futures positions. Sumitomo reaped significant profits by eventually selling at the artificially high prices it created. The CFTC concluded that Sumitomo's conduct reflected an intentional effort to manipulate copper prices and charged Sumitomo with violating the CEA. Sumitomo agreed to pay a fine of $150 million to settle the charges.[333]

Sumitomo's attempt to corner the copper market also sparked several civil suits by private plaintiffs. Sumitomo and its co-conspirators settled a private class action based on CEA violations for $134,600,000, which was described at the time as "the largest class action recovery in the 75 plus year history of the Commodity Exchange Act."[334] Private plaintiffs also launched lawsuits against Sumitomo and other members of the conspiracy alleging violations of the Sherman Act.[335] Plaintiffs alleged that Sumitomo, Global Minerals and Metals (a U.S. copper merchant in

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330 *See Minpeco, S.A. v. ContiCommodity Serv*., 673 F. Supp. 684 (S.D.N.Y. 1987).

331 *See Minpeco, S.A. v. Hunt*, 718 F. Supp. 168 (S.D.N.Y. 1989).

332 *See In re Sumitomo Corp*., CFTC No. 98-14 (May 11, 1998).

333 *Id.*

334 *See In re Sumitomo Copper Litig*., 74 F. Supp. 2d 393, 395 (S.D.N.Y. 1999).

335 *See e.g.*, *Loeb Industries, Inc. v. Sumitomo Corp.,* 306 F.3d 469 (7th Cir. 2002).

coordination with whom Sumitomo acquired its massive position in copper), and several others conspired together to "fix and maintain the price of copper at artificially high levels from September 1993 to June 1996."[336]

5. False Reporting and Collusion

False reporting, which is prohibited by the CEA, could also violate the Sherman Act if an actor knowingly provides false or misleading information through interstate commerce in concert with others to manipulate price. False reporting is transmission or delivery of market reports or information through interstate commerce which are false, misleading, or inaccurate and which affect or tend to affect the price of a commodity in interstate commerce. [337] Collusion is an agreement between two or more persons to defraud another of his or her rights or obtain any object forbidden by law.[338]

For example, entities and individuals involved in setting benchmark interest rates have been charged with violating both the CEA and the Sherman Act by making false reports to manipulate or attempt to manipulate price. Section 6b(a) of the CEA prohibits any person from willfully making any false reports or misleading statements in connection with the sale of any commodity,[339] and courts have recognized that "one of the most common manipulative devices [is] the floating of false rumors which affect futures prices"[340] through a false impression concerning supply and demand and the willingness of others to enter into trades at specified prices. Under § 1 of the Sherman Act, all horizontal price-fixing agreements and conspiracies are illegal per se (i.e., illegal regardless of their objectives, mechanisms, or effects due to their actual or potential threat to the economy),[341] including "conspiracies and agreements to rig benchmark interest rates and Forex benchmark rates that serve as components to the prices of derivatives and other financial instruments."[342]

Additionally, in follow-on civil cases, plaintiffs alleged that competitor banks and interdealer brokers not only violated § 6b(a) of the CEA through false reports but also engaged in horizontal price-fixing in violation of § 1 of the Sherman Act by colluding to artificially set the benchmark interest rates that served as components of the prices of interest rate swaps and other derivatives.[343] The plaintiffs alleged that, from 2005 to 2012, employees at several of the world's largest banks and interdealer brokers conspired with their co-workers and employees at competing banks and interdealer brokers "to rig LIBOR and other benchmark interest rates of various tenors and

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336 *Id.*

337 *CFTC v. Atha*, 420 F. Supp. 2d 1373, 1380 (N.D. Ga. 2006) (citing *United States v. Valencia*, 394 F.3d 352, 354-55 (5th Cir. 2004)).

338 *Lincoln Printing Co. v. Middle W. Utils. Co*., 74 F.2d 779, 784 (7th Cir.1935).

339 7 U.S.C. § 6b(a).

340 *Cargill,* 452 F.2d at 1163.

341 *Socony-Vacuum*, 310 U.S. at 226 n.59.

342 Scorpino, *supra* note [•], at 607.

343 *Id*. at 581.

currencies by coordinating their submissions to panels that set those rates."[344] Because the banks were direct competitors in selling and buying derivatives and other financial instruments that were premised on LIBOR, the benchmark interest rate-rigging conspiracies and schemes allegedly violated § 1 of the Sherman Act through "the warping of market factors affecting the prices for LIBOR-based financial instruments."[345]

Case Study: *United States v. Deutsche Bank AG*, 15-cr-61 (D.Ct. filed on April 23, 2015)

As part of its settlement of the DOJ and CFTC's investigations into LIBOR and EURIBOR manipulation, Deutsche Bank was charged with one-count of wire fraud and one-count of price fixing in violation of the Sherman Act pursuant to a deferred prosecution agreement with the DOJ, filed with the U.S. District Court of Connecticut on April 23, 2015. The DOJ alleged that Deutsche Bank violated the Sherman Act through its participation in a scheme in which Deutsche Bank traders coordinated their EURIBOR requests with traders at other banks to benefit their trading positions from at least June 2005 through October 2008.

According to the filed agreement, the Deutsche Bank derivatives traders, whose compensation was directly connected to their trading in LIBOR-based financial products, engaged in efforts to move these benchmark rates in a direction favorable to their trading positions. Specifically, the traders requested that LIBOR submitters at Deutsche Bank and other banks submit contributions favorable to trading positions, rather than rates that complied with the definition of LIBOR. Through agreements made between Deutsche Bank employees and traders at other banks in person and through emails, chats, and calls, – Deutsche Bank worked with other banks to manipulate LIBOR contributions and made false reports regarding the U.S. dollar LIBOR and EURIBOR through its submissions that were not made in accordance with the BBA definitions and criteria, thereby violating both § 6b(a) of the CEA and § 1 of the Sherman Act.

Case Study: *United States v. Usher et al.*, 17-cr-19 (S.D.N.Y. filed on Jan. 10, 2017)

In January 2017, DOJ's Antitrust Division charged three former currency traders with a criminal antitrust violation in connection with an alleged conspiracy to manipulate the FX spot market. The indictment, a follow-up to the billions of dollars in penalties the DOJ had extracted from banks previously for the same conspiracy, charged the traders with conspiring to suppress and eliminate competition for the purchase and sale of USD-Euro currency pairs in the U.S. market by coordinating their bidding, refraining from trading in a way that would move the market against their co-conspirators' interests, and otherwise influence benchmarks of the EUR/USD exchange rate to profit the traders. Consistent with DOJ policy, the Antitrust Division asserted only a *per se*, horizontal theory of criminal liability.

The *Usher* case is notable as the first time the Antitrust Division has had to test its legal theories in court against individual participants in cartel conduct in the financial industry. In November 2017, the *Usher* defendants moved to dismiss the indictment arguing that their conduct did not constitute a *per se* violation of the Sherman Act because they were "regularly potential counterparties of one another" instead of horizontal competitors in the FX spot market. The

[344] *Id*. at 576.

[345] *Gelboim v. Bank of Am. Corp*., 823 F.3d 759, 776 (2d Cir. 2016)

district court was unpersuaded by the defendants' argument, finding that the alleged agreement was among competitors "in the same level of the market" and therefore they were in competition with one another in the market, "whether or not they were buying or selling at any given moment."

The *Usher* decision underscores that the horizontal-or-vertical question can sometimes be more complicated in Covered Markets than in traditional markets. Indeed, Covered Markets can include participants that are not at the same "level" of their respective industries, yet might under certain circumstances arguably be considered horizontal competitors for price, for purposes of Sherman Act Section 1. For example, a manufacturer may use derivatives contracts to hedge their exposure to price fluctuations in the market(s) for physical commodities that are production inputs for the products they make; meanwhile, an investor may enter the same derivatives market to speculate on future changes in price in that market. While the manufacturer and investor would not appear to be natural horizontal competitors in their respective markets (for manufactured goods, and for trading and investment), they might, if the *Usher* rationale were extended, be considered competitors in the market to buy or sell derivatives contracts, exposing them to potential criminal liability for conspiring with one another to manipulate those markets.

Indeed, the Antitrust Division has shown a willingness to view market participants as horizontal competitors in contexts *other than* those parties' natural markets for their goods or services. For example, the Division has recently prioritized criminal targeting of so-called "no poach" agreements, in which companies agree not to hire each other's employees. In pursuing this conduct, DOJ has emphasized that companies can be subject to *per se*, criminal liability *not* simply as horizontal competitors in the respective business lines in which they normally operate, but rather, because, for the purpose of the challenged "no poach" agreement, they are horizontal competitors in the markets for skilled employees.[346] This segmenting reflects that market participants are deemed not to operate *only* in the specific markets in which they sell goods or services, but in any ancillary market in which they become natural competitors.

6. CDS & Boycotts/Price-Fixing

There have also been accusations of market manipulation related to the transition of certain commodities and derivatives from over-the-counter ("OTC") to on-exchange trading. In a number of actions, plaintiffs have alleged that dealers and others who benefited from the OTC system colluded to ensure that new, more efficient markets were not established. Some of the world's largest banks are accused of acting as a "cartel" to stifle competition in markets for credit default swaps ("CDS"), which are swaps "whose payoffs are derived from the occurrence or non-occurrence of a 'credit event' of some reference entity or entities, such as the bankruptcy of an

[346] *See* U.S. DEP'T OF JUSTICE, ANTITRUST DIVISION & FED. TRADE COMM'N, ANTITRUST GUIDANCE FOR HUMAN RESOURCE PROFESSIONALS 2 (Oct. 2016), https://www.justice.gov/atr/file/903511/download ("From an antitrust perspective, firms that compete to hire or retain employees are competitors *in the employment marketplace*" and can be *per se* liable for restraining the employment market, "regardless of whether the firms make the same products or compete to provide the same services.").

identified corporation" and which "may be used as [a] credit protection device that exchanges a set value for a debt security upon a default or other credit event."[347]

Antitrust concerns arise from CDS transactions because they are traded OTC, which requires communications between potential competitors in the same market, and the markets for many types of OTC swaps are dominated by only a handful of large banks, thereby making it easier for cartel activity (e.g. a group boycott) to occur.

For example, on June 8, 2017, Tera Group Inc. ("Tera") filed a lawsuit, alleging that Bank of America Corp., Citigroup Inc., J.P. Morgan Chance & Co., and nine other banks[348] conspired to keep Tera from entering into a $9.9 trillion credit default swap market.[349] Tera alleged that the banks coordinated to boycott its TeraExchange platform by refusing to send it any CDS transactions and to clear and settle any CDS trades that customers wanted to handle through the platform. By using their combined ninety-five percent market share to enforce an opaque and inefficient protocol for trading, the banks allegedly increased their profits and kept traders in the dark about prices while instilling fear of retaliation in traders who defected to rival platforms.

Case Study: *In re Credit Default Swaps Antitrust Litigation*, 13-md-2476 (S.D.N.Y. filed Oct. 22, 2013)

In *In re Credit Default Swaps Antitrust Litigation*, private plaintiffs alleged that the defendant banks, who were the primary OTC CDS dealers, colluded to "squash the threat" of a proposed CME/Citadel CDS exchange, which would have eliminated their control of market information, and colluded to ensure that no clearinghouse had the capability to threaten their market dominance.

According to the complaint, the defendant banks engaged in this behavior because they were able to receive supracompetitive profits in the OTC market, as they had structured the market to be highly opaque. In particular, the complaint alleged that the defendant banks denied market participants accurate real-time price data that could be used to determine whether the price that a dealer quoted was accurate. Instead, the market was forced to rely on price quotes from dealers or non-binding price runs, which would often change after a counterparty expressed interest in a contract. Counterparties were unable to determine the bid-ask spread for CDS contracts because that information was kept private. As a result, plaintiffs claimed that the banks were able to receive supracompetitive profits because the bid-ask spread was "grossly inflated."

As a result, there was allegedly demand for an exchange-based CDS market, which would be more transparent, efficient, and competitive. According to plaintiffs, the defendant banks blocked the proposed CME/Citadel Credit Market Derivatives Exchange ("CMDX") from creating a central limit order booking, open-access market by boycotting CMDX and forcing ISDA and Markit to deny CMDX the licenses that it would need to operate. Additionally, the complaint alleged that the defendant banks colluded to stop other clearinghouses from forming exchanges by either

[347] Timothy E. Lynch, *Derivatives: A Twenty-First Century Understanding*, 43 Loy. U. Chi. L. J. 1, 22 (2011); Jerry W. Markham, Law Enforcement and the History of Financial Market Manipulation 7 (2014).

[348] The other defendants are Barclays PLC, BNP Paribas SA, Credit Suisse Group AG, Deutsche Bank AG, Goldman Sachs Group Inc, HSBC Holdings Plc, Morgan Stanley, Royal Bank of Scotland Group PLC and UBS Group AG.

[349] *Tera Group Inc. v. Citigroup Inc.*, No. 17-CV-04302 (S.D.N.Y. June 8, 2017).

refusing to deal with the entity or by taking control of the risk committees to create barriers to entry in the market. The complaint further alleged that the defendant banks also colluded to drive business to ICE Clear, which was allegedly created by the defendant banks and ICE for the purpose of furthering their market domination.

In October 2015, the defendant banks reached a $1.9 billion settlement, for which the court granted preliminary approval, and the court granted final approval in April 2016. Finding that the prerequisites under Federal Rule of Civil Procedure 23 were met, the court certified a class defined as all persons who purchased CDS from or sold CDS to the dealer defendants in any covered transaction during the period of January 1, 2008 through September 25, 2015. It concluded that the settlement was fairly negotiated and in good faith and that the value of present recovery outweighed the possibility of future relief after a drawn-out litigation.

7. Key Distinctions between CEA and Sherman Act Claims

While the CEA and the antitrust laws can cover overlapping types of conduct in many circumstances, there are important differences as to what is required to establish liability.

One key area of distinction is the defendant's state of mind that a plaintiff or prosecutor must show to prove a violation of the CEA or the Sherman Act. Generally speaking, CEA manipulation claims require a showing of specific intent to create an artificial price with respect to a covered commodity, since "specific intent to create an 'artificial' or 'distorted' price is a *sine qua non* of manipulation" [350] or attempted manipulation [351] given concerns that a weaker standard would blur the line between unlawful activity and "innocent trading activity" that is only regarded as unlawful manipulation "with the advantage of hindsight."[352]

In contrast, violations of § 1 of the Sherman Act do not require a showing of "specific intent to restrain trade."[353] Rather, § 1 violations are subject only to a "general intent" requirement, meaning that, by knowingly participating in an anticompetitive conspiracy, the defendant's intent to restrain trade is presumed.[354] Given the CEA's stricter intent standards, there may be cases where evidence of a defendant's participation in an anticompetitive conspiracy is sufficient to sustain a claim under

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[350] *In re Indiana Farm Bureau Coop. Ass'n, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, 1982 WL 30249, at *3 (Dec. 17, 1982).

[351] *See CFTC v. Wilson*, No. 13-CV-7884, 2016 WL 7229056 (S.D.N.Y. Sept. 30, 2016) (rejecting argument by CFTC that in attempted manipulation cases, the CFTC need only prove that defendant had a specific intent to "affect market prices").

[352] *In re Indiana Farm Bureau*, 1982 WL 30249, at *3.

[353] *See United States v. Gillen*, 458 F. Supp. 887, 893 (M.D. Pa. 1978) (citing *Socony-Vacuum*, 310 U.S. 150).

[354] *See id*. *See also* U.S. Dep't of Justice, U.S. Attorneys' Manual, Antitrust Resource Manual § 1 ("In a Sherman Act criminal case, general intent must be proven. Customarily, however, proof of the existence of a price fixing, or bid rigging or market allocation agreement is sufficient to establish intent to do what the defendants agreed among themselves to do.") [hereinafter Antitrust Manual], https://www.justice.gov/usam/antitrust-resource-manual-1-attorney-generals-policy-statement.

§ 1 of the Sherman Act while insufficient to establish defendant's specific intent to manipulate prices.

The Sherman Act's intent requirements under § 2 are more closely aligned with those of the CEA . A monopolization claim requires a "willful" acquisition or maintenance of monopoly power, meaning something more than just an intent to increase market share or customers must generally exist. Claims of *attempted* monopolization and conspiracy to monopolize, like manipulation claims, require proof of a specific intent to monopolize.

The CEA and the Sherman Act may also be somewhat more closely aligned on intent with respect to claims under CEA § 6(c)(1), a product of the 2010 DFA's amendments to the CEA, and CFTC Rule 180.1, which prohibits the use of manipulative or deceptive devices in connection with commodity or swap transactions[355] The CFTC has asserted that it need only show that the defendant acted "recklessly," a lower standard than specific intent, to establish violations of 6(c)(1) and Rule 180.1. While courts have had few opportunities to analyze Rule 180.1, at least one court has held that a claim under 6(c)(1) can be sustained by showing that the defendant's conduct was "an extreme departure from the standards of ordinary care" and presented a danger of misleading buyers or sellers so obvious that the defendant "must have been aware of it."[356] However, that court also held that, because § 6(c)(1) is an anti-fraud provision, alleged violations must meet the heightened pleading standards under Federal Rule of Civil Procedure 9(b).[357] Ultimately, while the case law on Rule 180.1 is still developing, recklessness is a potentially easier standard to overcome than specific intent, but likely to be more challenging to meet than Sherman Act § 1's general intent standard.

Another key area of distinction is whether an overt act in furtherance of the anticompetitive or manipulative scheme must be shown to establish a violation under the CEA or the Sherman Act. To prove manipulation under the CEA, in addition to showing that the defendant intended to manipulate prices in the relevant market, the defendant must also succeed in creating an artificial price. [358] To prove *attempted* manipulation, one must show that the defendant intended to manipulate prices and took some overt act in furtherance of that intent. [359] Similarly, monopolization claims under § 2 of the Sherman Act must show that the defendant successfully acquired or maintained monopoly power or, in attempt cases, engaged in exclusionary conduct with the intent of achieving monopoly power.

Section 1 of the Sherman Act, on the other hand, prohibits *agreements* in restraint of trade, and thus it is not necessary to show that a defendant took any particular act in furtherance of the anticompetitive conspiracy, only that the defendant agreed with a co-conspirator to restrain trade.[360]

[355] *See* 7 U.S.C.§ 9(1); Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices, 17 C.F.R. § 180.1 (1998).

[356] *See CFTC v. Kraft Foods Group, Inc*., 153 F. Supp. 3d 996, 1015 (N.D. Ill. 2015).

[357] *Id.*

[358] *See In re Indiana Farm Bureau*, 1982 WL 30249, at *3.

[359] *CFTC v. Bradley*, 408 F. Supp. 2d 1214, 1220 (N.D. Okla. 2005).

[360] *See United States v. Rose*, 449 F.3d 627 (5th Cir. 2006) ("Conspiracies under the Sherman Act are not dependent on any overt act other than the act of conspiring.").

Accordingly, the differing requirements as to overt acts may mean that conduct that cannot be targeted under the CEA may still violate the Sherman Act in certain cases. While competitors who merely discuss and agree to coordinate on prices or output without taking concrete steps in furtherance of the agreement are potentially liable under the antitrust laws, the CFTC would likely refrain from acting against such conduct in the absence of successful price manipulation or an overt act in furtherance of the agreement to manipulate prices.

8. Conclusion

It is advisable for market participants to develop and maintain internal compliance and risk functions capable of discouraging this conduct before it begins, spotting the signs of this type of conduct quickly once undertaken, and, when confronted with evidence of possible manipulative conduct, to conduct an immediate, expedited internal investigation into potential violations of both the CEA and the Sherman Act. The stakes are high at the point of early detection: in addition to allowing prompt cessation of any misconduct, DOJ Antitrust Division's Corporate Leniency program offers full immunity to the first company (and its employees) to report a criminal violation of the antitrust laws. The other members of the conspiracy are at risk of full prosecution. CFTC also has a cooperation program, though the benefits and obligations differ (sometimes in material ways).

That said, such an expedited assessment can be challenging, because in addition to time pressure on identifying and analyzing relevant trading and market data along with related communications, the legal standards and penalties under those statutes are sufficiently different to merit differing approaches to investigations under those laws. And the self-reporting leniency and cooperation regimes adopted by each enforcing agency are not fully aligned. Further, the line between permissible trading conduct and collusion is not always clear. Unlike the markets for most consumer goods, the efficient operation of many markets covered by the CEA—particularly decentralized, over-the-counter markets—frequently depends on *some* degree of interaction between nominal competitors, for example, as market-makers, trading counterparties, and/or resources of price discovery through "market color"-style communications.

E. Regulation of Bitcoin and Other Virtual Currencies

1. Blockchain, Bitcoin and Other Virtual Currencies

The size of the global virtual currency market has now reached around $700 billion USD, with Bitcoin futures now listed for trading on the CME. Initial Coin Offerings ("ICOs") raised over $4 billion USD in 2017, with one ICO alone raising $700 million USD, surpassing all but the ten largest IPOs in the U.S. in 2017. Cryptocurrency could represent a new asset class which some claim as having low price correlation with other traditional assets, fostering increasing investor interest due to their ability to offer portfolio diversification.

Bitcoin and all cryptocurrencies are built on blockchain, a special type of data structure (ie a database), in which the data is set out and built up in successive blocks. Each of the blocks of data includes a small piece of data that verifies the content of the previous block. As a result, if an attempt is made to modify an earlier block in the chain, all of the later blocks cease to match up. Imagine that the database looks like a tower of Lego pieces which follow a particular sequence

red-green-green-blue-yellow-red. If a change is made to the second block, the rest of the sequence upwards from the second block will change and become, say, red-black-brown-orange-purple-pink. The system that maintains the blockchain will be able to detect and reject the attempted modification, and this is what makes the blockchain tamper-proof.

Blockchain also relies upon the use of public key cryptography, which ensures that each participant in the system is uniquely identified and can validate any change to the blockchain using a cryptographically secure private key. While public key cryptography is not unique to blockchain, it is one of the essential underlying technologies which ensure that blockchains are secure and that only authorized participants can make changes to a blockchain. It can also be used to encrypt data stored on the blockchain so that the data can only be accessed by those with the key to decrypt it.

Blockchain also uses distributed ledgers rather than a traditional ledger system, which requires each participant to maintain its own decentralized ledger or that participants to trust a centralized ledger. The problem with decentralized ledgers is that they can be costly to maintain and to keep secure, and it may not become immediately apparent when they diverge – until a transaction down the line reveals that each ledger in fact records a different version of the facts. A centralized ledger, on the other hand, requires all the parties to trust the holder of the authoritative central ledger and creates a critical vulnerability – what happens if the central ledger is hacked or a disgruntled employee deletes it? The key to a distributed ledger is that each authorized participant (a node) maintains a complete version of the ledger and each transaction, ie each proposal to modify the ledger, is sent out to all of the nodes and is only approved if a sufficient number of nodes agree that it is a valid transaction.

This validation of proposed changes to the blockchain is performed by the nodes in accordance with certain pre-set rules whereby the nodes will reach a consensus as to whether the new data entry will be permitted (eg, the nodes might conduct a check to confirm that according to the records on the blockchain, the participant purporting to conduct a particular transaction owns the relevant asset which is the subject of that transaction). This is the consensus mechanism and only if there is agreement between the nodes as to the validity of the transaction represented by that data entry will that data entry be permitted to be appended to the blockchain (ie another Lego block will be added to the tower). Once that transaction has been approved, however, the updated version of the blockchain with the newly-appended entry will rapidly spread throughout the system, so that that all of the nodes end up with an identical version of the ledger.

This consensus mechanism means that there is a rigorous means, applied uniformly by all participants, that ensures that only valid data can be appended to the blockchain. It is the consensus mechanism that enables the gate-keeping function to be entrusted to a network of participants, rather than a single central authority.

2. The Regulatory Landscape

Developments in blockchain and cryptocurrencies have not escaped the attention of regulators across the globe. Bitcoin and other decentralized cryptocurrencies, coupled with smart contracts and decentralized autonomous organizations, present a vision of a decentralized future. Yet to the extent virtual currencies – neither issued nor backed by any national government – catch on, they promise to reduce the amount of control individual governments have over the global financial

system, as they offer a borderless, Internet-based medium of exchange for accomplishing anonymous international transfers. Whether they are captured by existing rules, or if the blockchain technology on which they are based demands entirely new ones, has become an increasingly pressing question for authorities around the world, including in the United States.

The U.S. approach is to divide new cryptocurrencies into two existing categories – cryptocurrencies, which as discussed below may be classified as commodities or currencies and subject to provisions of the CEA and under state money transfer and federal anti-money laundering laws; and ICO tokens, generally considered securities and regulated by the U.S. Securities & Exchange Commission and state equivalents.

(a) CFTC Regulation of Cryptocurrencies

The scope of CEA jurisdiction over cyptocurrencies is in the early stages of its development. At least one district court has taken a broad view of that CEA jurisdiction. On March 9, 2018, a New York federal district court judge held that virtual currencies are "commodities" as defined under the CEA and at the request of the CFTC enjoined the defendants from trading cryptocurrencies on their own or others' behalf or soliciting funds from others.[361] The judge in that case, did not preclude other regulatory agencies from playing a role in cryptocurrency enforcement, by finding the CFTC had jurisdiction over physical "spot" trading in bitcoin when that trading, or solicitation of funds to engage in trading, is conducted for fraudulent purposes, the federal court took the view that the "CFTC is the federal overseer of digital currencies like bitcoin.".[362] As discussed below, the merits of this view are open to questions. Other federal regulators, such as the SEC and bank regulators, supervise specific institutions and discrete activities, and state regulators have jurisdiction in their states over money transmission.

The CFTC's authority to regulate cryptocurrency trading is drawn from its general authority under the CEA. As discussed further above, the CEA gives the CFTC has authority over "commodities," which are broadly defined as "all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in."[363] In effect, a commodity is any product which is or may in the future be traded on a futures exchange.[364] Therefore, virtual currencies come within the definition of a "commodity"[365] under the CEA when it is or is capable of being traded as a future.[366] Therefore, all cryptocurrencies could be deemed "commodities" because they could in the future support a futures contract. Nonetheless, the CFTC has only asserted limited jurisdiction over spot markets in virtual currencies – in which participants buy and sell virtual currencies for

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[361] CFTC v. McDonnell, No. 18-cv-0361, Dkt. 29 (E.D.N.Y. Filed Jan 18, 2018).

[362] Robert Schmidt and Benjamin Bain, *Who Wants to Be Bitcoin's Watchdog?* BLOOMBERG (Jan. 12, 2018), https://www.bloomberg.com/news/articles/2018-01-12/who-wants-to-be-bitcoin-s-watchdog

[363] 7 U.S.C. § 1a(9).

[364] *See CFTC v. Am. Bd. of Trade, Inc*., 803 F.2d 1242, 1248 (2d Cir. 1986) ("[A]nything other than onions could become a 'commodity' . . . simply by its futures being traded on some exchange.").

[365] 7 U.S.C §1a(9) (2012).

[366] *See, e.g.,* Complaint, *CFTC v. My Big Coin Pay, Inc., Randall Crater, and Mark Gillespie*, Case 1:18-cv-1007-RWZ (D.Mass. filed Jan. 16, 2018) (the "*MBCP Complaint*").

prompt delivery – while it has broad jurisdiction over derivatives markets, including futures, in such currencies. We discuss the CFTC's regulation of virtual currency spot and derivatives markets in greater detail below.

(1) Spot Markets

According to the CFTC, the general rule is that "U.S. law does not provide for direct, comprehensive Federal oversight of underlying Bitcoin or virtual currency spot markets," [367] though the two critical qualifications are "Federal" – as state banking regulators may have jurisdiction over virtual currency spot exchanges under state money transfer laws – and "comprehensive." The CFTC exercises *limited* jurisdiction over commodity spot markets, primarily restricted to preventing fraud and manipulation. The CFTC also has the power to distinguish between spot and derivatives markets and has done so for certain retail exchanges.

The CFTC has recently brought two enforcement actions alleging fraudulent activities in virtual currency spot markets. In My Big Coin Pay, Inc. *et al*. (2018)[368], the defendants solicited potential customers to purchase MBC (My Big Coins), a virtual currency, ultimately obtaining over $6 million in customer funds for that purpose. The defendants claimed MBC was actively traded on "several currency exchanges… for dollars, euros, and more," that MBC was the only virtual currency backed by gold,[369] and that they had partnered with MasterCard, when in fact, MBC was not actively traded on any currency or other exchange, MBC was not backed by gold, and there was no partnership with MasterCard.[370] According to the CFTC, the price or value displayed on the website was not, in fact, based on actual trading. Instead, the CFTC alleged that the defendants simply misappropriated most of the over $6 million in customer funds they raised selling MBC in violation of CEA Section 6(c)(1) and Rule 180.1(a). This action is pending as of the date of the Guide's publication following the denial of My Big Coin's motion to dismiss in October 2018.

In the case of Patrick K. McDonnell and CabbageTech, Corp., d/b/a Coin Drop Markets (2018)[371] the defendants advertised membership in Internet Bitcoin and Litecoin trading groups using social media, which purportedly would allow customers to receive expert trading advice and continuous, ongoing monitoring from the defendants' "dedicated team of digital asset trading specialists" leading to up to 300% returns on virtual currency trading in less than a week, in one case. However, instead of providing any of the contracted-for trading and advisory services after receiving customer funds, the defendants allegedly simply broke off communications with the customers to whom the funds belonged and absconded with their money. To conceal their scheme, the McDonnell Defendants allegedly deleted their websites and social media posts. The customers

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[367] Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets, January 4, 2018, http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/backgrounder_virtualcurrency01.pdf (hereinafter the "Futures Backgrounder").

[368] *See supra* note 366.

[369] *Id.* at 7.

[370] *Id.* at 9.

[371] Complaint, *CFTC v. Patrick K. McDonnell, and CabbageTech, Corp. d/b/a Coin Drop Markets*, Case No. 18-CV-0361 (E.D.N.Y. filed Jan. 18, 2018).

allegedly defrauded lost most if not all their funds in violation of CEA Section 6(c)(1) and Rule 180.1(a). In August 2018, the CFTC won a $1.1 million verdict against the defendants following a four day bench trial.

(2) Retail Virtual Currency Transactions

On December 15, 2017 the CFTC released "Retail Commodity Transactions Involving Virtual Currency" (the "2017 Interpretation"),[372] which proposes an interpretation that regulates certain leveraged retail transactions in virtual currencies as futures. Under §2(c)(2)(D) of the CEA, certain provisions of the CEA apply to any commodity transaction (a "retail commodity transaction") involving a retail investor that is financed by the offeror or the counterparty, or entered into on a leveraged or margined basis, unless the transaction results in "actual delivery" within 28 days.[373] If §2(c)(2)(D) applies, then the transaction is subject to regulation *as if* it were a futures contract, meaning it must be entered into on or subject to the rules of a CFTC-registered futures exchange. In the 2017 Interpretation, the Commission pointed out that delivery of a virtual currency to a buyer's digital wallet would not constitute "actual delivery" if the rights of the wallet holder were restricted by the provider of the wallet, the virtual currency exchange, or the seller. The lack of actual delivery would mean, as a practical matter, that the system providing the wallet or facilitating the transaction would be in violation of the CEA if the transaction was leveraged. The CFTC provided several detailed examples of what would constitute "actual delivery" in the context of delivering virtual currency to digital wallets.

Under the CEA, futures exchanges may list new products by "self-certifying" i.e. submitting a certification that the futures contracts meet the requirements of the CEA. Both the CME and the CBOT used self-certification for their listing of Bitcoin futures.[374] Self-certification was also used by TeraExchange, the first cryptocurrency exchange to register with the CFTC, to list its first Bitcoin non-deliverable forwards on September 12, 2014.[375]

The CME and the CBOE voluntarily chose to give the CFTC the chance to review the proposed terms of their respective Bitcoin futures contracts months before filing their self-certifications. As an extension of this practice, for all future applications by derivatives exchanges to list virtual currency derivatives, the CFTC will institute a regime known as "heightened review," in which it will request voluntary compliance by applicant derivatives exchanges with several criteria, including "substantially high" initial and maintenance margins, information sharing agreements, and coordinating product launches with the CFTC's market surveillance branch to enable the CFTC to monitor "minute by minute developments.[376]

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[372] Retail Commodity Transactions Involving Virtual Currency, 82 Fed.Reg. 60335 (Dec. 20, 2017) (codified at 17 C.F.R. pt. 1)

[373] 7 U.S.C. §2(c)(2)(D)(ii)(III)(aa).

[374] *See* Futures Backgrounder, *supra* note 367 at 2.

[375] *See* Press Release, TeraExchange Launches First Regulated Bitcoin Derivatives Trading (Sep. 12, 2014), https://www.teraexchange.com/news/2014_09_12_Launches%20First%20Regulated%20Bitcoin%20Derivatives.pdf.

[376] Futures Backgrounder, *supra* note 367 at 3.

For its part, the CFTC has announced plans to closely monitor both virtual currency derivatives markets as well as underlying settlement reference rates through the collection of trade- and counterparty-level data, and to coordinate with other federal regulatory agencies.[377]

(3) NFA Reporting Requirements

Set forth in a wave of releases in mid-December 2017, the National Futures Association ("NFA"), which has delegated authority from the CFTC, set out new reporting requirements for NFA members who are commodity pool operators or commodity trading advisors that execute transactions involving either underlying virtual currency spot/cash contracts or virtual currency futures, options, or swaps on behalf of a commodity pool or managed account[378], introducing brokers that solicit or accept orders for virtual currency futures, swaps, or options[379], and futures commission merchants that offer customers or non-customers the ability to trade virtual currency futures only.[380]

(b) SEC Regulation of ICOs

While the CFTC claims primary regulatory authority over cryptocurrencies, the SEC claims authority over ICOs. An ICO is a transaction that is remarkably similar to an initial public offering – individuals will provide money to an enterprise and depending on the success of the venture, the value of their investment will increase. In an initial public offering, this typically takes the form of investors providing cash to an entity and receiving stock. The investor is then entitled to a portion of the profit from the entity. In an ICO, on the other hand, investors provide either cash or a cryptocurrency, such as Bitcoin, and in exchange receives a "token" or "coin" that represents their investment.[381] The company that sponsored the ICO will then use the consideration they received for the tokens for whatever project they were financing and the investor will make a profit if the project is successful and a the token increases in value.

ICOs, unlike IPOs, have typically been unregulated transactions. For example, the DAO transaction that was examined by the SEC in a July 2017 Report of Investigation (the "DAO

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[377] J. Christopher Giancarlo, *Remarks of Chairman J. Christopher Giancarlo to the ABA Derivatives and Futures Section Conference, Naples, Florida,* (Jan. 19, 2018), http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo34#P96_20693.

[378] NFA Notice I-17-28, December 14, 2017, *Additional reporting requirements for CPOs and CTAs that trade virtual currency products*, https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4974.

[379] NFA Notice I-17-27, December 6, 2017, *Additional reporting requirements regarding virtual currency futures products for FCMs for which NFA is the DSRO*, https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4973.

[380] NFA Notice I-17-29, December 14, 2017, *Additional reporting requirements for IBs that solicit or accept orders in virtual currency products*, https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4975.

[381] This transaction will typically be recorded in a "blockchain," a special type of data structure (ie a database), in which the data is set out and built up in successive blocks. Each of the blocks of data includes a small piece of data that verifies the content of the previous block. As a result, if an attempt is made to modify an earlier block in the chain, all of the later blocks cease to match up. For further information, see our publication, Clifford Chance, *Blockchain What it is and why it's important* (April 2018), available at: https://www.cliffordchance.com/briefings/2017/06/blockchain_-_whatitisandwhyitsimportant.html.

Report"), related to the issuance of approximately 1.15 billion DAO tokens in exchange for approximately 1.2 million in Ether virtual currency (worth approximately $150 million at closing). The DAO was marketed to investors through a variety of channels – the co-founders launched a website where DAO tokens could be purchased, they published a "White Paper" describing the concept behind the DAO and how it would operate, and made frequent media appearances discussing the DAO.

According to the DAO's co-founders explanation, the DAO was intended to "blaze a new path" in corporate governance by using blockchain to support "smart contracts" that would be enforced via software. In a YouTube video, co-founder Christoph Jentzsch described participating in the DAO as being similar to "buying shares in a company and getting . . . dividends." [382] As a result, participants in the DAO ICO would receive some voting and ownership rights, as well as the right to vote on how DAO should treat any return its investments. Moreover, the DAO also promised that DAO tokens could also be traded on the secondary market.

In total, during the two-month offering period, DAO sold tokens would approximately 12 million Ether a virtual currency used on the Ethereum Blockchain, worth at closing approximately $150 million in U.S. dollars. During this period, purchasers could use pseudonyms to purchase DAO tokens, and there were no limitations on the level of sophistication of purchasers or their ability to resell the tokens.

Following the launch of DAO tokens, the SEC launched an investigation to determine whether the DAO and related parties had violated the federal securities laws in connection with the offer and sale of DAO tokens. The SEC determined it would not pursue enforcement action based on the conduct and activities known to it at the time it completed its investigation. Instead, the SEC issued the DAO Report, setting out its views as to application of the federal securities laws to DAO tokens.

In the DAO Report, the SEC analyzed tokens issued by the DAO to determine whether they were in fact securities by using the facts and circumstances test established by the Supreme Court in *SEC v. W.J. Howey Co.* Pursuant to this test, the SEC analyzed whether purchasers of the ICO: (i) invested money or valuable goods or services; (ii) were investing in a common enterprise; (iii) with a reasonable expectation of earning profits; (iv) that were to be derived from the efforts of others.

Using this test, the SEC determined that the elements of the *Howey* test were met because: (i) the purchasers payments in Ether were an investment of money; (ii) the Ether was invested in a common enterprise; and (iii) investors had a reasonable expectation of profit; and (iv) investors relied on the efforts of others because of the key role played by the founders and "curators"[383] of

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[382] Slock.it, *Slock.it DAO demo at Devcon1: IoT + Blockchain*, YOUTUBE (Nov. 13, 2015), https://www.youtube.com/watch?v=49wHQoJxYPo.

[383] Curators were given "considerable power" in the DAO and had the ability to control which proposals were submitted to the DAO and voted on by DAO tokenholders.

the DAO. The SEC, however, did not state that all ICOs will be considered securities, instead, they stressed the importance of the facts and circumstances of a particular offering.

The DAO Report also addressed the secondary market for DAO tokens to determine whether the secondary market functioned as an exchange subject to registration with the SEC. Pursuant to the Exchange Act of 1934, a securities change is a "any organization . . . which . . . provides a market place. . . for bringing together purchasers and sellers of securities . . . "[384] and it is illegal to act as an exchange unless the exchange is registered as a national securities exchange or is exempted from such registration.[385] The test for a securities exchange is codified in Exchange Act Rule 3b-16 and pursuant to this rule an organization is an exchange if it (1) brings together the orders of multiple buyers and sellers of securities; and (2) uses established, non-discretionary methods to effect a trade. Applying this test, the DAO report concludes that various platforms that traded DAO tokens met the definition of an "exchange" under the Exchange Act and did not appear to have a valid exemption from registration.

(1) Subsequent Steps and the SEC's First Enforcement Action

At the same time that the Division of Enforcement released the DAO Report, the Division of Enforcement also released a public statement in conjunction with the Division of Corporation Finance reminding market participants that the "hallmark of a security is an investment of money or value in a business or operation where the investor has a reasonable expectation of profits based on the efforts of others."[386] Both divisions have subsequently followed up with additional actions that make clear that many, if not all, ICOs are likely securities. First, during the course of August, the SEC suspended trading in three public companies that had indicated they were likely to engage in an ICO. Second, on September 29, 2017, the SEC filed a civil complaint against Maksim Zaslavisky and two companies that had engaged in ICOs.

In the complaint against Zaslavisky, the SEC alleged that he used the two companies – REcoin Group Foundation and DRC World to sell unregistered securities through an ICO for digital tokens, which ultimately did not exist. The complaint further alleged that the REcoin ICO included a number of false statements, including that Recoin had a "team of lawyers, professionals, brokers, and accountants" that would invest REcoin's ICO proceeds into real estate when in fact none had been hired or even consulted. This scheme was then repeated with DRC, which purportedly invested in diamonds and obtained discounts with product retailers for individuals who purchase "memberships" in the company. Despite their representations to investors, the SEC alleged that Zaslavskiy and Diamond have not purchased any diamonds nor engaged in any business operations. Yet they allegedly continue to solicit investors and raise funds as though they have.

The Zaslavisky enforcement action, which targeted what is in essence a fraud scheme, is nonetheless notable in two ways. First, the speed with which the SEC brought the action, as Zaslavisky only started soliciting investments in REcoin in July 2017 and the SEC began the

[384] 15 U.S.C. § 78c(a)(1).

[385] 15 U.S.C. §78e.

[386] U.S. Securities and Exchange Commision, *Investor Bulletin: Initial Coin Offerings*, INVESTOR.GOV (Jul. 25, 2017), https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-initial-coin-offerings.

investigation in August 2017. Second, the paucity of allegations related to the violation of the registration requirements. In particular, while the SEC issued an 18 page report addressing whether the DAO tokens were securities, in this case the SEC simply alleged that the tokens constituted securities. This approach suggests that the SEC, despite taking a more nuanced approach in the DAO token case may take a more aggressive approach in subsequent investigations and enforcement actions.

Following the Zaslavisky enforcement action, the SEC and the DOJ have brought a number of additional actions against ICO promoters. For example, on February 21, 2018, the SEC and the DOJ filed complaints against BitFunder, a bitcoin-denominated exchange and its founder ("BitFunder").[387] The SEC's civil complaint alleges that BitFunder operated as an unregistered online securities exchange for virtual "shares" of currency-related enterprises (e.g., virtual currency mining operations) (the "virtual assets"), and defrauded exchange users by misappropriating their bitcoins and failing to disclose a cyberattack that resulted in the theft of more than 6,000 bitcoins. The virtual "shares" at issue were uncertificated and many paid dividends in bitcoins. Online account statements provided by BitFunder to users reflected their ownership of virtual assets and bitcoins. Purchasing virtual assets and trading on the BitFunder platform also required users to deposit bitcoins in a single wallet controlled by BitFunder, a factor that made the cyberattack and theft experienced by BitFunder possible.

In identifying the unregistered exchange activity, the SEC complaint states that BitFunder: (i) required users to deposit the bitcoins used to purchase and sell shares in virtual assets in a wallet that it controlled; (ii) allowed users to buy and sell shares of virtual assets using bitcoins through an electronic matching system based on price and time priority; (iii) automatically executed buy and sell orders; (iv) publicly displayed all of its quotes, trades, and daily trading volumes in the listed shares of virtual assets; and (v) charged transaction-based fees when virtual asset shares were sold.

3. CFTC Cryptocurrency Enforcement Actions

The CFTC has brought a number of enforcement actions in respect of virtual currency derivatives. Two of these cases (*In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, and *In re TeraExchange LLC*) were brought before Bitcoin futures were actually traded on exchanges. Other cases have been brought for conduct related to virtual currencies that have no futures market.

Example Case: In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan, CFTC Docket No. 15-29 (Sep. 17, 2015).

In a case brought before the CME listed a Bitcoin futures contract, the CFTC alleged that the defendants' web-based trading platform allowed traders to post (and accept) bids and offers on Bitcoin option contracts in violation of CEA Sections 4c(b) and 5h(a)(1). Traders would deposit Bitcoin into an account on defendants' website and use Bitcoin to pay premiums and settlement payments to the other party. The CFTC charged the defendants with operating a facility for the trading, processing, and execution of swaps without registering with the CFTC as a swap execution

[387] *See generally* the BitFunder Complaints. The DOJ BitFunder Complaint focuses on non-securities criminal claims.

facility ("SEF") in violation of Section 5h(a)(1) of the CEA and CFTC Regulation 37.3(a)(1). Without admitting or denying the allegations, defendants agreed to cease and desist from violating the relevant provisions.

Example Case: *In re TeraExchange LLC*, CFTC Docket No. 15-33 (Sept. 24, 2015).

In another case brought before the CME listed a Bitcoin futures contract, the CFTC alleged that the defendants operated a platform for the online trading of non-deliverable forward contracts based on the relative value of the U.S. dollar and Bitcoin. At the time of the enforcement action, TeraExchange was provisionally registered with the CFTC as a SEF, and on September 11, 2014 it filed a self-certification with the CFTC to list Bitcoin swaps. A month later, on October 8, 2014, a TeraExchange employee arranged for a pair of offsetting transactions between unaffiliated counterparties to be executed on TeraExchange in order to "test the pipes by doing a round-trip trade with the same price in, same price out, (i.e. no P/L [profit/loss] consequences." The CFTC charged TeraExchange with conducting a pre-arranged "wash trade" involving counterparties who took no bona fide market risk, in violation of CEA Section 5h(f)(2). Without admitting or denying the allegations defendants agreed to cease and desist from violating the relevant provision.

Example Case: *CFTC v. Gelfman Blueprint, Inc. and Nicholas Gelfman,* No. 17-cv-07181 (E.D.N.Y. filed September 21, 2017).

In October 2018, a Brooklyn federal court ordered Gelfman Blueprint, Inc. ("GBI") and its CEO Nicholas Gelfman to pay in total over $2.5 million in civil monetary penalties and restitution in what was the first anti-fraud enforcement action involving Bitcoin filed by the CFTC.

The court found that from approximately 2014 through approximately January 2016, Gelfman and GBI operated a Bitcoin Ponzi scheme in which they fraudulently solicited more than $600,000 from at least 80 customers in violation of CEA Section 6(c)(1). The customers' funds were supposedly placed in a pooled commodity fund that purportedly employed a high-frequency, algorithmic trading strategy executed by Defendants' computer trading program called "Jigsaw." However, the strategy was fake, the purported performance reports were false, and the payouts of supposed profits to GBI Customers in actuality consisted of other customers' misappropriated funds.

To conceal GBI's trading losses and misappropriation, GBI and Gelfman made false performance reports to pool participants, including statements that created the appearance of positive Bitcoin trading gains, when in truth the trading account records reveal only infrequent and unprofitable trading. Gelfman, in order to conceal the scheme's trading losses and misappropriation, also staged a fake computer "hack" that supposedly caused the loss of nearly all customer funds.

Example Case: CFTC v. Dillon Michael Dean and The Entrepreneurs Headquarters Limited, No. 18-cv-00345 (E.D.N.Y. filed Jan. 18, 2018).

In the case of Dillon Michael Dean and The Entrepreneurs Headquarters Limited, the defendants are alleged to have engaged in a fraudulent scheme to solicit at least $1.1 million worth of Bitcoin for a pooled investment vehicle that was supposedly trading binary options. Instead, the defendants allegedly misappropriated the customers' funds, and then lied to customers that their funds had been stolen by hackers in an attack on defendants' website. The CFTC charged the

defendants with engaging in a business of the nature of an investment trust or syndicate that received customer property – Bitcoin – for the purpose of trading in commodity options, without registering with the CFTC as a commodity pool operator, as well as with fraud in violation of CEA Sections 4c(b), 4o, 4m, 4k, and CFTC Regulations 32.4 and 3.12. In July 2018, the CFTC received a default judgment ordering Dean and his company to pay $1.9 million in civil monetary penalties and restitution.

Example Case: *CFTC v.* John Doe 1 a/k/a Morgan Hunt d/b/a Diamonds Trading Investment House and John Doe 2 a/k/a Kim Hecroft d/db/a First Options Trading, No. 18-cv-807 (N.D. Texas, filed Sept. 28, 2018).

The CFTC alleged that defendants used Facebook and email to defraud at least two customers. According to the complaint, defendants made a number of misrepresentations to customers including: (i) misrepresenting that customer funds would be used to invest in trading for the benefit of the customers; (ii) misrepresenting their experience and track record as traders and portfolio managers; (iii) misrepresenting that they were trading commodity interests and were doing so profitably, including by providing customers with fake account statements; (iv) misrepresenting that they could not withdraw any of their purported investment profits unless they first paid a tax to the CFTC; and (v) misappropriating customer funds for unauthorized purposes.

The CFTC further alleged that both Defendants supplied their victims with phony documents in furtherance of their fraud, including doctored versions of a publicly available February 5, 2018, memorandum to CFTC staff from the CFTC's General Counsel. As alleged, the forgeries altered the CFTC memorandum to make it appear, falsely, that retail investors were required to pay a "tax obligation" to the CFTC if they wished to withdraw funds from their Bitcoin accounts. In addition, the Complaint alleges that Hunt arranged for an associate to impersonate a fictitious CFTC investigator in a telephone conversation with his customer so as to support Hunt's false story about the customer's "tax obligation."

In February 2019, the default was entered because defendants failed to answer or otherwise defend within the time allowed.

Example Case: *In re Joseph Kim*, CFTC Docket 19-02 (Oct. 29, 2018).

In November 2018, the CFTC issued an order filing and settling charges against Joseph Kim related to a fraudulent Bitcoin and Litecoin scheme that led to more than $1 million in losses in violation of CEA Section 6(c)(1). In the order, Kim admitted that between September 2017 and November 2017, he misappropriated Litecoin and Bitcoin from his employer through a series of transfers between his employers accounts and his own personal accounts. When questioned about the missing Litecoin and Bitcoin, Kim falsely represented that there were security issues with a virtual currency exchange that necessitated transfers into various accounts. Kim's employer discovered his misappropriation in November 2017 and terminated him.

Following his termination, Kim began fraudulently soliciting funds from individuals to continue trading in virtual currency with the hope of using trading profits to repay his former employer. Between December 2017 and March 2018, Kim obtained approximately $545,000 from at least 5 customers to trade virtual currency. However, in soliciting the funds, Kim falsely told customers

that he had decided to voluntarily leave his old job to start his own trading company , and concealed from customers that he had been fired for misappropriating virtual currency. Kim also falsely told customers that he would invest their funds in a low-risk virtual currency arbitrage strategy, when, in fact, Kim made high-risk, directional bets on the movement of virtual currencies that resulted in Kim losing all $545,000 of his customers' funds. Kim concealed those losses by sending false account statements to customers reflecting profitable trading.

As part of the settlement, Kim was required to pay more than $1.1 million in restitution and to accept a permanent trading and registration bar.

Simultaneously with his CFTC settlement, Kim also pled guilty to one count of wire fraud for the scheme.

Example Case: U.S. Commodity Futures Trading Commission v. Kantor et al., No. 18-cv-2247 (E.D.N.Y. 2018).

The CFTC filed a complaint against Blake Harrison Kantor, Nathan Mullins, and their U.K.-based company Blue Bit Banc and related entities accusing them of selling illegal off-exchange binary options, misappropriating the funds they received from investors, and covering up their scheme by transferring the options into virtual currency in violation of CEA Sections 2(e), 4c, 4d, and 6c, and Rule 180.1. Blue Bit allegedly allowed customers to trade binary options that allowed investors to receive an established payout if they accurately predicted the price of an asset on a given date and time. Of the over $600,000 received in investor funds, the bulk was allegedly used for personal and business expenses, funneled through a separate entity called Mercury Cove Inc. To try to mask the fraud, Blue Bit converted customer account balances into a virtual currency called ATM coin. The CFTC is seeking restitution, disgorgement, civil monetary penalties, permanent registration and trading bans, and a permanent injunction against future violations of federal commodities laws. On April 17, 2018, the district court granted an asset freeze against the defendants and ordered that they be prevented from destroying financial records. The case is currently pending.

F. Examples of Proceedings Brought Against Large Traders

1. Manipulation: On Exchange Trading

(a) "Marking the Close"

The CFTC has brought a number of enforcement actions on the theory that defendants manipulated commodities prices by effecting large purchases or sales at or near the close of a futures market trading session in order to artificially affect closing prices – typically to advantage a commodities or commodities futures position of the defendant that is tied to the settlement price. This practice is variously referred to as "marking the close," "banging the close," or "buying the board."

Example Case: *In re Moore Capital Mgmt., L.P.*, CFTC Docket No. 10-09 (Apr. 29, 2010)

On April 29, 2010, the CFTC settled claims that Moore Capital and affiliates attempted to manipulate the settlement prices of platinum and palladium futures contracts on NYMEX by "banging the close" – i.e., entering orders in the last ten seconds of the close in an attempt to exert

upward pressure on the settlement price of the futures contracts in violation of CEA Sections 6 and 9(a)(2). Without admitting or denying, Moore Capital agreed to a settlement based on charges of attempted manipulation and inadequate supervision of trading activities , pursuant to which it paid a civil monetary penalty of $25 million, agreed to restricted trading for a period of two years, and agreed to institute policies and procedures to ensure compliance with the CEA and with CFTC regulations.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Optiver US, LLC*, No. 08-6560 (S.D.N.Y. Apr. 19, 2012)

On April 19, 2012, the CFTC settled claims for manipulation and attempted manipulation against Optiver Holding BV, two subsidiaries, and several company officers. The CFTC alleged that Optiver repeatedly manipulated and attempted to manipulate the price of futures contracts in crude oil, heating oil, and gasoline traded on the New York Mercantile Exchange ("NYMEX") by "marking the close" in violation of CEA Sections 6, 9(a)(2), and 9(a)(4). Optiver's alleged scheme was to execute between 20% and 30% of its futures trades from 2:25 p.m. until just before the closing period in order to begin driving the price of the futures contracts in an advantageous direction. Optiver then executed the remaining 70% to 80% of its futures trades during the close in order to further influence pricing. Without admitting or denying, Optiver agreed to a settlement based on charges of manipulation, attempted manipulation, and making false statements , pursuant to which it paid a civil monetary penalty of $13 million, disgorged profits of $1 million, agreed to restricted trading for a period of two years, and agreed to institute policies and procedures to ensure compliance with the CEA and with CFTC regulations.

Example Case: U.S. Commodity Futures Trading Comm'n v. Donald R. Wilson, No. 13-CV-7884 (S.D.N.Y. Sept. 30, 2016)

On November 6, 2013, the CFTC filed a civil enforcement action against Donald R. Wilson and his company, DRW Investments, LLC (collectively "DRW"), alleging that DRW attempted to and did manipulate an exchange-traded interest rate swap futures contract in violation of Rule 180.2 by placing bids to influence its settlement price. Seeking to dismiss the claims at the pleadings stage, DRW did not deny that its trading conduct was intended to influence price. Instead, they argued that they lacked the requisite intent because their bids were not intended to create artificial prices and were based on their "own calculations and beliefs about value," thus reflecting a legitimate source of demand instead of an intent to manipulate. The court rejected DRW's motion, citing a short-hand version of the CFTC's traditional four-part manipulation test and characterizing the requisite intent as the intent to "influence market prices."

After the conclusion of discovery, DRW and CFTC both sought summary judgment. In its motion for partial summary judgment with respect to the attempted price manipulation claim, the CFTC asserted that, under the law of the case, it needed to prove only that defendants: (i) intended to affect the price of those contracts and (ii) took an overt act in furtherance of that intent. The CFTC maintained that both elements were satisfied because DRW did not dispute that it "intentionally placed bids with the intent to affect price." In response, DRW argued that the CFTC's position on the requisite intent standard runs counter to decades of precedent requiring specific intent to create artificial prices. The CFTC's position was also questioned by five key participants in the futures market – including futures exchanges, clearinghouses, and trade industry associations – which

filed an amicus curiae brief in June 2016 expressing concern that there may be no way "to ensure that innocent trading activity not be regarded with the advantage of hindsight as unlawful manipulation" under the CFTC's looser interpretation of the requisite intent.

In a September 2016 decision, the court agreed with DRW and the amici, holding that the "CFTC's interpretation is incorrect" and that the CFTC must prove specific intent to cause artificial prices. That decision also partially rejected motions by both the CFTC and DRW to exclude testimony from experts that both parties had retained to testify at trial. By rejecting the motions for summary judgment and allowing this expert testimony, the court has put the case on track for trial, which is likely to come down to a "battle of the experts" that may make proving artificial price "a daunting task," as stated by a former CFTC Commissioner.[388] Indeed, one of DRW's testifying experts, a former Chief Economist of the CFTC, has filed an expert report indicating that DRW's bids were consistent with the true value of the contract and contributed to the price discovery function of the contract, making it all the more difficult for the CFTC to establish its case.

In December 2018, in a sharply worded decision, a New York federal court provided some much-needed clarity for commodities market participants by dismissing the charges against DRW. This made clear that the CFTC must show that a trader intends to create an artificial price in order to be guilty of attempting to manipulate or manipulating a commodity price and that an intent to merely influence the price is insufficient. The decision, which the CFTC has decided not to appeal, has dealt the CFTC a serious blow in its attempt to expand the definition of what constitutes unlawful price manipulation.

(b) Fraudulent Trading

The CFTC has brought a number of enforcement actions on the theory that defendants manipulated commodities prices by engaging in manipulation through fraudulent trading. These cases typically involve conduct where a party has traded in order to send a false signal about its demand for a physical commodity.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Kraft Foods Group, Inc., et al.*, No. 1:15-CV-02881, 2015 WL 9259885 (N.D. Ill. Dec. 18, 2015)

CFTC charged that Kraft Foods' trading in wheat futures contracts on CBOT, principally during June through December 2011, violated two anti-manipulation provisions under the CEA (Rules 180.1 and 180.2) as well as CBOT speculative position limits and the prohibition on certain fictitious transactions. The core charge was that Kraft took a large position to purchase December CBOT wheat futures as a means to reduce its cost to purchase physical wheat in the cash market without the intent to take delivery of physical wheat in respect of those futures contracts. Although the CFTC does not explain how an anonymous purchase on the futures market would accomplish this, Kraft's alleged strategy was to give the market the impression that it would satisfy its needs for physical wheat by taking delivery from the CBOT futures market and thereby cause the market to believe that there would be less demand in the cash market with the effect of lowering cash market prices. Ultimately, according to the CFTC, it was Kraft's strategy from the beginning to then reduce its CBOT wheat futures position and purchase physical wheat at a lower price in the

[388] *Chilton*, *supra* note 60.

cash market. The CFTC alleged that this strategy violated CFTC anti-fraud regulation 180.1 as well as anti-manipulation regulation 180.2.

On December 18, 2015, Judge Robert Blakey of the Northern District of Illinois denied Kraft Foods' motion to dismiss the market manipulation charges. Kraft sought certification for interlocutory appeal on two issues: (1) whether a large futures position, coupled with an alleged intent to affect market prices but absent any other false communications to the market, constitutes "false signaling" market manipulation; and (2) whether prices can be artificial when the cash and futures market prices converge. On motion to dismiss, Kraft argued that the answer to both questions was no because a Seventh Circuit precedent established that manipulation requires a deceptive act beyond open market trading and that converging prices are not artificial. Kraft also moved to stay the case pending appeal. In July 2016, Judge Blackey denied Kraft's motion for interlocutory appeal. The case is currently pending.

In addition, the CFTC charged that, since Kraft never intended to take delivery on CBOT futures contracts and was not acting as a bona fide hedger, Kraft violated the CBOT position limits applicable to speculative positions and that it also wrongfully engaged in certain CBOT wheat futures "exchanges of futures for physical" transactions.

Example Case: *In re Lansing Trading Group, LLC*, CFTC Docket No. 18-16 (July 12, 2018).

In July 2018, the CFTC settled charges alleging that the Lansing Trading Group ("Lansing") attempted to manipulate the price of certain CBOT wheat futures and options contracts and aided and abetted the attempted manipulation of the cash price for yellow corn from Columbus, Ohio in violation of CEA Sections 9(a)(2), 6(c)(1), and 6(c)(3).

According to the settlement, in March 2015, Lansing attempted to manipulate the price of certain CBOT wheat futures and options contracts by acquiring and loading-out for delivery wheat with 3 parts per million deoxynivalenol (3 ppm Vomitoxin) through the purchase and cancellation of 250 wheat shipping certificates. The CFTC alleged that through the cancellation of these wheat certificates, Lansing intended to send a false or misleading signal to the market of a demand for 3 ppm Vomitoxin wheat in order to attempt to influence the price of the CBOT wheat futures and options contracts. The CFTC further alleged that, as part of this strategy, a Lansing trader communicated with the writer of a market newsletter, who agreed to disseminate information about Lansing's intent to cancel and load-out the Wheat Certificates to the market.

Separately, the CFTC alleged that on February 19, 2015, broker contacted a trader at Lansing by phone and requested that Lansing enter into a transaction with a grain company for Columbus Corn at a price below the market price. The CFTC alleged that the broker told the Lansing trader that its counterparty wanted this reduced price for the Columbus Corn put "out there" to the market, and that this transaction would be used by the counterparty to spread false or misleading information about the price of Columbus Corn. Written confirmations from Lansing confirmed that Lansing entered into two transactions with the grain company on that day at the exact lower prices discussed with the broker. By such conduct, Lansing aided and abetted an attempt to manipulate downward the price of Columbus Corn.

As part of the settlement, Lansing agreed to pay a civil monetary penalty of $3.4 million. Simultaneously with the CFTC settlement, the CME Group issued a Notice of Disciplinary Action in which Lansing agreed to pay a fine of $3.15 million arising out of the attempted manipulation of the wheat futures contracts that is the subject of the CFTC's Order.

(c) Spoofing

Example Case: *In re Panther Energy Trading LLC*, CFTC Docket No. 13-26 (July 22, 2013)

In re Panther Energy Trading was the first case in which the CFTC applied its new anti-disruptive trading practice authority. By consent, the CFTC found that Panther Energy Trading violated CEA Section 4c(a)(5)(C) by utilizing a computer algorithm designed to place and quickly cancel bids and offers in futures contracts to engage in spoofing. For example, a sell order (that the company wanted to execute) would be placed along with longer buy orders (that the company intended to withdraw) to give the market a false impression of buying interest. If the small sell orders were filled, the large buy orders were immediately cancelled.

Without admitting to or denying the allegations, Panther Energy Trading agreed to pay a $1,4 million civil penalty.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Nav Sarao Futures Limited plc and Navinder Singh Sarao*, 15-CV-03398 (N.D. Ill. Apr. 17, 2015)

The CFTC charged the defendants with unlawfully manipulating, attempting to manipulate, and spoofing the E-mini S&P 500, a stock market index futures contract based on the Standard & Poor's 500 Index, which is traded only at the CME (discussed in more detail under the Disruptive Trading Practices section below) in violation of CEA Sections 4c(a)(5), 6(c)(1), 6(c)(3) and 9(a)(2) The CFTC Complaint alleged that Sarao successfully manipulated the E-mini S&P on at least 12 days, attempted to manipulate the E-mini S&P tens of thousands of times, submitted tens of thousands of spoof orders, and attempted to employ a manipulative device in connection with these spoof orders.

Sarao was permanently enjoined from violating the relevant provisions and ordered to pay disgorgement in the amount of $12,871,587.26 and a civil penalty in the amount of $25,743,174.52.

Example Case: *In re Geneva Trading USA, LLC*, COMEX 13-9490-BC-1 (Oct. 7, 2016)

A panel of the CME Business Conduct Committee found that during the time period, from March 2013 through July 2013, a Geneva trader engaged in a pattern of activity in the Gold futures contract market wherein he entered larger-sized orders on one side of the market and then cancelled them several seconds after smaller-sized orders on the opposite side of the book were executed. The panel found that the trader violated NYMEX Rules 432.B.2., 432.Q., and 432.T. The trader's purpose in entering these larger-sized orders included encouraging market participants to trade with his smaller-sized orders and in many cases his orders had that effect. The panel concluded that, pursuant to exchange rules, Geneva is strictly liable for the acts of its employees. Geneva settled the allegations, which it neither admitted nor denied, agreeing to disgorge profits in the amount of $12,683.

Example Case: *In re Simon Posen*, CFTC Docket No. 17-20 (July 26, 2017)

In July 2017, the CFTC settled charges with Simon Posen alleging that Posen engaged in thousands of incidents of spoofing in gold, silver, and copper futures contracts over a period spanning more than three years between December 2011 and March 2015 in violation of Section 4c(a)(5)(C) of the CEA . In the order, the CFTC alleged that Posen acted individually, trading from home for his own personal account, and manually placed orders to buy and sell gold, silver, copper, and crude oil futures contracts in a distinct pattern with the intent to cancel these orders before execution. Posen allegedly would place one or more iceberg orders (orders where only a small portion was visible to the market) on the opposite side of the market shortly after placing a large spoof order. Once the smaller orders were filled, he would cancel the unfilled spoof order. Often, Posen would immediately repeat this spoofing pattern in reverse to exit the position he had created and revert to being flat. As part of the settlement, Posen agreed to pay $635,000, cease and desist from violating the CEA's spoofing prohibition, and to a permanent ban from trading in any market regulated by the CFTC and cooperate with the CFTC.

Example Case: *In re The Bank of Tokyo-Mitsubishi UFJ, Ltd.*, CFTC Docket No. 17-21 (Aug. 7, 2017)

In August 2017, the CFTC settled charges with The Bank of Tokyo-Mitsubishi UFJ, Ltd. ("BTMU"), alleging that BTMU engaged in spoofing in a variety of futures contracts, including futures contracts based on United States treasury notes and Eurodollars, between July 2009 and December 2014, in violation of CEA Section 4c(a)(5)(C). In the order, the CFTC alleged that one of BTMU's employees accessed the markets through a trading platform in Tokyo and placed multiple orders for futures contracts with an intent to cancel the orders before their execution to move the market in a direction favorable to his orders. The employee's spoofing strategies included submitting orders on opposite sides of the same market at nearly the same time. Once aware of the employee's misconduct, BTMU promptly suspended the trader, commenced an expansive internal review, and reported the conduct to the CFTC's Division of Enforcement. In addition to assisting the CFTC with its investigation, BTMU launched an overhaul of its systems and controls, implemented a variety of enhancements to detect and prevent similar misconduct, revised its policies, updated its training, and implemented electronic systems to identify spoofing. As part of the settlement, BTMU agreed to pay $600,000 and cease and desist from violating the CEA's prohibition against spoofing.

Example Case: *In re Logista Advisors LLC*, CFTC Docket No. 17-29 (Sept. 29, 2017)

In September 2017, the CFTC settled charges with Logista Advisors LLC ("Logista"), a crude-oil-trading firm based in Houston, Texas, alleging that Logista engaged in spoofing in crude oil futures trading on a foreign exchange and that Logista failed to diligently supervise its employees and officers between September 2013 and October 2014 in violation of Rule 166.3. The CFTC alleged that the employee primarily responsible for Logista's crude oil futures trading from approximately September 2013 through September 2014 was given inadequate training, direction, and supervision, which resulted in him repeatedly engaging in spoofing, while trading futures on a foreign futures exchange. After the trader's misconduct was detected by the exchange's compliance department, the CFTC alleged that Logista failed to satisfy its obligation to supervise an appropriate investigation that would enable Logista to provide accurate responses to the

exchange's inquiries. As a part of the settlement, Logista agreed to pay a $250,000 civil monetary penalty and to cease and desist from violating the CFTC Regulation governing diligent supervision.

Example Case: *In re Arab Global Commodities DMCC*, CFTC Docket No. 18-01 (Oct. 10, 2017)

In October 2017, the CFTC settled charges with Arab Global Commodities DMCC ("AGC"), a proprietary trading firm headquartered in Dubai, alleging that AGC engaged in spoofing of copper futures contracts between March and August 2016 in violation of Section 4c(a)(5)(C) of the CEA. In the order, the CFTC alleged that a AGC trader engaged in spoofing through after-hours trading. His spoofing involved placing one or more large orders on one side of the book, while he had a small resting order on the opposite side of the book, and he immediately cancelled the large order(s) when his small order got filled. The CFTC further alleged that the trader also used another AGC trader's account to hide his spoofing. Once aware of the misconduct, AGC promptly terminated the trader's employment, according to the Order. As part of the settlement, AGC agreed to pay $300,000 and to cooperate fully with the CFTC.

Example Case: *In re Deutsche Bank AG and Deutsche Bank Securities*, CFTC Docket No. 18-06 (Jan. 29, 2018)

In January 2018, the CFTC settled charges with Deutsche Bank AG and Deutsche Bank Securities (collectively "Deutsche Bank") for a scheme of spoofing and manipulative conduct conducted by its precious metal traders between February 2008 and September 2014 in violation of CEA §§ . 4c(a)(5),9(a)(2),6(c)(1), 6(c)(3), and 6(d).

These traders would place large spoofing bids or offers to create the false appearance of market interest in a particular metal. The traders did not intend for these orders to be filled, and instead they were to assist filling smaller orders placed by the traders on the other side of the market at favorable prices. These smaller genuine orders were placed as iceberg orders, which constitute a large order but only displays a small portion publicly on the orderbook at a time. Thus, this lopsided depiction of market depth caused the price of the futures to shift in favor of these genuine orders. Traders engaged in this both individually and collusively, often coordinating their efforts through internal chats.

Concurrently, an additional trader at Deutsche Bank coordinated with an external trader to enter into fraudulent trades to manipulate the price of the futures. These coordinated trades were intended to push the price of a future up or down and trigger customers' stop-loss orders placed with Deutsche Bank. The trader was able to benefit from buying or selling futures contracts through these stop-loss orders at favorably manipulated prices.

The order notes that Deutsche Bank is liable for both the acts of its agents and for a failure to supervise. However, Deutsche Bank was also given credit for cooperation that it provided. Without admitting or denying any of the findings, Deutsche Bank agreed to pay a civil penalty of $30 million and take remedial steps.

Similar consent orders were concurrently entered into with HSBC Securities (USA) Inc. and UBS AG.

(d) Violating Offers

Example Case: *DiPlacido v. U.S. Commodity Futures Trading Comm'n*, 364 F. App'x 657 (2d Cir. 2009)

The Second Circuit affirmed the CFTC's finding that DiPlacido manipulated settlement prices for electricity futures contracts on NYMEX in violation of CEA Sections 6(c), 6(d), 9(a)(2), and 4c, as well as CFTC Regulations 1.31(a) and 1.38(a). The CFTC had found that DiPlacido falsely recorded and reported an after-hours, non-competitive trade and that "violating bids and offers – in order to influence prices" was "sufficient to show manipulative intent."[389]

(e) Corners and Squeezes

The CEA does not define the terms "corner" and "squeeze," but courts have provided definitions. A corner "occurs when a trader secretly acquires a long futures position, that is, a contract to purchase very large relative to the physical supply that is available to be delivered, and simultaneously acquires the means, by ownership or otherwise, to prevent delivery at reasonable prices of the physical commodity."[390]

"[A] 'squeeze' has been defined as a type of manipulation, generally occurring when the long holder does not have direct control over the cash crop, as in a 'corner.' A prototypical squeeze occurs when a trader attains a dominant long position and can force shorts facing inadequate cash supply to cover their positions at unfair prices. The shorts are 'squeezed' into settling their holdings with the dominant long at above-market prices as the delivery date approaches."[391]

To prove a manipulation through a squeeze, the CFTC must prove "(1) that the accused holds a controlling dominant long position in the market; (2) that the accused specifically intends to execute a squeeze; (3) that an artificial price exists at the time of the offense; and (4) that the accused causes the artificial price."[392]

Example Case: *In re Fenchurch Capital Mgmt.*, Comm. Fut. L. Rep. (CCH) ¶ 26,747 (CFTC July 10, 1996)

A trading manager settled with the CFTC by agreeing to a finding of price manipulation through "cornering." The CFTC found that the manager used repo transactions for the purpose of taking

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389 *In re DiPlacido*, 2008 WL 4831204, at *28.

390 *United States v. Radley*, 659 F. Supp. 2d 803, 813 (S.D. Tex. 2009) (citing *United States v. Radley*, 558 F. Supp. 2d 865, 874 (N.D. Ill. 2008), *aff'd*, 632 F.3d 177 (5th Cir. 2011)); *see also Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1162 (8th Cir. 1971) ("[A] corner amounts to nearly a monopoly of a cash commodity, coupled with the ownership of long futures contracts in excess of the amount of that commodity, so that shorts — who because of the monopoly cannot obtain the cash commodity to deliver on their contracts — are forced to offset their contract with the long at a price which he dictates.").

391 *Frey v. CFTC*, 931 F.2d 1171, 1175 (7th Cir. 1991).

392 *Id*.

off the market the cheapest-to-deliver securities deliverable on the 10-year Treasury note futures contract in order to drive up the value of its long futures contract position.

Example Case: *In re Hunt*, Comm. Fut. L. Rep. (CCH) ¶ 24,570 (CFTC 1989); *In re Hunt*, Comm. Fut. L. Rep. (CCH) ¶ 24,569 (CFTC 1989).

The defendants settled CFTC charges alleging that the Hunt Brothers had manipulated and attempted to manipulate the prices of silver futures contracts and silver bullion during 1979 and 1980 after a failed effort to corner the world silver market. As part of the settlements of claims for false reporting and manipulation, which was neither admitted nor denied, the Hunt Brothers received a $10 million penalty and were barred from trading on commodity markets.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Parnon Energy Inc., et al.*, No. 11-CV-3543 (S.D.N.Y. Aug. 4, 2014)

The defendants settled CFTC charges alleging that they had executed a manipulative trading strategy designed to affect NYMEX crude oil futures contracts by knowingly acquiring a controlling position in physical crude oil, holding the physical position until after futures expiry with the intent to affect NYMEX crude oil spreads, and then selling off the physical position at a loss during the "cash window." The defendants settled the action via consent order and agreed to pay a $13 million fine.

2. Manipulation: Over the Counter Trading

(a) Trading to Impact Reference Index Price

Example Case: *In re Total Gas & Power North America, Inc., and Therese Tran*, CFTC Docket No. 16-03 (Dec. 7, 2015)

Total Gas & Power North America and Therese Tran, a trader for Total Gas, settled CFTC charges that alleged attempted manipulation of natural gas monthly index settlement prices at four major trading hubs during a monthly settlement period known as "bid-week." The CFTC alleged that Total Gas attempted to manipulate monthly index settlement prices of natural gas through their physical fixed-price trading and accounted for more than half of the fixed-price trades by volume during bid-weeks, even though Total Gas had no material customer business, assets, or transportation at the hubs during bid-weeks for September 2011, October 2011, March 2012, and April 2012. . According to the Order, Total Gas engaged in this trading in an attempt to favorably affect the monthly index settlement prices to benefit its related financial positions. Pursuant to the settlement, Total Gas and Tran agreed to jointly pay a $3.6 million civil monetary penalty. The Order also imposed a two-year trading limitation on trading physical basis or physical fixed-price natural gas at hub locations when Total Gas also holds, prior to and during bid-week, any financial natural gas position whose value is derived in any material part from natural gas bid-week index pricing.

Following the CFTC settlement, FERC issued an order to show cause directing Total Gas and two traders to show that they had not violated the prohibition on market manipulation through this conduct on April 28, 2016. FERC's order to show cause alleges that the scheme occurred between June 2009 and June 2012 and proposed civil penalties of $213.6 million against Total Gas and $1

million and $2 million against the two traders as well as disgorgement of $9.18 million, plus interest.

(a) Foreign Exchange Benchmark Cases

Example Case: *In re Citibank, N.A.*, CFTC Docket No. 15-03 (Nov. 11, 2014); *In re JPMorgan Chase Bank, N.A.*, CFTC Docket No. 15-04 (Nov. 11, 2014); *In re The Royal Bank of Scotland plc*, CFTC Docket No. 15-05 (Nov. 11, 2014); *In re UBS AG*, CFTC Docket No. 15-06 (Nov. 11, 2014); *In re HSBC Bank plc*, CFTC Docket No. 15-07 (Nov. 11, 2014)

In November 2014, the CFTC simultaneously issued five Orders filing and settling charges against Citibank, HSBC, JPMorgan, RBS, and UBS AG for attempted manipulation of, and for aiding and abetting other banks' attempts to manipulate, global foreign exchange ("FX") benchmark rates CEA Sections 6(c)(4)(A) and 6(d). According to the Orders, certain FX traders at these banks coordinated their trading with traders at other banks in their attempts to manipulate the FX benchmark rates. The CFTC alleged that FX traders used private chat rooms to communicate and plan their attempts to manipulate the FX benchmark rates. These traders also disclosed confidential customer order information and trading positions, altered trading positions to accommodate the interests of the collective group, and agreed on trading strategies as part of an effort to attempt to manipulate certain FX benchmark rates. The Orders collectively imposed over $1.4 billion in civil monetary penalties, including $310 million each from Citibank and JPMorgan, $290 million each from RBS and UBS, and $275 million from HSBC.

Example Case: *In re Barclays Bank PLC*, CFTC Docket No. 15-24 (May 20, 2015)

The CFTC issued an Order filing and settling charges against Barclays for attempted manipulation, false reporting, and aiding and abetting other banks' attempts to manipulate FX benchmark rates to benefit the positions of certain traders in violations CEA Sections 6(c), 6(d) and 9(a)(2). According to the Order, Barclays' traders, like the traders at the five banks that settled in November 2014, coordinated their trading or indicative rate submissions to attempt to manipulate certain FX benchmark rates, as well as disclosed confidential customer order information and trading positions, altered trading positions to accommodate the interests of the collective group, and agreed on trading strategies as part of an effort to attempt to manipulate certain FX benchmark rates. Pursuant to the settlement, Barclays agreed to pay $400 million and to implement and strengthen its internal controls. The Order noted that the $400 million reflects in part that Barclays did not settle at an earlier stage in the investigation.

(b) ISDAFIX Cases/Impact Trading/False Reports

Example Case: *In re Citibank, N.A.*, CFTC Docket No. 16-16 (May 25, 2016)

The CFTC issued an Order filing and settling charges that from at least as early as January 2007 to January 2012, Citibank attempted to manipulate and made false reports concerning USD ISDAFIX in violation of CEA Sections 6(c), 6(d), and 9(a)(2). According to the order, on multiple occasions, Citibank's ISDAFIX submission was a rate or spread higher or lower than the reference rates and spreads disseminated to the panel banks on certain days that Citibank had a derivatives position settling or resetting against the USD ISDAFIX benchmark. The Order also finds that Citibank, on multiple occasions, attempted to manipulate USD ISDAFIX by bidding, offering, and

executing transactions in targeted interest rate products at or near the critical 11:00 a.m. fixing with the intent to affect the reference rates and spreads captured in the snapshot sent to submitting banks. The CFTC order required Citibank to pay a $250 million civil monetary penalty, cease and desist from further violations as charged, and take specified remedial steps, including measures to detect and deter trading intended to manipulate swap rates such as USD ISDAFIX, to ensure the integrity and reliability of the bank's benchmark submissions, and to improve related internal controls.

Example Case: *In re The Goldman Sachs Group, Inc., and Goldman, Sachs & Co.,* CFTC Docket No. 17-03 (Dec. 21, 2016)

In December 2016, the CFTC settled charges with The Goldman Sachs Group, Inc., and Goldman, Sachs & Co. (collectively, "Goldman"), alleging that Goldman attempted to manipulate by and through certain of its traders in New York on many occasions and made false reports concerning USD ISDAFIX between January 2007 and March 2012 in violation of CEA Sections 6(c), 6(d), and 9(a)(2).

In the order, the CFTC alleged that Goldman—through its traders and the head of Goldman's Interest Rate Products Trading Group in the United States—bid, offered, and executed transactions in interest rate swap spreads, U.S. Treasuries, and Eurodollar futures contracts in a manner deliberately designed—in timing, price, and other respects—to influence the published USD ISDAFIX to benefit the Bank in its derivatives positions. The CFTC further alleged that Goldman, through its employees making the Bank's USD ISDAFIX submissions, also attempted to manipulate and made false reports concerning USD ISDAFIX by skewing the Bank's submissions in order to benefit the Bank at the expense of its derivatives counterparties and clients.

As part of the settlement, Goldman agreed to pay $120 million; cease and desist from further violations as charged; and take specified remedial steps, including measures (1) to detect and deter trading intended to manipulate swap rates such as USD ISDAFIX, (2) to ensure the integrity and reliability of Goldman's benchmark submissions, and (3) to improve related internal controls. Also, the current supervisor responsible for the oversight of various United States interest-rate trading desks at Goldman agreed to provide a certification as to, among other things, the effectiveness of the internal controls and procedures undertaken and implemented by Goldman as a result of this settlement.

Example Case: *In re The Royal Bank of Scotland plc*, CFTC Docket No. 17-08 (Feb. 3, 2017)

In February 2017, the CFTC settled charges with The Royal Bank of Scotland plc ("RBS"), alleging that RBS, through multiple traders, attempted to manipulate the U.S. Dollar International Swaps and Derivatives Association Fix (USD ISDAFIX) benchmark between January 2007 and March 2012 to benefit certain derivatives positions it held that were priced or valued off of the USD ISDAFIX benchmark in violation of CEA Sections 6(c), 6(d), and 9(a)(2) . Through certain traders, RBS bid, offered, and executed transactions in targeted interest rate products, including both swap spreads and U.S. Treasuries, at the critical 11:00 a.m. fixing time with the intent to affect the reference rates and spreads captured by a leading interest rates swaps broker ("Swaps Broker") in the "print" sent to submitting banks, and thereby to affect the published USD ISDAFIX. RBS attempted to manipulate USD ISDAFIX through its trading at the 11:00 a.m.

fixing in order to benefit cash-settled swaptions held by RBS that were priced or valued against the USD ISDAFIX benchmark. The 11:00 a.m. USD ISDAFIX rate was used for cash settlement of options on interest rate swaps, or swaptions, and as a valuation tool for certain other interest rate products. As part of the settlement, RBS agreed to pay $85 million and take specified steps to implement and strengthen its internal controls and procedures, including measures to detect and deter trading potentially intended to manipulate swap rates such as USD ISDAFIX and to ensure the integrity of interest-rate swap benchmarks.

Example Case: *U.S. Commodity Futures Trading Comm'n v. TFS-ICAP LLC and TFS-ICAP Ltd., Ian Dibb, and Jeremy Woolfenden*, No. 1:18-cv-08914 (S.D.N.Y., filed Sept. 28, 2018).

In a complaint filed in New York federal court, the CFTC alleged that, from approximately 2008 through 2015, brokers at TFS-ICAP offices in the United States and the United Kingdom routinely attempted to deceive their clients by communicating fake bids and offers and fake trades in the foreign exchange options market. According to the CFTC, these practices — known as "flying prices" and "printing trades" — were a core part of TFS-ICAP's broking business. The CFTC claims that brokers flew prices and printed trades to clients over the phone, in instant message chats, and on TFS-ICAP's proprietary electronic trading platform. According to the complaint, the purpose of "flying" fake bids and offers and "printing" fictitious trades was to give clients the impression that there was more liquidity on TFS-ICAP's platform than there actually was and to induce traders to transact at times and at prices that they would not otherwise have transacted. The complaint alleged that when a client attempted to trade with a fake bid or offer and the TFS-ICAP broker could not find a real counterparty to step into the trade, the broker would lie — making up an excuse as to why the bid or offer was not available.

In addition, the complaint charged the Chief Executive Officer, Ian Dibb, and the Head of Emerging Markets broking, Jeremy Woolfenden, with the underlying violations and supervisory failures due to their alleged knowledge and/or encouragement of the fraudulent practices. According to the CFTC, Woolfenden explicitly encouraged brokers under his supervision to fly prices and print trades. The CFTC further alleged that Dibb had actual knowledge and/or reason to know of the pervasive, fraudulent practices, but failed to take appropriate steps to discourage or prevent the practices.

The case, which is currently pending, seeks, among other relief, disgorgement of benefits from violations of the Commodity Exchange Act and CFTC Regulations, civil monetary penalties, registration bans, and permanent injunctions against future violations of federal commodities laws, as charged.

(c) Corners and Squeezes

Example Case: *U.S. Commodity Futures Trading Comm'n v. BP Products North America, Inc.*, No. 06-C-3503 (N.D. Ill. Oct. 25, 2007)

In a civil action arising from the same activities underlying the *Radley* case, discussed below, the CFTC alleged that in February 2004, BP Products North America, Inc. ("BP") attempted to corner the market in February TET delivery contracts by buying up all the propane available. This conduct allegedly drove up the price of propane from 65 cents per gallon to 90 cents. According to the

CFTC, BP held a long position in excess of 5 million barrels. BP reached a settlement with the CFTC, which alleged that BP violated CEA Sections 6(c), 6(d), and 9(a)(2). As part of the settlement, BP agreed: (1) to a permanent injunction against further CEA violations; (2) to implement a compliance and ethics program to detect and prevent future CEA violations; (3) to a three-year period of oversight by a court-appointed independent monitor; and (4) to pay a civil penalty of $125 million. BP neither admitted nor denied the factual allegations or the legal findings set forth in the consent order embodying the parties' settlement agreement.

BP and certain affiliates also entered into a three-year Deferred Prosecution Agreement with the DOJ in a related criminal case charging BP with wire fraud and CEA violations for manipulating and attempting to manipulate the price of February 2004 TET Propane. As part of the DPA, BP America admitted to the facts supporting the criminal information and agreed: (i) to pay a total of approximately $173 million in fines, restitution, and contributions to the United States Postal Inspection Service Consumer Fraud Fund; and (ii) to the appointment of a monitor. On January 31, 2011, the court dismissed the case on the government's motion, finding that BP had fulfilled all of the requirements of the DPA.[393]

(a) Defending a Price

Example Case: *In re JPMorgan Chase Bank, N.A.*, CFTC Docket No. 14-041 (Oct. 16, 2013)

The CFTC used its Rule 180.1 fraud-based-manipulation authority for the first time in relation to the JPMorgan "London Whale" matter. The CFTC found that JPMorgan recklessly employed manipulative devices and contrivances in connection with a particular type of credit default swap in violation of CEA § 6(c)(1). The CFTC found that JPMorgan traders sold large volumes of the CDX on the last day of the month, causing the price of the CDX to fall and the value of JPMorgan's short protection position to increase. The CFTC also found that the traders acted "with reckless disregard to obvious dangers to legitimate market forces from their trading." JPMorgan settled the CFTC's charge (with an admission as to certain of the CFTC's factual findings but not the CFTC's legal conclusions), pursuant to which it paid a civil monetary penalty of $100 million and agreed to institute policies and procedures to enhance its supervision and control systems in connection with swap trading activity.

3. Manipulation: Cross-Market Trading

(a) Marking the Close

Example Case: *In re Avista Energy, Inc.*, CFTC Docket No. 01-21, 2001 WL 951736 (Aug. 21, 2001)

Avista Energy held over-the-counter derivative contracts, the value of which was based on the settlement price of electricity futures contracts on the last day of options trading for the contracts. The CFTC alleged that Avista Energy created artificial settlement prices in the futures contracts in order to benefit its holdings by (i) placing large orders to sell futures contracts at prices less than the prevailing bids during the last two minutes of trading on the last day of options trading for the

[393] *United States v. BP Am. Inc.*, No. 07-cr-00683 (N.D. Ill. filed Oct. 25, 2007).

contracts and (ii) placing large orders to buy futures contracts at prices higher than the prevailing offers during the last two minutes of trading on the last day of options trading. Avista Energy agreed to a settlement based on charges of attempted manipulation, manipulation, non-competitive trading, and recordkeeping violations (neither admitted nor denied), pursuant to which it paid a civil monetary penalty of $2.1 million.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Amaranth Advisors, LLC*, 554 F. Supp. 2d 523 (S.D.N.Y. 2008)

The CFTC sued a hedge fund that traded both natural gas futures contracts and over-the-counter natural gas swaps, alleging that the defendant sought to profit from large short positions on natural-gas swaps – the prices of which depended on the closing price of natural-gas futures – by manipulating the closing price of natural-gas futures. The defendant allegedly purchased a substantial number of futures contracts leading up to the closing range on expiration day and then sold those contracts several minutes before the close. The goal was to create artificial prices of natural-gas futures contracts by deliberately selling a substantial number of futures contracts during the close on expiration day. Amaranth agreed to a settlement based on charges of attempted manipulation and making material misrepresentations in violation of CEA §§ 6(c), 6(d) and 9(a)(2) without admitting nor denying and to pay a civil monetary penalty of $7.5 million.

4. False Reporting

In the wake of Enron's collapse, the CFTC brought several actions against energy and natural-gas firms for making false reports to energy price indexers. As of November 2008, the CFTC reported filing more than twenty-five enforcement actions involving false-reporting allegations in the energy sector. More recently, the CFTC has opened several investigations into the integrity of submissions made to benchmark rates (such as LIBOR, ISDAFIX, and WM/Reuters rates), which have ensnared a number of large banks, trading companies, and brokers. The CFTC's benchmark interest rate investigation has already led to settlements with several banks or brokerage firms, all of which involved findings of false reporting

These claims are often coupled with allegations that a defendant has manipulated or attempted to manipulate price through its false reports. Courts have recognized that "one of the most common manipulative devices [is] the floating of false rumors which affect futures prices." [394] The motivating principle is that false statements concerning commodities transactions may have the ability to affect price by creating a false impression concerning supply and demand and the willingness of others to enter into trades at specified prices, which information other market participants may factor into their own trading decisions.

The CFTC began investigating global benchmark interest rates – "key interest rates set by central banks under domestic public law and transnational, private, benchmark rates set by associations of globally operating banks"[395] – in 2009. They subsequently reached their first settlement in June 2012 with Barclays. Since that time, the CFTC has imposed penalties of $5.29 billion in its

[394] *Cargill*, 452 F.2d at 1163.

[395] THOMAS COTTIER ET AL., THE RULE OF LAW IN MONETARY AFFAIRS: WORLD TRADE FORUM (Thomas Cottier et al. eds., 2014).

investigation of manipulation of global benchmark rates. Of this, over $3.4 billion has been imposed for misconduct relating to ISDAFIX, LIBOR, Euribor, and other interest rate benchmarks, and over $1.8 billion in penalties has been imposed for misconduct relating to foreign exchange benchmarks. In its settlements, the CFTC has required the charged financial institutions to (1) cease and desist from further violations of the Commodity Exchange Act; (2) fully cooperate with the CFTC; (3) prepare, retain, and provide relevant documents and reports to the CFTC; (4) implement auditing, monitoring, and training measures and systems to detect and prevent improper transactions, trading, or communications; (5) implement and strengthen internal controls and procedures, including supervision; and (6) adhere to specific undertakings and provide certifications to ensure the integrity of their benchmark interest rate submissions.

(a) LIBOR-Related Benchmark Interest Rate Investigation Settlements

Example Case: *In re Barclays PLC*, CFTC Docket No. 12-25 (June 27, 2012)

Barclays settled CFTC claims that it submitted false, misleading, or knowingly inaccurate reports concerning benchmark interest rates in violation of CEA Sections 6(c), 6(d), and 9(a)(2) . Barclays was a member of the panel of banks that submits rates for the daily calculation of LIBOR and EURIBOR. The CFTC found, among other things, that over a period of several years, Barclays based its LIBOR submissions on the requests of Barclays swaps traders who were attempting to affect the official published LIBOR in order to benefit Barclays' derivatives trading positions. Barclays settled charges of attempted manipulation, false reporting, and aiding and abetting (admitting facts only to the extent that they were admitted in its DOJ settlement), pursuant to which it paid a civil monetary penalty of $200 million and agreed to institute policies and procedures to ensure compliance with the CEA and with CFTC regulations.

Example Case: *In re UBS AG*, CFTC Docket No. 13-09 (Dec. 19, 2012).

UBS settled CFTC claims that it manipulated and attempted to manipulate LIBOR, EURIBOR, and Euroyen TIBOR, and submitted false, misleading, or knowingly inaccurate reports regarding those benchmarks in violation of CEA Sections 6(c), 6(d) and 9(a)(2). The CFTC found that UBS made false LIBOR submissions; manipulated JPY LIBOR; attempted to manipulate JPY, GBP, CHF, and EUR LIBOR, EURIBOR, and Euroyen TIBOR; and aided and abetted attempted manipulations of Yen LIBOR and Euroyen TIBOR by other banks. UBS agreed to a settlement (admitting facts only to the extent that they were admitted in its DOJ settlement), pursuant to which it paid a civil monetary penalty of $700 million and agreed to institute policies and procedures to ensure compliance with the CEA and CFTC regulations. Concurrent with the CFTC settlement, UBS also settled charges with the DOJ, the FSA, and the Swiss Financial Market Supervisory Authority.

Example Case: *In re The Royal Bank of Scotland plc*, CFTC Docket No. 13-14 (Feb. 6, 2013).

RBS settled CFTC claims that it manipulated and attempted to manipulate two global benchmark interest rates, Yen and Swiss Franc LIBOR. The CFTC found that RBS made false LIBOR submissions, manipulated and attempted to manipulate JPY and CHF LIBOR, and aided and abetted other banks' attempts to manipulate JPY and CHF LIBOR in violation of CEA 6(c), 6(d), and 9(a)(2). RBS agreed to a settlement that included CFTC charges of manipulation, attempted

manipulation, false reporting, and aiding and abetting (admitting facts only to the extent that they were admitted in its DOJ settlement), pursuant to which it paid a civil monetary penalty of $325 million and agreed to institute policies and procedures to ensure compliance with the CEA and with CFTC regulations. Concurrent with the CFTC settlement, RBS also settled charges with the DOJ and the FSA.

Example Case: *In re ICAP Europe Ltd.*, CFTC Docket No. 13-38 (Sept. 25, 2013).

ICAP settled CFTC claims of false reporting, manipulation, and attempted manipulation in relation to Yen LIBOR in violation of CEA Sections 6(c), 6(d) and 9(a)(2) . The CFTC found that from October 2006 through January 2011, ICAP brokers on its Yen derivatives and cash desks knowingly disseminated false and misleading information concerning Yen borrowing rates to market participants in attempts to manipulate the official Yen LIBOR daily fixing. ICAP agreed to a settlement based on charges of manipulation, attempted manipulation, false reporting, and aiding and abetting (neither admitted nor denied), pursuant to which it paid a civil monetary penalty of $65 million and agreed to take specified steps to ensure the integrity and reliability of the benchmark interest rate-related market information that it disseminates. Concurrent with the CFTC settlement, ICAP also settled charges with the U.K. Financial Conduct Authority.Example Case: *In re Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.*, CFTC Docket No. 14-02 (Oct. 29, 2013)

Rabobank settled CFTC claims of false reporting, manipulation, attempted manipulation, and aiding and abetting in relation to LIBOR for several currencies and EURIBOR in violation of CEA Sections 6(c), 6(d) and 9(a)(2). The CFTC found that from mid-2005 through early 2011, Rabobank knowingly caused false, misleading, or knowingly inaccurate U.S. Dollar, Yen and Sterling LIBOR and EURIBOR submissions to be disseminated globally, and that these submissions affected or tended to affect the prices of commodities in interstate commerce. Rabobank agreed to a settlement (admitting facts only to the extent that they were admitted in its DOJ settlement), pursuant to which it paid a civil monetary penalty of $475 million and agreed to institute policies and procedures to ensure compliance with the CEA and with CFTC regulations. Concurrent with the CFTC settlement, Rabobank also settled investigations with the DOJ, the FSA, the Japan Financial Services Authority, the Dutch national bank, and the Dutch public prosecutor.

Example Case: *In re Deutsche Bank AG*, CFTC Docket No. 15-20 (Apr. 23, 2015)

Deutsche Bank settled CFTC claims that it submitted false, misleading, or knowingly inaccurate reports concerning benchmark interest rates in violation of CEA Sections 6(c), 6(d) and 9(a)(2). Deutsche Bank admitted engaging in false reporting, manipulation, attempted manipulation, and aiding and abetting in relation to LIBOR for several currencies (U.S. Dollar, Yen, Sterling, and Swiss Franc) and EURIBOR. The CFTC found that over a period of more than six years, from at least 2005 through 2011, Deutsche Bank systemically and pervasively took into consideration other Deutsche Bank traders' derivatives trading positions and their own cash and derivatives trading positions when making LIBOR and EURIBOR submissions. The conduct took place across numerous trading desks in multiple locations, specifically, London, Frankfurt, New York, Tokyo, and Singapore. The CFTC further found that Deutsche Bank lacked internal controls, procedures, and policies regarding LIBOR and EURIBOR submissions and failed to adequately

supervise traders and trading desks. Deutsche Bank was fined $800 million, the largest settlement in CFTC history.

Example Case: *In re Citibank, N.A., Citibank Japan Ltd., and Citigroup Global Markets Japan Inc.,* CFTC Docket No. 15-20 (Apr. 23, 2015)

Citibank settled CFTC claims that it and its Japanese affiliates attempted to manipulate Yen LIBOR and Euroyen TIBOR submissions and submitted false, misleading, or knowingly inaccurate reports concerning Yen LIBOR, Euroyen TIBOR, and USD LIBOR. The CFTC Order alleges that Citibank's Japanese affiliates attempted to manipulate Yen LIBOR on multiple occasions from at least February 2010 through August 2010 and Euroyen TIBOR, at times, from April 2010 through June 2010 to benefit the derivatives trading positions of a Tokyo-based senior Yen derivatives trader hired to enhance the bank's reputation in the Tokyo derivatives market. According to the order, the senior Yen derivatives trader attempted to manipulate the benchmark fixings by using his contacts to influence the Yen LIBOR submissions of other Yen panel banks. In addition, a senior manager who ran Citibank's Tokyo interest rates derivatives trading desk pressured Euroyen TIBOR submitters to adjust their submissions to benefit derivatives trading positions.

The Order further alleged that between the spring of 2008 through the summer of 2009, Citibank's USD LIBOR submitters-based submissions on a desire to protect Citi's reputation in the market. According to the order, Citi, at times, had difficulty securing funding in the London interbank market at or below Citi's LIBOR submissions, particularly in the longer tenors. The submitters became concerned that Citi's USD LIBOR submission could have a signaling effect in the market. Accordingly, during this period, the submitters, at times, made submissions based in whole or in part on a desire to avoid that negative scrutiny.

Pursuant to the settlement, Citi and its affiliates paid a civil monetary penalty of $175 million and agreed to cease and desist from further violations of the CEA, as well as adhere to specific undertakings to ensure the integrity of its LIBOR, Euroyen TIBOR, and other benchmark interest rate submissions.

Example Case: *In re BNP Paribas Securities Corp.*, CFTC Docket No. 18-19 (Aug. 28, 2018).

In August 2018, the CFTC settled charges that BNP Paribas Securities Corp. ("BNP") attempted to manipulate by and through certain of its traders in New York on many occasions and made false reports concerning USD ISDAFIX between May 2007 and August 2012 in violation of CEA Sections 6(c), 6(d), and 9(a)(2). .

As part of the settlement, BNP agreed to pay a $90 civil monetary penalties.

Example Case: *In re Bank of America, N.A.,* CFTC Docket No. 18-34 (Sept. 19, 2018).

In September 2018, the CFTC settled charges with Bank of America, N.A. ("Bank of America") alleging that Bank of America, attempted to manipulate by and through certain of its traders in New York on many occasions and made false reports concerning USD ISDAFIX between January 2007 and December 2012 in violation of CEA Sections 6(c), 6(d), and 9(a)(2). .

As part of the settlement, Bank of America agreed to pay a $30 million civil monetary penalty.

(b) Other False Reporting Cases

Example Case: *In re Morgan Stanley Capital Group, Inc.*, CFTC Docket No. 10-10 (Apr. 29, 2010)

Morgan Stanley settled CFTC allegations that a Morgan Stanley trader and a UBS broker discussed an opportunity for Morgan Stanley to act as a counterparty to a third-party UBS customer in the purchase of a large block of NYMEX March 2009 crude oil futures contracts and sell a similar amount of April 2009 contracts (commonly known as a spread position) at a price to be determined later by the market closing price, an arrangement known as a "Trade at Settlement" or "TAS" block trade. Prior to the trade's being finalized, the Morgan Stanley trader requested that the UBS broker not report the block trade until after the close rather than when it was agreed to earlier in the day, as then required by NYMEX rules. The block trade was agreed around mid-day, but per their agreement, the UBS broker did not report the TAS block trade to NYMEX until after the market closed.

5. Wash Sales, Non-Bona Fide Sales, and Other § 4c Violations

Example Case: *U.S. Commodity Futures Trading Comm'n v. Royal Bank of Canada*, No. 12-CV-02497 (S.D.N.Y. 2012)

The CFTC filed a civil complaint alleging that a trading strategy entered into by the Royal Bank of Canada ("RBC") after consultation with the OneChicago futures exchange constituted a "wash trading scheme of massive proportions" in violation of CEA Section 4c(a)(l).The transactions at issue were block trades between RBC affiliates, which were designed to provide tax benefits for RBC, because any tax paid on U.S. dividend income could be deducted from its Canadian tax liability. RBC stated in court filings that the CFTC knew of the transactions at the time and that the transactions were approved by OneChicago and the CME after consultation with the CFTC. The case settled on December 18, 2014 by consent order for $35 million.

Example Case: *In re Benjamin Hutchen*, CFTC Docket No. 13-07 (Nov. 27, 2012)

The CFTC alleged that Benjamin Hutchen, a former Morgan Stanley Managing Director, entered into non-bona fide trades to minimize his customers' slippage on trades. The CFTC alleged that Hutchen executed a scheme wherein he entered into off-exchange trades with Morgan Stanley's Government and Swap Desks, which he improperly reported as exchange for related position ('EFRP") trades to the CME and CBOT in violation of CEA Section 4c(a). Hutchen agreed to settle the claim based on his entering into non-bona fide trades (neither affirmed nor denied), to cease and desist from violating the CEA, to pay a civil monetary penalty of $300,000, and to a four-month suspension of his registration with the CFTC.

Example Case: *In re Gelber Group LLC*, CFTC Docket No. 13-15 (Feb. 8, 2013); *In re Lorenzen*, CFTC Docket No. 13-16 (Feb. 8, 2013).

The CFTC found that Gelber Group LLC, a futures commodity merchant, and its former manager Martin A. Lorenzen would falsely report orders during pre-opening trading sessions which they

had no intention of executing and that Gelber and Lorenzen were also engaging in wash sales in violation of CEA §§ 4c(a)(2)(A), 4c(a)(2)(B), and 9(a)(2). Gelber Group LLC agreed to cease and desist from violating the relevant provisions and pay a $750,000 civil monetary penalty.

Example Case: *In re Cargill de México S.A. de C.V.*, CFTC Docket No. 15-34 (Sept. 24, 2015).

The CFTC alleged that Cargill de México engaged in wash sales and unlawful non-competitive transactions in agricultural futures products on the CBOT, including corn, soybeans, and wheat, and in hard red wheat traded on the KCBT on multiple occasions between March 2010 and August 2014. Cargill de México claimed that these trades occurred because it was moving hedging positions for its physical business among numerous accounts. Cargill de México maintained that it typically effected these transfers through a clearing broker, but when the clearing broker was unable to make the transfer, Cargill de México traders transferred the positions using the market but did so in a non-competitive fashion. Cargill de México agreed to a settlement based on wash sales and illegal noncompetitive trades, neither admitted nor denied, pursuant to which it paid a civil monetary penalty of $500,000 and agreed to certain undertakings.

Example Case: *In re Copersucar Trading AVV.*, CFTC Docket No. 17-22 (Aug. 15, 2017)

In August 2017, the CFTC settled charges with Copersucar Trading AVV. ("Copersucar")—an Aruban corporation and a subsidiary of Copersucar S.A., the world's largest sugar and ethanol company based in São Paolo, Brazil—alleging that Copersucar executed prearranged, noncompetitive wash trades involving Sugar No. 11 futures Trade at Settlement ("TAS") contracts traded on the ICE between April 2013 and September 2014. In the order, the CFTC alleged that Copersucar engaged in wash sales in ICE Sugar No. 11 futures TAS contracts on multiple occasions through its authorized agents responsible for Copersucar's trading operations. The CFTC alleged that the agents entered equal and opposite orders in the same futures product for separate accounts that were owned by Copersucar and which matched the product, quantity, and price of those orders when they were entered on the Exchange. The CFTC further alleged that Copersucar also engaged in noncompetitive transactions by prearranging, structuring, and entering these orders, which negated the risk incidental to an open and competitive marketplace. As part of the settlement, Copersucar agreed to pay $300,000 and cease and desist from further violations of § 4c(a)(1) of the CEA and CFTC Regulation 1.38(a), as charged.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Yumin Li and Kering Capital Ltd.*, 15-CV-05839 (N.D. Ill. Dec. 9, 2016)

The U.S. District Court for the Northern District of Illinois issued an opinion and order finding that Yumin Li stole in excess of $300,000 from her former employer by trading the employer's account noncompetitively against an account belonging to Kering Capital Ltd. ("Kering"), a British Virgin Islands company formed by Li's mother. The CFTC complaint charged Li and Kering with fraud, fictitious sales, and non-competitive transactions in connection with a series of transactions engineered by Li on the CME Group Inc.'s electronic trading platform that resulted in "money passes," whereby Li moved money from her former employer's trading account to Kering's trading account in violation of CEA §§ 6b(a)(l)(A) and (C)

The court found that, on six separate occasions between March and May 2015, Li intentionally engineered and engaged in commodity futures trades that were designed to give the appearance of taking place on the open market, while being structured to avoid market risk, and resulted in a gain to Kering at the expense of Li's former employer. The court also found that Li prearranged trades by trading her employer's account opposite an account she controlled at Kering, while concentrating the trading in illiquid Eurodollar contracts outside of normal trading hours. Using this strategy, Li was found to have stolen over $300,000 from her employer and moved it to Kering. Li was not authorized by her employer to enter into any of the transactions, and Kering was found vicariously liable for Li's trading. Li fled the United States after her employer discovered the trading activity and confronted Li about the trades.

The court ordered Li and Kering to make restitution of over $300,000 to Li's former employer and imposed a civil monetary penalty of over $900,000, representing three times the unlawful gains. The court not only enjoined Li and Kering from further violations of the Commodity Exchange Act permanently but also enjoined Li from trading in the commodity futures markets for five years and prohibited Kering from allowing Li access to its trading accounts or relying upon Li for trading advice and direction for the same period.

Example Case: *In re Rosenthal Collins Capital Markets LLC,* CFTC Docket No. 17-17 (June 29, 2017)

In June 2017, the CFTC settled charges alleging that Rosenthal Collins Capital Markets, LLC ("RCCM") engaged in illegal wash sales to generate rebates of exchange fees based upon increased trading volumes between early 2013 and July 2015. In the order, the CFTC alleged that proprietary traders at RCCM engaged in three different wash trading strategies to generate rebates through the Eurodollar Pack and Bundle Market Maker Program ('Program") offered by the CME, under which RCCM had certain quoting obligations that, in return, could allow RCCM to earn rebates in the form of fee credits for its trading in the Program. To generate the firm's desired level of rebates apart from actual market conditions, an RCCM trader allegedly evaded RCCM's wash blocking system to trade against himself and generate rebates and continued generating rebates using wash trades until his trading was detected and RCCM tightened its wash blocking system. Two RCCM traders also began engaging in prolonged periods of scratch trading (i.e., buying and selling opposite each other) to generate the rebates, and they continued trading in that manner until the CME informed RCCM that it would exclude trades among RCCM traders from the rebate calculations. Another RCCM trader later discovered a third strategy in which he could trade against himself in rebate-eligible products and avoid detection using the exchange's implied matching engine to buy and sell contracts. The trader allegedly engaged in fictitious trading strategies to generate rebates from the Program. As part of the settlement, RCCM agreed to pay $5 million and cease and desist from violating § 4c(a) of the CEA and Commission Regulation 1.38(a), as charged. In a separate order, one of the former RCCM traders agreed to pay $200,000 and cease and desist from violating CEA § 4c(a) and Commission Regulation 1.38(a), as charged.

6. False Statements to the CFTC

Example Case: *U.S. Commodity Futures Trading Comm'n v. eFloorTrade, LLC and John A. Moore*, No. 16-CV-7544 (S.D.N.Y.)

The CFTC alleged that eFloorTrade and its majority owner and sole principal John Moore violated the CEA's recordkeeping provisions and committed supervision failures in violation of CEA § 4g(a)The CFTC further alleged that Moore made false and misleading statements of material fact in sworn testimony before the CFTC in violation of CEA § 9(2). In particular, the CFTC alleged that Moore falsely testified that he, or another eFloorTrade employee working under his direct supervision, created and maintained spreadsheets relating to trades executed on behalf of customers whose orders were generated from trading instructions received from third party trading system providers. However, as the Complaint also alleges, EFT made or kept no such records, as Moore and EFT, through counsel, later admitted. The case is currently pending.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Arista LLC, Abdul Sultan Walji a/k/a Abdul Sultan Valji, and Reniero Francisco*, No. 12-CV-9043 (S.D.N.Y. May 28, 2013)

The CFTC alleged that Arista LLC and its principals defrauded investors, misappropriated funds, and made false statements in filings with the NFA. The CFTC alleged that in a September 2011 letter to the CFTC's Division of Enforcement, the defendants misrepresented Arista's account balances, asset values, and fee calculations. The CFTC further alleged that the defendants misrepresented their basis for transmitting statements to investors and falsely asserted that they had no intention to provide inaccurate or misleading information to the Arista investors. On December 2, 2013, the district judge issued a consent order reflecting, among other things, that the defendants' statements to the CFTC violated § 6(c)(2) of the CEA[396] because the statements were false and misleading, and the defendants knew or reasonably should have known that each of the statements was false or misleading.

Example Case: *U.S. Commodity Futures Trading Comm'n v. MF Global Inc.*, No. 11-CV-07866 (S.D.N.Y. 2013)

The CFTC alleged that MF Global, a registered FCM, unlawfully used customer funds and violated customer protection laws in violation of CEA Sections 4d(a)(2) and 6(c)(2). The complaint alleged that, on two days in October 2011, MF Global filed segregation reports with the CFTC stating that MF Global had approximately $116 million and $200 million in excess segregated funds, respectively. However, the CFTC alleged that MF Global actually had deficits in its customer segregated accounts of approximately $298 million and $413 million, respectively. The CFTC alleged that the segregation reports constituted false or misleading statements of material fact and that MF Global knew or reasonably should have known that they were false or misleading. MF Global agreed to a settlement finding that it violated § 6(c)(2) of the CEA.[397]

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[396] 7 U.S.C. § 9(c)(2).

[397] *Id.*

Example Case: *In re Butterfield*, CFTC Docket No. 13-33 (Sept. 16, 2013)

The CFTC filed and settled charges with Susan Butterfield, who was alleged to have given false statements to the Division of Enforcement during an investigation into her employer's procedures for documenting customers' orders in violation of CEA Section 6(c)(2). Butterfield paid a civil monetary payment of $50,000 and agreed to never seek registration with the CFTC or act in any capacity that requires registration and to never act as a principal or officer of any company registered with the CFTC.

Example Case: *In re Artem Obolensky*, CFTC Docket No. 14-05 (Jan. 2, 2014)

The CFTC filed and settled charges that Obolensky, the president of a Russian bank, had made false and misleading statements during a Division of Enforcement interview in violation of CEA Section 6(c)(2). The CFTC found that Obolensky had falsely stated in an interview that the crossing of trades by two entities he controlled was "purely coincidental," when in fact Obolensky was responsible for making trading decisions on behalf of the entities and the two entities had traded opposite each other more than 180 times. Obolensky agreed to pay a civil monetary penalty of $250,000 for the false statement charge, but the Commission did not bring any charges for the crossed trades.

Example Case: *In re Sean R. Stropp*, CFTC Docket No. 14-34 (Mar. 18, 2014)

The CFTC filed and settled charges against Sean Stropp, a principal at Barclays Metals, Inc., for providing false representations to the CFTC in a signed financial disclosure statement in violation of CEA § 6(c)(2) . The Commission's consent order found that Stropp falsely represented that the disclosure included all of his known assets but that he had deliberately omitted material facts from the statement, including his control of another entity and ownership of that entity's bank account. Stropp agreed to pay a civil monetary fine in the amount of $250,000 and cease and desist from violating the relevant provisions.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Peregrine Financial Group, Inc. and Russell R. Wasendorf, Sr.*, No. 12-CV-05383 (N.D. Ill. Apr. 30, 2014)

The CFTC alleged that PFG, a registered futures commission merchant, and its owner Russell R. Wasendorf, Sr., committed fraud by misappropriating customer funds, violated customer fund segregation laws, and made false statements in financial statements filed with the CFTC. According to the CFTC's complaint, PFG filed monthly 1-FR statements with the CFTC in its capacity as a futures commission merchant. One section of the 1-FR statements requires the reporting of customer segregated funds. The CFTC alleged that, since August 15, 2011, PFG and Wasendorf filed at least three statements falsely reporting the amount of funds in customer segregated accounts, in violation of § 6(c)(2). In a parallel criminal action, Wasendorf was also criminally convicted under §§ 9(a)(3) and (4) of the CEA[398] for making false statements to the CFTC and the NFA.

[398] 7 U.S.C. § 13(a)(2).

Example Case: *U.S. Commodity Futures Trading Comm'n v. Newell, et al.*, No. 12-CV-06763 (N.D. Ill. Aug. 25, 2014)

The CFTC alleged that Newell and his company, Quiddity, LLC, had entered orders for trades without specifying account information and were allocating the most profitable trades to their proprietary account and most of the losing trades to their customers' accounts in violation of CEA §§ 4b(a)(1)(A) and (C), 4c(b), 4n(3)(A), 4o(1).The CFTC also charged Newell with falsely testifying during the investigation that he had provided account numbers when placing the orders in violation of CEA § 6(c)(2).In December 2014, the parties informed the court that they had reached an agreement in principle to settle the case. As a result, the court denied without prejudice cross-motions for summary judgment

Example Case: *In re Scotty A. Beatty, et al.*, CFTC Docket No. 14-34 (Sept. 30, 2014)

The CFTC filed and settled charges with Scott A. Beatty and two companies he controlled. The consent order found that Beatty had fraudulently solicited and accepted nearly $1 million from customers but had in fact misappropriated some of the funds for his own use or had returned it to some of the customers as purported profit in violation of: CEA §§ 4b(a)(2)(A),(C) and 4m(1)The consent order also found that Beatty had made false statements to the CFTC by stating that one of the companies he owned was not attempting to solicit new clients and that its website was only active because Beatty planned to return to the industry in the future in violation of CEA § 6(c)(2). As part of the settlement, Beatty and his company agreed to pay restitution of $641,000 and a civil monetary penalty of $1 million and agreed to a permanent bar from trading on any registered entity.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Gary Creagh and Wall Street Pirate Management, LLC*, No. 15-CV-6140 (S.D.N.Y. 2017)

The U.S. District Court for the Southern District of New York entered an opinion and order against Defendants Gary Creagh and Wall Street Pirate Management, LLC ("Wall Street Pirate") for violating § 6c of the CEA. The court found that Wall Street Pirate and Creagh, the managing member and sole employee of Wall Street Pirate, made false statements to and concealed material information from the NFA. In addition, the court found that Wall Street Pirate, by and through Creagh, failed to maintain required books and records and provide account statements and privacy notices to pool participants. The order, entered on May 10, 2017, permanently prohibits Wall Street Pirate and Creagh from registering with the CFTC in any capacity and engaging in any commodity interest trading and requires payment of a $125,000 civil monetary penalty. The supplemental order, entered on June 16, 2017, permanently bans Wall Street Pirate and Creagh from trading for themselves or on behalf of any other person or entity.

7. Position Limits

Example Case: *In re D.E. Shaw & Co. L.P.*, CFTC Docket No. 12-09 (Feb. 22, 2012).

The CFTC alleged that D.E. Shaw held aggregated net short positions in soybean futures contracts that exceeded the single-month speculative position limits of 6,500 contracts and that D.E. Shaw held aggregated short positions of corn futures that exceeded the single-month speculative limit of 13,500 contracts. D.E. Shaw agreed to a settlement based on exceeding the stated position limits

(neither admitted nor denied) in violation of CEA Section 4a(b), pursuant to which it paid a civil monetary penalty of $140,000.

Example Case: *In re Interactive Brokers LLC*, CFTC Docket No. 12-27 (Jul. 25, 2012).

The CFTC alleged that Interactive Brokers acting as a broker FCM failed to aggregate related customer accounts that would have resulted in a total speculative position held by Interactive Brokers in excess of the stated position limits in violation of CEA Section 4g. During 2010 and 2011, the CFTC notified Interactive Brokers on more than twenty occasions that Interactive Brokers had erroneously reported separate positions that should have been aggregated. Interactive Brokers agreed to a settlement based on inaccurate reporting, failure to properly supervise reporting activities, and failure to maintain proper internal controls over reporting procedures and personnel (neither admitted nor denied), pursuant to which it paid a civil monetary penalty of $700,000.

Example Case: *In re Citigroup Inc. and Citigroup Global Capital Markets Ltd.*, CFTC Docket No. 12-34 (Sep. 21, 2012).

The CFTC alleged that Citigroup held aggregated net long positions in wheat contracts that exceeded the all-months speculative position limits established by the CFTC, which was 6,500 contracts for all months combined. Citigroup agreed to a settlement based on exceeding the stated position limits (neither admitted nor denied) in violation of CEA Section 4a(b)(2), pursuant to which it paid a civil monetary penalty of $525,000.

Example Case: *In re JP Morgan Chase Bank, N.A.*, CFTC Docket No. 12-37 (Sep. 27, 2012)

The CFTC alleged that JP Morgan held net short futures equivalent positions in Cotton No. 2 futures in excess of speculative position limits, which were 5,000 contracts for all months and 3,500 contracts in a single month. JP Morgan agreed to a settlement based on exceeding the speculative position limits (neither admitted nor denied) in violation of CEA § 4a(b)(2), pursuant to which it paid a civil monetary penalty of $600,000.

Example Case: *In re Glencore Agriculture B.V., f/k/a Glencore Grain B.V., and Glencore Ltd.*, CFTC Docket No. 18-12 (Apr. 30, 2018).

The CFTC alleged that Glencore Ltd., based in Connecticut, and Glencore Grain B.V., based in the Netherlands, were affiliated companies that engaged in cotton trading as part of Glencore's overall global cotton business. The CFTC claimed that Glencore's global cotton business was centralized under the direction of a single manager, who supervised traders at both companies, oversaw and communicated overarching cotton strategies and policies across Glencore entities, remained generally apprised of trader activities and positions across Glencore entities, and participated in discussions regarding certain trade-level decisions at both companies. Therefore, positions held by Glencore Ltd. and Glencore Grain B.V. should have been aggregated for purposes of calculating compliance with CFTC cotton futures position limits.

Based on these allegations, without admitting or denying the findings, the respondents agreed to a settlement based on the aggregated positions exceeding 5,000 net contracts in violation of Sections

4a(b) and 4c(a) of the CEA and to cease and desist from further violations and to pay a civil monetary penalty of $2 million.

8. Control Person Liability

Example Case: *U.S. Commodity Futures Trading Comm'n v. MF Global Holdings Ltd., Jon S. Corzine, and Edith O'Brien*, 11-CV-7866 (S.D.N.Y. filed Jan. 5, 2017)

In January 2017, the CFTC obtained consent orders against Jon S. Corzine, the former CEO of MF Global Inc. (MF Global) and CEO and Chairman of the Board of Directors of MF Global's parent company, and Edith O'Brien, the former Assistant Treasurer of MF Global who was responsible for directing, approving, and/or causing certain wire transfers and other payments into and out of MF Global's customer accounts. The orders found that MF Global unlawfully used customer segregated funds to support its own proprietary operations and the operations of its affiliates and to pay broker-dealer securities customers and pay FCM customers for withdrawals of secured customer funds in October 2011. More specifically, MF Global was found to have (1) failed to treat, deal with, and account for its FCM customers' segregated funds as belonging to such customers; (2) failed to account separately for, properly segregate, and treat its FCM customers' segregated funds as belonging to such customers; (3) commingled its FCM customers' segregated funds with the funds of any other person; (4) used its FCM customers' segregated funds to fund the operations of MF Global and its affiliates, thereby using or permitting the use of the funds of one futures customer for the benefit of a person other than such futures customer; and (5) withdrawn from its FCM customer segregated funds beyond MF Global's actual interest therein. The CFTC charged defendants with violating CEA Sections 4d(a)(2) and6(c)(2).

As the CEO, Corzine was liable for MF Global's violations due to his control over the company, which was experiencing a worsening liquidity crisis at the time the transfers occurred, and his failure to supervise diligently the activities of the officers, employees, and agents of MF Global in their handling of customer funds in violation of CFTC Regulation 166.3.[399] Knowing that certain funds would be transferred from customer segregated accounts to MF Global's proprietary accounts in October 2011, O'Brien was found to have directed, approved, and/or caused seven transfers of funds from customer segregated accounts to MF Global's proprietary accounts totaling hundreds of millions of dollars—more than MF Global had in excess segregated funds as last reported to O'Brien—that caused and/or contributed to a deficiency in the customer segregated accounts. By this conduct, O'Brien was found to have aided and abetted MF Global's segregation violations.

Corzine was ordered to pay a $5 million civil monetary penalty; prohibited from seeking or accepting, directly or indirectly, reimbursement or indemnification from any insurance policy with regard to the penalty amount; and required to undertake that he will never act as a principal, agent, officer, director, or employee of a Futures Commission Merchant and that he will never register with the CFTC in any capacity. O'Brien was ordered to pay a $500,000 civil monetary penalty and prevented from associating with an FCM or registering with the CFTC in any capacity for a period of eighteen months.

[399] 17 C.F.R. § 166.3.

9. Disruptive Trading Practices

Example Case: *In re Panther Energy Trading LLC*, CFTC Docket No. 13-26 (July 22, 2013)

In the CFTC's first case applying its new anti-disruptive trading practice authority, the CFTC found, by consent, that Panther Energy Trading engaged in spoofing in violation of § 4c(a)(5)(C), of the CEA, [400] without Panther Energy admitting or denying the allegations, by utilizing a computer algorithm designed to place and quickly cancel bids and offers in futures contracts. For example, a sell order (that the company wanted to execute) would be placed along with longer buy orders (that the company intended to withdraw) to give the market a false impression of buying interest. If the small sell orders were filled, the large buy orders were immediately cancelled.

In connection with this conduct, Michael Coscia, Panther's owner was also charged with six counts of criminal commodities fraud. In July 2016, Coscia, who had argued that probation was an appropriate sentence, was sentenced to three years in federal prison for his conduct.

Example Case: *U.S. Commodity Futures Trading Comm'n v. Nav Sarao Futures Limited plc and Navinder Singh Sarao*, 1:15-CV-03398 (N.D. Ill. filed Apr. 17, 2015)

The CFTC charged the defendants with unlawfully manipulating, attempting to manipulate, and spoofing the E-mini S&P 500, a stock market index futures contract based on the Standard & Poor's 500 Index, which is traded only at the CME.

The CFTC alleged that the defendants engaged in a massive effort to manipulate the price of the E-mini S&P by utilizing a variety of exceptionally large, aggressive, and persistent spoofing tactics in violation of CEA Sections 4c(a)(5),. 6(c)(1),6(c)(3), and 9(a)(2). The complaint focused particular attention on Sarao's use of an off-the-shelf software, which was modified to automatically simultaneously "layer" four to six exceptionally large sell orders into the visible E-mini S&P central limit order book, with each sell order one price level from the other. As the E-mini S&P futures price moved, the software allegedly modified the price of the sell orders to ensure that they remained at least three or four price levels from the best asking price; thus, they remained visible to other traders but stayed safely away from the best asking price.

The CFTC further alleged in the complaint that the defendants were exceptionally active in the E- mini S&P on May 6, 2010, the day of the "Flash Crash."

In November 2016, the CFTC submitted a proposed Consent Order that would resolve the case. Pursuant to the consent order, Sarao would admit the allegations in the CFTC Complaint, as well as to findings of fact and conclusions of law that Sarao: (1) successfully manipulated the E-mini S&P on at least twelve days; (2) attempted to manipulate the E-mini S&P tens of thousands of times; (3) submitted tens of thousands of spoof orders; and (4) attempted to employ a manipulative device in connection with these spoof orders. Sarao was ordered to pay disgorgement in the amount of $12,871,587.26 and a civil monetary penalty in the amount of f $25,743,174.52.

[400] 7 U.S.C. § 6c(a)(5)(C).

In connection with this conduct, Sarao was also charged with four criminal counts of manipulation and attempted manipulation. In November 2016, Sarao pled guilty to one count of spoofing and one count of wire fraud in a related criminal action

Example Case: *U.S. Commodity Futures Trading Comm'n v. Khara, et al.*, No. 15-CV-3497, 2015 WL 2066257 (S.D.N.Y. filed May 5, 2015)

On May 5, 2015, the CFTC filed a civil enforcement action against Heet Khara and Nasim Salim, both residents of the United Arab Emirates. Khara and Salim were accused of spoofing in the gold and silver futures markets (specifically COMEX) from at least February 2015 through at least April 28, 2015 in violation of CEA Section 4c(a)(5)(C). Khara and Salim's alleged misconduct included working in tandem to enter a large quantity of orders on one side of the market while having at least one smaller order on the opposite side of the market. Once the small order(s) traded, they would allegedly cancel the numerous orders on the opposite side. The CME suspended Khara and Salim from trading on April 30, 2015.[401]

On May 14, 2015, the New York federal judge presiding over the case took the extraordinary step of issuing a preliminary injunction against Khara and Salim, precluding the individuals from trading in commodities, freezing the defendants' assets, and ordering that the CFTC have access to and inspect the defendants' books and records.

On April 5, 2016, without Khara and Salim admitting or denying the allegations, the court issued a Consent Order imposing a permanent injunction, prohibiting them from engaging in spoofing in violation of the Commodity Exchange Act. The Order further requires that Khara a $1.38 million civil monetary penalty and Salim pay a $1.31 million civil monetary penalty, as well as permanent trading and registration bans on Khara and Salim.

Example Case: *In re The Bank of Nova Scotia*, CFTC Docket Np. 18-50 (Sept. 28, 2018)

In September 2018, the CFTC settled charges alleging that the Bank of Nova Scotia ("BNS") engaged in multiple acts of spoofing in gold and silver futures contracts traded on the CME in violation of CEA Section 4c(a)(5)(C). The CFTC alleged that BNS engaged in this activity through traders on its precious metals trading desk from June 2013 through June 2016. According to the settlement, the traders' spoofing strategy involved a trader placing a small order on one side of the market at or near the best price, then placing a large bid or offer on the opposite side of the market away from the best price. This created the impression of greater buying or selling interest than would have otherwise existed, and that the larger orders were placed in order to induce other market participants to fill the smaller resting order.

The settlement noted that BNS alerted the CFTC and voluntarily reported the conduct. According to the settlement, "[d]ue to BNS's self-reporting, cooperation, and remediation, the civil monetary penalty imposed by the Commission has been substantially reduced." As part of the settlement,

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[401] Both traders were summarily denied access to any CME Group exchange for 60 days. *See Nasim Salim*, COMEX File No. 15-0103-SA-1 (April 30, 2015); *Heet Khara*, COMEX File No. 15-0103-SA-2 (April 30, 2015).

BNS agreed to pay an $800,000 civil monetary penalty and to take specified steps to maintain and implement training programs and systems and controls to detect and deter spoofing.

10. Failure to Supervise

Example Case: *In re MF Global, Inc.*, CFTC Docket No. 10-03 (Dec. 17, 2009)

The CFTC found, by consent, that MF Global, a futures commission merchant, failed to supervise its employees on numerous occasions in violation of Rule 166.3. On two occasions, a customer entered into certain natural gas ("EFS") trades.[402] The MF Global floor broker who executed the trades was required to properly prepare trading cards. Each of the trading cards that the broker prepared purported to reflect that the trades occurred during the time period allowed under the trading rules but on both occasions the trade actually took place outside of the permitted time period. The CFTC found that MF Global had failed to implement procedures to ensure that its employees recorded and submitted accurate trade information and that MF Global had therefore failed to diligently supervise the proper and accurate preparation of trading cards. MF Global was ordered to cease and desist from violating the relevant provision and pay a $10,000,000 civil monetary penalty.

Example Case: *In re E*Trade Securities LLC & E*Trade Clearing LLC*, CFTC Docket No. 17-07 (Jan. 26, 2017)

In January 2017, the CFTC settled charges with E*TRADE Securities LLC ("E*TRADE Securities"), a registered introducing broker,, and E*TRADE Clearing LLC ("E*TRADE Clearing"), a Futures Commission Merchant, alleging that E*TRADE Securities and E*TRADE Clearing did not comply with applicable record-keeping rules and failed to diligently supervise between October 2009 and January 2014. In the order, the CFTC alleged that E*TRADE Securities did not preserve and maintain certain audit trail logs for their customers, and E*TRADE Clearing did not preserve and maintain customer audit trail logs after becoming registered as a Futures Commission Merchant. By not preserving and maintaining these records, E*TRADE Securities and E*TRADE Clearing allegedly violated § 4g(a) of the CEA and CFTC Regulations 1.31 and 1.35. The CFTC further alleged that E*TRADE Securities and E*TRADE Clearing violated CFTC Regulation 166.3 by failing to implement policies and procedures to ensure the retention of these records and failing to respond to a previous warning from its vendor that it did not preserve these records. As part of the settlement, E*TRADE Securities and E*TRADE Clearing agreed to jointly pay $280,000, cease and desist from further violations of the CEA as charged, and improve their recordkeeping procedures by updating their policies and procedures and providing appropriate training to officers and employees regarding the CEA's recordkeeping requirements.

Example Case: *In re Tillage Commodities, LLC*, CFTC Docket No. 17-27 (Sept. 28, 2017)

In September 2017, the CFTC settled charges with Tillage Commodities, LLC ("Tillage"), a Commodity Pool Operator ("CPO"), alleging that Tillage failed to supervise its fund administrator's operation of the commodity pool's bank account containing pool participants' funds

[402] An EFS trade involves an exchange of futures for, or in connection with, a swap.

in violation of Rule 166.3. Tillage's fund administrator received and processed several fraudulent requests to transfer funds from the commodity pool's bank account over the course of 21 days in March 2016, resulting in significant losses to the funds. The requests were made by an unknown party who spoofed Tillage's managing member's email address and sent requests that imitated Tillage's typical transfer requests. In the order, the CFTC alleged that the inadequacy of Tillage's supervision of its agent regarding wire transfers and the operation of the pool's bank account, the insufficiency of Tillage's policies and systems to monitor and alert, and the failure to review the pool bank account's balance delayed detection of the ongoing fraud. As part of the settlement, Tillage agreed to pay $150,000, cease and desist from further violations of the Commodity Exchange Act, and fully cooperate with the CFTC.

Example Case: *In re Morgan Stanley & Co. LLC*, CFTC Docket No. 17-28 (Sept. 28, 2017)

In September 2017, the CFTC settled charges with Morgan Stanley & Co. LLC ("MSCO"), a registered future commission merchant, alleging that MSCO failed to diligently supervise the reconciliation of exchange and clearing fees with the amounts it ultimately charged customers for certain transactions on the CME Group, ICE Futures US, and other exchanges in violation ofRule 166.3. Customer transactions executed on exchanges are subject to payment of exchange and clearing fees that are applied to each transaction in the normal course of business. Clearing firms such as MSCO receive invoices for these fees from the exchange clearinghouses, which the firms pass on to their customers. In the order, the CFTC alleged that MSCO failed in certain respects to implement and maintain adequate systems and procedures for reconciling exchange and clearing fees from at least 2009 through April 2016, thereby failing to account for and protect against the risk of overcharging customers. As a part of the settlement, MSCO agreed to pay $500,000, cease and desist from violating the CFTC Regulation governing diligent supervision, and fully cooperate with the CFTC.

Example Case: *In re Michael Leibowitz*, CFTC Docket No. 18-52 (Sept. 28, 2018)

In September 2018, the CFTC issued an order filing and simultaneously settling charges against Michael Leibowitz, a Chairman of the Board of TFS-ICAP LLC and TFS-ICAP Ltd. ("TFS-ICAP"), for failing to diligently supervise the handling by brokers on the emerging markets desks at TFS-ICAP of foreign exchange options ("FX Options") trades in violation of Rule 166.3. According to the settlement, it was common practice for TFS-ICAP brokers on the emerging markets desks in both London and New York to engage in practices known as "flying" and "printing" where brokers would communicate to clients fake bids and offers and fake trades intended to create an illusion of greater liquidity and induce clients to trade via TFS-ICAP. The further settlement alleged that senior managers at TFS-ICAP had reason to know that brokers were flying and printing and that Leibowitz failed to implement any policies or procedures to ensure that brokers did not engage in this conduct.

The settlement required Leibowitz to pay a $250,000 civil monetary penalty and required him to cease and desist from further violations of the Commodity Exchange Act and to cooperate with the CFTC in related ongoing litigation against TFS-ICAP and certain senior managers.

11. Reporting Violations

Example Case: *In re CNCGC Hong Kong Ltd.*, CFTC Docket No. 17-05 (Jan. 17, 2017)

In January 2017, the CFTC settled charges with CNCGC Hong Kong Ltd. ("CNCGC HK"), an investment and trading company headquartered in Hong Kong, alleging that CNCGC HK (1) failed to file the required CFTC Form 304 Cotton On-Call Reports to report its call cotton purchases and sales while holding or controlling at least 100 cotton futures positions and (2) filed Form 304 reports late on two occasions.

In the order, the CFTC alleged that CNCGC HK held or controlled at least 100 cotton futures but failed to file weekly Form 304 reports on 53 occasions from March 2014 through August 2015 and that the firm filed Form 304 reports late on two occasions in October 2015 and January 2016. Cotton merchants or dealers that hold or control at least 100 cotton futures positions (the reportable level for cotton futures contracts under CFTC Regulations) are required to file weekly CFTC Form 304 reports that show their call cotton purchases and sales as of the close of business Friday and file no later than two business days following the date of the report. According to CFTC Regulations, call cotton refers to "spot cotton bought or sold, or contracted for purchase or sale, at a price to be fixed later based upon a specific future." The CFTC uses information it gathers from CFTC Form 304 Reports in its weekly Cotton On-Call Reports, published with other Market Reports on the CFTC website.

As part of the settlement, CNCGC HK agreed to pay $150,000 and cease and desist from committing future violations of CFTC Regulation 19.02, as charged.

(a) Swap-Dealer Disclosure Violations

Example Case: *In re Société Générale SA*, CFTC Docket No. 17-01 (Dec. 7, 2016).

In December 2016, the CFTC settled charges with Société Générale SA alleging that Société Générale, a provisionally registered swap dealer, failed to properly report certain non-deliverable forward transactions to an SDR and failed to timely report to an SDR a large number of FX swap, FX forward, and non-deliverable forward transactions, in violation of CEA §§ 2(a)(l3)(F), (G) and 4r(a)(3), and CFTC Regulations 43.3(a)(3), 43.4(a), 45.3(c)(l) and 45.4(a).

In the order, the CFTC alleged that, in July 2014, Société Générale implemented a software update to its FX trading platform which led to the trading platform incorrectly coding Société Générale's counterparty as the reporting counterparty for certain FX swap, FX forward, and non-deliverable forward transactions, resulting in no reports being made to the SDR regarding the swaps. Société Générale allegedly did not discover the error until January 2015 and was not able to fix it until April 2015. Société Générale initiated a project to identify trades affected by the coding error and in September 2015 notified CFTC staff about its failure to report. Société Générale back-loaded approximately 51,821 unreported transactions in October 2015 and made submissions to its SDR for approximately 2,024 non-deliverable forward transactions in April and May 2016.

As part of the settlement, Société Générale agreed to pay a $450,000 penalty and cease and desist from committing further violations of the CEA and CFTC Regulations, as charged.

Example Case: *In re Citibank, N.A. and Citigroup Global Markets Limited*, CFTC Docket No. 17-26 (Sept. 25, 2017)

In September 2017, the CFTC settled charges with Citibank, N.A. ("CBNA") and Citigroup Global Markets Limited ("CGML") (collectively, "Citi"), alleging that Citi failed to: (1) report Legal Entity Identifier ("LEI") information for swap transactions properly to an SDR; (2) establish the electronic systems and procedures necessary to do so; (3) correct errors in LEI data previously reported to an SDR; and (4) perform supervisory duties diligently with respect to LEI swap data reporting, all in violation of CFTC Regulations. The CFTC charged CBNA with violating Rules 23.204, 23.602, 45.4, 45.6, 45.14, 46.3, 46.4, and 46.11.

CBNA is a swap dealer that has been provisionally registered with the CFTC in that capacity since December 31, 2012. CGML is a non-U.S. swap dealer with a principal place of business in London, United Kingdom, that has been provisionally registered with the CFTC in that capacity since October 9, 2013. In the order, the CFTC alleged that Citi failed to report LEIs properly for tens of thousands of swaps from April 2015 to December 2016 and to correct errors or omissions in its swap data reporting due to a design flaw in its swap data reporting systems with respect to swap continuation data. The CFTC also alleged that Citi violated its reporting obligations by reporting "Name Withheld" as the counterparty identifier for tens of thousands of swaps with counterparties in certain foreign jurisdictions. Additionally, the CFTC alleged that Citi failed to perform their supervisory duties diligently with respect to LEI swap data reporting by failing to enforce existing policies, failing to adequately address compliance with no-action relief where they sought to rely upon such relief, and failing to detect repeated LEI reporting errors. As part of the settlement, Citi agreed to pay $550,000 and comply with undertakings to improve its LEI swap data reporting.

Example Case: *In re NatWest Markets Plc*, CFTC Docket No. 18-32 (Sept. 14, 2018)

In September 2018, the CFTC settled charges alleging that NatWest Markets Plc ("NatWest"), formerly The Royal Bank of Scotland plc ("RBS"), a provisionally registered swap dealer failed to comply with its swap transaction reporting obligations as a swap dealer. According to the settlement, NatWest failed to report on a timely basis and misreported hundreds of thousands of transactions to a SDR in violation of Sections 2(a)(13)(F),(G) and 4r(a)(3).

The settlement specifically alleged that NatWest had multiple swaps reporting errors across more than 50 discrete areas, including at least several hundred thousand swaps in rates, credit, equities, and foreign exchange asset classes that were affected by the identified deficiencies in its swaps reporting practices, which resulted in reporting errors. According to the settlement, these swap reporting errors centered primarily on NatWest's inability to timely and properly report to an SDR swaps creation data, swaps continuation data, unique swap identifiers, pre-enactment swap transactions, and corrected swaps data. Moreover, the settlement alleged that NatWest failed to report in a timely manner to an SDR the required primary economic terms and continuation data for hundreds of thousands of pre-enactment swap transactions in the rates and credit asset classes that were in existence on or after April 25, 2011.

As part of the settlement, NatWest agreed to pay a $750,000 civil monetary penalty on NatWest, among other sanctions, for these reporting violations.

Example Case: *In re Commerzbank AG*, CFTC Docket No. 19-03 (Nov. 8, 2018)

In November 2018, Commerzbank AG settled charges alleging that it failed to supervise its Swap Dealer's activities for more than 5 years and made misleading statements and omissions to the CFTC concerning its Swap Dealer's operations and compliance with the CEA and CFTC Regulations in violation of CEA Sections 2(a)(13)(G), 2(h)(8), 4s(f)(1)(A), 4s(h)(1)(B) and 6(c)(2).

According to the settlement, Commerzbank management allegedly failed to supervise its Swap Dealer's activities from December 31, 2012 until at least 2018. Specifically, the settlement alleged that Commerzbank failed to adopt any effective process for determining whether swap transactions with certain non-U.S. swap counterparties were subject to DFA requirements; failed to report swap transactions to Swap Data Repositories; failed to submit Large Trader Reports; and failed to execute certain swaps on Swap Execution Facility. According to the settlement, these violations constituted a systematic failure to supervise, which directly resulted in thousands of violations of other provisions of the CEA and CFTC Regulations.

The order also alleged that Commerzbank made misleading statements and material omissions in its 2014 and 2015 annual Chief Compliance Officer reports to the CFTC by failing to disclose deficiencies in its systems and controls for swap dealer compliance, and made misleading statements and material omissions regarding the Swap Dealer's compliance with the CEA and Regulations.

As part of the settlement, Commerzbank agreed to pay a $12 million penalty and comply with specified undertakings including retention of an outside consultant to review swap dealer compliance for a period of two years and to generate, during that period, annual reports assessing the swap dealer's compliance with the CEA and CFTC Regulations. The Order further requires Commerzbank to submit annual reports to the CFTC regarding swap dealer compliance and remedial efforts for a period of two years.

12. Disclosure Violations

Example Case: *In re JP Morgan Chase Bank, N.A.*, CFTC Docket No. 16-05 (Dec. 18, 2015)

In December 2015, the CFTC alleged that JP Morgan Chase Bank ("JP Morgan"), acting in the capacity of a commodity trading advisor ("CTA") failed to disclose certain conflicts of interest to clients of its U.S.-based wealth management business, JP Morgan Private Bank in violation of 4o(l)(B). Specifically, the CFTC found by consent that JP Morgan failed to fully disclose its preference for investing its client funds in commodity pools or exempt pools managed and operated by an affiliate and subsidiary of JP Morgan. According to the consent order, the CFTC's rules prohibiting deception by any person fitting the definition of a CTA apply whether or not that person is required to register as such.

The CFTC also found by consent that JP Morgan failed to disclose its preference for investing its clients' funds in third-party hedge funds that shared management and/or performance fees with JP Morgan. JP Morgan admitted to facts set forth in the Order and acknowledged that its conduct violated the Commodity Exchange Act and/or related regulations. The CFTC Order required JP

Morgan to pay a $40 million civil monetary penalty, to pay disgorgement in the amount of $60 million, and to cease and desist from further violations as charged.

13. Criminal Prosecutions

Willful violations of the CEA or CFTC rules or regulations promulgated under the CEA are punishable by a fine of not more than $ $1,191,842 million or imprisonment for not more than 10 years, or both, together with the costs of prosecution.[403] The CFTC has no criminal prosecutorial authority but regularly refers matters to the DOJ, as well as state criminal prosecutors. Examples of these cases are listed in Section III at pages 185-92.

14. Private Civil Suits

Example Case: *In re: Libor-Based Financial Instruments Antitrust Litigation*, No. 11-MD-02262 (S.D.N.Y. filed Aug. 12, 2011)

In follow-on litigation from the LIBOR benchmark rate investigation discussed above, numerous actions were filed in federal and state courts across the United States alleging that the LIBOR panel banks manipulated USD LIBOR. As the Second Circuit wrote in one decision in the case, the "sprawling MDL involves a host of parties, claims, and theories of liability" and "has already once been to the Supreme Court."[404] Much of the case was initially dismissed by the district court in 2013, but that decision was reversed in May 2016. The case remains ongoing.

A separate litigation related to yen LIBOR and Euroyen TIBOR also remains ongoing.

Example Case: *In re Foreign Exchange Benchmark Rates Antitrust Litigation*, 13 - CV - 7789 (S.D.N.Y. filed Nov. 1, 2013)

In follow-on litigation from the FX benchmark rate investigation discussed above, numerous actions were filed in federal and state courts across the United States alleging that 16 banks engaged in FX market manipulation and price rigging in violation of the Sherman Act, 15 U.S.C. §§ 1 and 2. In December 2015, the court granted preliminary approval for settlements with nine banks, which collectively agreed to pay over $2 billion to settle the case. In September 2016, the judge overseeing the case narrowed, but refused to completely dismiss, the lawsuit, dismissing antitrust claims, claims based on transactions conducted before December 1, 2007, and CEA claims for false reporting. Claims for market manipulation were allowed to proceed because the complaint "plausibly pleads both that artificial prices existed on FX exchanges," causing investors to pay more, "and that this artificiality was caused by defendants' actions."

Example Case: *In re: Commodity Exchange, Inc. Gold Futures & Options Trading Litigation*, No. 14-MD-2548 (S.D.N.Y. filed Aug. 21, 2014)

In these consolidated class actions, silver and gold futures traders sued groups of banks alleging they rigged prices for the precious metals and their derivatives. The class action alleged claims for

[403] 7 U.S.C. § 13(a)(5).

[404] *Gelboim*, 823 F.3d at 767.

unlawful restraint of trade in violation of the Sherman Act, 15 U.S.C. § 1, and manipulation and false reporting in violation of CEA §§6(c)(1), (3), and 9(a)(2).

The cases concern the London Gold Fix and the London Silver Fix—key benchmark rates for gold, silver, and related financial instruments. Historically, the Gold and Silver Fixes were determined by groups of banks that would meet in private to determine the daily fix price for gold and silver. The plaintiffs allege that the banks utilized their preferred positions at the Gold and Silver Fixes to collude and effectively "name their own" fix price, gaining an unfair advantage with respect to the contracts, derivatives, and physical positions that they held in the market. In April 2016, Deutsche Bank settled with the plaintiffs and agreed to turn over instant messages and other communications, which would help the plaintiffs' case. Following the Deutsche Bank settlement, in October 2016, the district court held that the plaintiffs had stated a claim for conspiracy in restraint of trade and have standing to bring antitrust and CEA claims.

Example Case: *Alaska Electrical Pension Fund v. Bank of America Corporation et al.*, 14-CV-07126 (S.D.N.Y. filed Sept. 4, 2014)

In follow-on litigation from the ISDAFIX benchmark rate investigation discussed above, institutional investors, including a pension fund from Alaska and several Pennsylvania counties, sued ISDAFIX panel banks, claiming that the banks engaged in market manipulation, price fixing, and an antitrust conspiracy. In March 2016, the court refused to dismiss the complaint.

Example Case: *Ploss v. Kraft Foods Group, Inc. and Mondelez Global LLC*, 15-CV-02937 (N.D. Il. filed Apr. 2, 2015)

In a follow-on civil litigation from the CFTC case discussed elsewhere in this guide, plaintiffs allege that Kraft engaged in market manipulation through a scheme to drive down the cash price for soft red winter wheat, while widening the spreads between futures contracts expiring in December 2011 and March 2012 in violation of CEA Sections 2(a)(1)(B), 6(c)(1), 9(a)(2) and the Sherman Act, 15 U.S.C. § 1 According to plaintiffs, Kraft's taking of a $90 million long position, in spite of the fact that the company physically lacked capacity to take on that much wheat, drove cash prices down. In June 2016, the court rejected Kraft's motion to dismiss the complaint, finding that allegations that Kraft using its market power to knowingly affect prices when it had no bona fide need for the physical wheat and no need to hedge against potential risk were sufficient to allege market manipulation.

Example Case: *In re Treasury Securities Auction Antitrust Litigation*, No. 15-MD-02673 (S.D.N.Y. filed July 23, 2015)

In litigation targeting major financial institutions that are active in the market for U.S. government debt, a multi-district litigation consolidated nearly 50 putative class action complaints alleging collusion and manipulation in the $13 trillion market for securities sold by the U.S. Department of the Treasury. The U.S. Treasury borrows money by selling various debt instruments, known as Treasury bonds or Treasury securities, and these sales take place in market actions conducted periodically. A select group of banks, known as Primark dealers, bid in the auctions. Plaintiffs filed an amended complaint on November 16, 2017 alleging defendant financial institutions

conspired to buy securities from the Treasury at artificially low prices and then selling them at artificially high prices.

Example Case: *McDonnell v. Royal Dutch Shell PLC*, No. 13-CV-7089 (S.D.N.Y. 2013)

The plaintiffs, individual NYMEX floor traders, filed a putative class-action complaint against various large producers and traders of Brent Crude Oil futures contracts on the NYMEX and ICE, alleging a conspiracy to monopolize the Brent Crude Oil market and to manipulate the prices of the oil itself and of oil futures contracts, in violation of the Sherman Act,15 U.S.C. § 1 and 2, and the CEA § 6(c)(1) . The plaintiffs also allege a common-law claim for unjust enrichment. The alleged conspiracy had the aim of manipulating spot prices of Dated Brent, which is a benchmark assessment of the price of light sweet North Sea crude oil. Dated Brent is based on cargoes of such oil due on specific delivery dates and is intended to reflect actual physical market prices for that oil. Dated Brent prices are determined and published by Platts, a global price-reporting service, using a Market on Close ("MOC") methodology based on trading prices during a particular period (or, failing any trades during that period, on bids and offers made during the period). The plaintiffs allege that the defendants manipulated Dated Brent prices by, *inter alia*, spoofing, in order to benefit the defendants' positions in related swap markets. On January 2, 2014, the *McDonnell* case was consolidated into the multidistrict litigation captioned *In re North Sea Brent Crude Oil Futures Litig.*[405] One of the defendants, Statoil ASA, was later dismissed from the matter after the Court found it did not have subject-matter jurisdiction over the claims related to the defendant.[406] The rest of the case is still pending.

G. CEA Investigations

A CFTC enforcement matter can be understood as having two phases. The first phase is an investigative phase, which comprises both an informal stage and a formal stage, and the second phase is a prosecutorial phase. The CFTC has powers to compel production of documents in both the formal investigative stage and the prosecutorial stage but does not have any power to impose sanctions in the investigative phase.

1. The CFTC Investigation Process

(a) Informal investigations

The CFTC staff may conduct informal investigations without formal Commission authorization under the CEA. The CFTC Division of Enforcement ("DOE") may conduct such investigations as it deems appropriate to determine whether any persons have violated, are violating, or are about to violate the CEA or the rules, regulations, and orders adopted by the CFTC pursuant to the CEA.[407] The DOE may ask investigation targets to volunteer statements or information, or they may use the CFTC's inspection powers over persons required to register with the CFTC to gather

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[405] *In re North Sea Brent Crude Oil Futures Litig.*, No. 1:13-md-02475(ALC), 2016 WL 1271063 (S.D.N.Y. Mar. 29, 2016).

[406] *Id.*

[407] Authority to Conduct Investigations, 17 C.F.R. § 11.2 (2017).

information.[408] The information gathered may be used by the DOE to request that the CFTC authorize a formal investigation.

(b) Investigations authorized under § 6(b) of the CEA

For the purpose of a CFTC investigation,

> A.ny member of the Commission or any Administrative Law Judge or other officer designated by the Commission may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records that the commission deems relevant or material to the inquiry.[409]

Most § 6(b) investigations are conducted by the DOE, which submits a confidential request to the CFTC to authorize a formal investigation. The CFTC's issuance of a formal order of investigation allows the DOE's investigation to proceed. The formal order generally provides a high-level description of the scope of the investigation and will designate who may subpoena witnesses and records. The DOE reports the results of its investigations to the CFTC and recommends enforcement actions as appropriate.[410]

(c) Trade-practice investigations

Trade-practice investigations review large-scale market activities and may be conducted by the CFTC's Division of Clearing and Risk.. These investigations are usually conducted through a review of trading data. Market participants are required to report to the CFTC, and subpoenas are rarely used.

(d) Investigations authorized under § 8 of the CEA

To efficiently execute the provisions of the CEA and to provide information for the use of Congress, the Commission [or the CFTC] may make investigations "as it deems necessary to ascertain the facts regarding the operations of boards of trade and other persons subject to the provisions of [the CEA]."[411] The CFTC may publish the results of these investigations, but it may not disclose information that would reveal the transactions or market positions of any person, trade secrets, or the names of customers.[412]

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408 *Id*.

409 7 U.S.C. § 9(5).

410 Authority to Conduct Investigations, 17 C.F.R. § 11.2 (2017).

411 7 U.S.C. § 12.

412 *Id*.

(e) Assisting the investigations of foreign futures authorities

The CFTC may also conduct any investigation as it deems necessary to collect information and evidence pertinent to a request for assistance from a foreign futures authority.[413] The CFTC has entered into Memoranda of Understanding ("MOUs") and cooperation agreements with regulators in more than 20 jurisdictions. MOUs typically provide access to non-public documents and information already in the possession of the authorities and often include undertakings to obtain documents and to take testimony of, or statements from, witnesses on behalf of a requesting authority. Cooperation agreements may include cooperative enforcement arrangements and arrangements relating to sharing of financial and other types of information.

(f) CFTC Record Keeping Requirements

Futures commission merchants and other registrants are required to comply with the CEA's record keeping requirements, such as maintaining daily trading records.[414] Currently, books and records must be maintained for five years and must be readily accessible for the first two years of the five-year period.[415] CFTC staff may seek inspection of these records without a formal order from the Commission.[416]

(g) Use of Subpoenas

A formal order of the CFTC is required to authorize the use of subpoenas.[417] Usually, such an order is included in the formal order of investigation. The CFTC subpoenas are not self-enforcing, but the CFTC may seek the assistance of a U.S. district court to compel compliance.[418]

(h) Transcript of Testimony

Technically, witnesses should be allowed to obtain a copy of the transcript of their testimony. The relevant language provides, "[a] person compelled to submit data or evidence in the course of an investigatory proceeding shall be entitled to . . . procure a copy or transcript thereof, except that the witness, for good cause, can be limited to inspection of the official transcript of his testimony."[419] However, in practice, the CFTC staff often denies requests for copies of transcripts. The CFTC has taken the position that good cause for denial can be shown where the CFTC staff believes that a witness may share the transcript with another witness to coordinate testimony.

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413 7 U.S.C. § 16(f).

414 7 U.S.C. § 6(g).

415 Regulatory Records; Retention and Production, 17 C.F.R. § 1.31 (2017).

416 7 U.S.C. § 6(g); 17 C.F.R. § 11.2.

417 Authority to Conduct Investigations, 17 C.F.R. § 11.2 (2017); Subpoenas, 17 C.F.R. § 11.4 (2002).

418 7 U.S.C. § 9(5); Subpoenas, 17 C.F.R. § 11.4 (2002).

419 Rights of Witnesses, 17 C.F.R. § 11.7(b) (1996).

(i) Counsel

Witnesses may be accompanied, represented, and advised by counsel.[420] A witness has the right to have counsel present during any aspect of an investigatory proceeding and to have counsel advise the witness before, during, and after the conclusion of an examination.[421]

(j) Disclosure of Information

All information and documents obtained during the course of an investigation are to be treated as non-public by the CFTC and its staff, unless (1) the CFTC directs that the information be disclosed; (2)the information is made a matter of public record in an adjudicatory proceeding; or (3) disclosures are required under the Freedom of Information Act ("FOIA").[422] Parties must submit a written request asking that the CFTC afford confidential treatment under FOIA to any information submitted to the CFTC. The procedures for submitting such a request are set forth in 17 C.F.R. § 145.9.

(k) Wells Submissions

The CFTC has a process similar to the Wells process used in SEC actions, 17 C.F.R. Pt. 11, App. A.. In certain instances, the submission of a white paper may be made in lieu of the CFTC's Wells process.

2. Cooperation

(a) Enforcement Advisory

On September 25, 2017, the U.S. Commodity Futures Trading Commission ("CFTC") issued an Enforcement Advisory outlining requirements and resulting benefits for companies and individuals that voluntarily self-report wrongdoing to the CFTC and fully cooperate with the Enforcement Division's investigation (the "Updated Advisory"). The Updated Advisory is an expansion of the CFTC's January 2017 Enforcement Advisory (see our January 2017 client briefing). The new self-reporting and cooperation program promises meaningful reductions in penalties. Specifically, where a company or individual self-reports, fully cooperates, and takes remedial measures, the Enforcement Division will recommend that the CFTC consider a "substantial reduction" from the civil monetary penalty that would otherwise be imposed. In informal comments following the rollout of the Updated Advisory, CFTC Division of Enforcement Director James McDonald suggested that companies and individuals meeting the Updated Advisory's requirements could see a 50 to 75 percent reduction in civil monetary penalties, and also suggested that self-reporting should occur "right away" upon learning of potential misconduct, even if the legality of the conduct is ambiguous, and the extent of the misconduct is not clear. Although companies and individuals who do not self-report, but otherwise fully cooperate and remediate, may also receive reduced penalties, the Updated Advisory makes clear that the

420 Rights of Witnesses, 17 C.F.R. § 11.7(c) (1996).

421 Rights of Witnesses, 17 C.F.R. § 11.7(c)(1) (1996).

422 Confidentiality of Investigations, 17 C.F.R. § 11.3 (2017).

Enforcement Division will reserve recommendations for the most substantial reductions where self-reporting is exhibited along with cooperation and remediation.

The Updated Advisory is an outgrowth of the CFTC's January 2017 Enforcement Advisory, which identified the value of cooperation to (1) CFTC investigations or enforcement actions, and (2) the CFTC's broader law enforcement interests, as factors that the CFTC will consider in evaluating cooperation. The January 2017 Enforcement Advisory also enumerated factors suggesting what constitutes uncooperative conduct.

The Updated Advisory sets forth additional information outlining requirements for full self-reporting and cooperation credit, which include:

- Voluntary disclosure to the CFTC prior to an imminent threat of exposure. Disclosure must be made within a reasonably prompt time after becoming aware of the misconduct, and include all relevant facts known at the time, including facts about individuals involved;

- Full cooperation in line with the requirements set forth in the January 2017 Enforcement Advisory; and

- Timely and appropriate remediation of flaws in compliance and control programs.

The Updated Advisory provides that where a company or individual self-reports, fully cooperates, and remediates, the Enforcement Division will recommend "the most substantial reduction" to the civil monetary penalty that would have been applied and, in extraordinary circumstances, may even recommend a declination of prosecution. However, the Updated Advisory makes clear that, in all instances, the company or individual will be required to disgorge profits (and pay restitution where applicable) resulting from any violations.

(b) A Carrot and Stick Approach to Enforcement

In remarks delivered on September 25, 2017 announcing the Updated Advisory, CFTC Division of Enforcement Director James McDonald characterized the CFTC's updated cooperation and self-reporting program as being designed to "achieve optimal deterrence" by "incentiviz[ing] voluntary disclosure at the earliest possible time." McDonald stated that the CFTC recognizes that the "decision whether to voluntarily report [misconduct] often comes down to a business decision" that weighs risks of detection and possible fines, and that the CFTC wants "to shift this analysis in favor of self-reporting." McDonald, who was appointed in March 2017 and had previously served as a U.S. prosecutor in the Southern District of New York, emphasized that "companies and individuals have a choice" and that while self-reporting and cooperation can be beneficial, those that choose not to do so should not "be surprised when they're met with vigorous, aggressive prosecution, accompanied by full monetary penalties."

(c) CFTC's Goal of Harmonizing Incentive Structures and Enforcement Policies

In his September 25, 2017 remarks, McDonald stated that one goal of outlining the CFTC's self-reporting and cooperation program is to bring the basic requirements of self-reporting,

cooperation, and remediation in line with other law enforcement agencies, particularly the DOJ. An intended benefit of the Updated Advisory for companies and individuals is to minimize conflicting incentives when navigating multiple self-reporting and cooperation regimes.

Echoing DOJ guidance stressing individual accountability in prosecutions related to corporate wrongdoing, McDonald emphasized that full cooperation includes disclosing all facts related to the involvement of any individuals, stating "[p]articular facts should be attributed to particular people."

(d) An Articulable Self-Reporting and Cooperation Program, With Items for Future Clarification

Companies and individuals can expect concrete benefits in exchange for proactive self-reporting of potential misconduct and complete cooperation with CFTC investigation and enforcement, but risk substantial penalties where such cooperation is lacking. As with the January 2017 Enforcement Advisory and earlier guidance issued in 2007, the Updated Advisory suggests that the CFTC wants companies to provide more robust and proactive cooperation during investigations and to improve systems and controls to prevent misconduct from occurring.

In informal comments following the rollout of the Updated Advisory, McDonald suggested that, through the Updated Advisory, the CFTC seeks to encourage self-reporting of suspicious conduct even where the legality of the conduct is ambiguous, and the extent of misconduct is unclear. Conversely, it is likely that passage of time from learning about potential misconduct to reporting could lessen or eliminate the amount of self-reporting credit that a company or individual may receive.

Unlike prior enforcement advisories, the Updated Advisory identifies substantial penalty reductions as a particular benefit for those who meet the CFTC's requirements for self-reporting and cooperation credit. The lack of a specific percentage reduction target (which was eliminated from McDonald's draft remarks)[423] indicates that credit will be evaluated on a case-by-case basis. In his informal comments, McDonald suggested those who self-reported and fully cooperated and remediated in accordance with the Updated Advisory guidelines could generally enjoy a 50 to 75 percent reduction in penalty. Future enforcement actions should indicate what facts and circumstances lead to more substantial reductions and also provide transparency as to how the CFTC calculates the baseline penalty that is subsequently reduced.

(e) Focus on Foreign Corrupt Practices

On March 6, 2019 at the American Bar Association's 33rd Annual National Institute on White Collar Crime, CFTC Enforcement Director James McDonald announced a new enforcement

[423] The New York Times has reported that Mr. McDonald "said in the draft speech and in an interview that the agency expected to reduce penalties by roughly 75 percent for those that fully cooperate." Subsequently, however, "Mr. McDonald told The Times that he and the commission's chairman, J. Christopher Giancarlo, had changed their minds and decided against setting a 75 percent target. Instead, he said, they will reduce penalties by a 'substantial' amount case by case." David Enrich, *A Wall Street Watchdog Hopes to Encourage Self-Reporting With Smaller Penalties*, N.Y. TIMES (Sept. 24, 2017), https://www.nytimes.com/2017/09/24/business/cftc-commodity-futures-trading-commission.html?_r=1.

advisory addressing self-reporting and cooperation for violations of the Commodity Exchange Act involving foreign corrupt practices (the "FCPA Advisory").

According to Director McDonald, the new enforcement advisory provides further clarity surrounding the benefits of self-reporting misconduct, full cooperation, and remediation, and reflects the enhanced coordination between the CFTC and law enforcement partners like the Department of Justice.

The new advisory builds on the Updated Advisory to further incentivize individuals and companies to self-report misconduct, cooperate fully in CFTC investigations and enforcement actions, and appropriately remediate to ensure the wrongdoing does reoccur. Specifically, the FCPA Advisory applies to those companies and individuals not registered, or required to be registered, with the CFTC that have timely and voluntarily disclosed CEA violations involving foreign corrupt practices. This disclosure must be accompanied by full cooperation and appropriate remediation, in accordance with the earlier advisories. The FCPA Advisory provides the following:

- The division will apply a presumption that it will recommend to the CFTC a resolution with no civil monetary penalty, absent aggravating circumstances involving the nature of the offender or the seriousness of the offense;

- In its evaluation of any aggravating circumstances, the division will consider, among other things, whether: executive or senior level management of the company was involved; the misconduct was pervasive within the company; or the company or individual has previously engaged in similar misconduct;

- If the division recommends a resolution without a civil monetary penalty pursuant to the advisory, the division would still require payment of all disgorgement, forfeiture, and/or restitution resulting from the misconduct at issue; and

- the division will seek all available remedies against companies or individuals implicated in the misconduct that were not involved in submitting the voluntary disclosure, including substantial civil monetary penalties where appropriate

Case Study: *In re Ikon Global Markets, Inc.*, CFTC Docket No. 17-23 (Aug. 31, 2017)

In August 2017, the CFTC settled charges with Ikon Global Markets, Inc. ("Ikon"), a Futures Commission Merchant ("FCM"), alleging that Ikon failed to keep and promptly produce documentation for thousands of gold Exchange for Physical ("EFP") trades, which were entered into and reported to the NASDAQ OMX Futures Exchange, Inc. ("NFX"), in violation ofCEA Section 4g(a) and CFTC Regulations 1.31(a)(1) and (2) and 1.35(a).

In the order, the CFTC alleged that, from February 2012, through September 2012, Ikon entered into thousands of EFP transactions with one of its customers that were reported to the NFX and which involved a privately negotiated and simultaneous exchange of a position in the XAU/USD Spot Gold Futures contract (NAU contract) for a corresponding and offsetting cash position in gold. As an FCM, Ikon was required to keep full, complete, and systematic records relevant to its dealings in the NAU contract and any related cash positions, including all orders, copies of confirmations, and copies of statements of purchase and sale. The CFTC further alleged that Ikon

failed to produce certain accounts and documents in response to two subpoenas issued by the CFTC's Division of Enforcement in March 2015 and August 2016. As part of the settlement, Ikon agreed to pay $200,000, cease and desist from further violations of the CEA and CFTC Regulations, as charged, and to withdraw from, and never again apply for, registration with the CFTC.

Example Case: *In re Mizuho Bank, Ltd.,* CFTC Docket No. 18-38 (Sept. 21, 2018)

In September 2018, the CFTC settled charges with Mizuho Bank, Ltd. ("Mizuho") alleging that a Mizuho trader in Singapore engaged in multiple acts of spoofing in a variety of futures contracts on the CME and the CBOT, including futures contracts based on United States Treasury notes and Eurodollars. The CFTC alleged that Mizuho engaged in this activity during the period starting at least May 2016 through May 2017 and that the trader placed multiple orders for futures contracts with intent to cancel the orders before their execution in violation of CEA Section 4c(a)(5)(C). Specifically, the trader placed large buy and sell orders and then cancelled them. The trader engaged in this spoofing strategy to test the market's reaction to his spoof orders.

The settlement further noted additional details about Mizuho's cooperation and remediation. In this regard, the settlement stated that Mizuho commenced an internal review and assisted the Division's investigation of the conduct. The settlement further noted that Mizuho had launched an overhaul of its systems and controls and implemented a variety of enhancements to detect and prevent similar misconduct including revising its policies, updating its training, and implementing electronic systems to identify spoofing.

The settlement stated that the cooperation and remediation resulted in a significantly reduced civil monetary penalty, but still required Mizuho to pay a $250,000 civil monetary penalty, and cease and desist from violating the Commodity Exchange Act's prohibition against spoofing. In announcing the settlement, James McDonald, the CFTC's Director of Enforcement noted that the case "shows that true cooperation—like that of Mizuho here—will be rewarded with a substantially reduced monetary penalty."

Example Case: *In re Jacob Bourne*, CFTC Docket No. 18-51 (Sep. 28, 2018) and Deutsche Bank Securities Inc. and Deutsche Bank AG Declination Letter (November 8, 2018).

In September 2018, the CFTC filed and settled charges alleging that Jacob Bourne, a former managing director at Deutsche Bank Securities Inc. ("DBSI") fraudulently mismarked swap valuations to conceal significant trading losses in violation of CEA Section 6(c)(l). Following the Bourne settlement, in November 2018, the CFTC issued its first public declination letter stating that it was closing the related investigation into DBSI based, in part, on its actions to identify the fraudulent activity, self-report the activity to the CFTC, fully cooperate, and proactively remediate.

According to the Bourne settlement, between June 15, 2017 to at least July 6, 2017, Bourne allegedly mismarked the valuations for certain swaps in an attempt to hide from Deutsche Bank estimated trading losses of more than $16 million. The settlement alleges that Bourne ignored Deutsche Bank's policy dictating the method for entering end-of-day marks into an internal spreadsheet used for internal asset valuations,. Bourne is also alleged to have attempted to conceal

his misconduct by altering historical versions of the internal spreadsheet to create the appearance that he had complied with the policy.

In the DBSI declination letter, the CFTC noted that it was declining to bring charges based on a number of factors, including DBSI's (1) timely, voluntary self-disclosure after the Bank discovered the alleged misconduct as part of its compliance program; (2) full cooperation (including its provision of all known relevant facts about the individuals involved in or responsible for the misconduct); and (3) proactive remediation efforts directed at strengthening and enhancing the Bank's swap valuation process.

Example Case: *In re Kamaldeep Gandhi*, CFTC Docket No. 19-01 (Oct. 11, 2018).

In October 2018, the CFTC filed and settled charges against Kamaldeep Gandhi, a former trader who admitted engaging in thousands of acts of spoofing with respect to a variety of futures products traded on the CME and other exchanges. The CFTC found that from at least September 2012 through October 2014, Gandhi, both individually and in coordination with others, placed thousands of orders to buy or sell futures contracts with the intent to cancel those orders prior to execution. In doing so, Gandhi intentionally sent false signals of increased supply or demand designed to trick market participants into executing against the orders he wanted filled. The CFTC settlement recognized Gandhi's entry into a formal cooperation agreement with the CFTC and, based on this cooperation agreement, the CFTC reserved its determination as to monetary sanctions against Gandhi.

H. Interagency and International Investigations

The CFTC regularly engages in cooperative enforcement with federal and state criminal and civil law enforcement authorities. In the past, the CFTC has conducted joint investigations with the DOJ, the SEC, the Federal Energy Regulatory Commission ("FERC"), the Federal Trade Commission ("FTC"), the New York Attorney General, and the Manhattan District Attorney, among others.

One early example of this interagency cooperation was the Enron Task Force, which was created in the wake of the Enron collapse. The interagency task force, which included the CFTC, DOJ, and the SEC was charged with leading the federal government's investigation of Enron. The success of the Enron Task Force led to the creation in July 2002 of the Corporate Fraud Task Force, which was led by the Deputy Attorney General. The Corporate Fraud Task Force was subsequently replaced with the Financial Fraud Enforcement Task Force.

In fiscal year 2017, the CFTC worked actively with federal and state criminal authorities as well as foreign regulators and law enforcement officials to combat the international roots of many of its investigations. The CFTC filed 49 new enforcement actions, including significant and complex cases charging manipulation, spoofing, and unlawful use of customer funds. The CFTC won

liability verdicts in both jury and bench trials in U.S. federal court, obtained orders imposing $413 million in monetary sanctions, and collected over $265 million. [424]

Currently, the CFTC is part of the Financial Fraud Enforcement Task Force. The Task Force includes a Securities and Commodities Fraud Working Group, which is co-chaired by the U.S. Attorney for the Southern District of New York, the Assistant Attorney General for the Criminal Division, the Director of Enforcement for the SEC, and the Director of Enforcement for the CFTC.

Despite the CFTC's willingness to cooperate, the CFTC has also taken actions to protect its exclusive jurisdiction to regulate transactions involving or conducted on regulated markets, such as the NYMEX.[425]

In May 2018, Deputy Attorney General Rod Rosenstein announced that the United States Department of Justice ("DOJ") would implement a new policy discouraging regulators and law enforcement agencies engaged in parallel investigations from "piling on" multiple penalties for the same misconduct.[426] DOJ's new policy, which has been incorporated into the U.S. Attorney's Manual, [427] encourages coordination between agencies, both among DOJ components and externally with other regulators in the U.S. and around the world, to prevent what Rosenstein characterized as "disproportionate" enforcement of laws and "duplicative" penalties against corporate actors. In its new policy, however, the DOJ is not taking the position of always allowing companies to escape settlements with multiple agencies because "[t]here may be situations where the penalties in a foreign country are not an adequate substitute for those imposed by U.S. authorities, or where the punishment by another enforcement authority does not make all victims whole, including the U.S. government and taxpayers."[428] Also, the DOJ continues to pursue claims against individuals who have "substantial involvement" under much of the policy established in the Yates Memo.[429]

1. Multijurisdictional Investigations

The DOE routinely works with international financial regulatory and criminal counterparts on multijurisdictional and multinational investigations and views the international regulatory community as instrumental to its success.

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[424] *See* U.S. Commodities Futures Trading Comm'n, *CFTC Releases Annual Enforcement Results for Fiscal Year 2017* (Nov. 22, 2017).

[425] *See Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013).

[426] Deputy Attorney General Rod Rosenstein, *Remarks to the New York City Bar White Collar Crime Institute* (May 9, 2018), *available at* https://www.justice.gov/opa/speech/deputy-attorney-general-rod-rosenstein-delivers-remarks-new-york-city-bar-white-collar.

[427] United States Dep't of Justice, UNITED STATES ATTORNEY'S MANUAL, 1-12.100 (2018) (hereinafter "U.S. Attorney's Manual).

[428] *Id*.

[429] *Id*.

In 2018, the CFTC reported that it was actively engaged internationally to avoid conflicting requirements and to improve international cooperative efforts wherever possible.[430] The CFTC participates in numerous international working groups regarding derivatives, and the CFTC, SEC, European Commission, European Securities Market Authority, and market regulators from around the globe have been meeting to discuss and resolve issues related to financial reform through various technical working groups over the past four years. The CFTC also consults with many other jurisdictions – such as Australia, Hong Kong, Singapore, Japan, Switzerland, and Canada – and has been engaged in ongoing international work and policy coordination in the development of data and reporting standards under Dodd-Frank Act rules. Furthermore, the CFTC has entered into and is negotiating cooperative supervisory arrangements for regulated cross-border entities and market participants.

According to the CFTC's 2019 Fiscal Year Budget, the CFTC plans to continue taking a strong role in international fora and standard-setting bodies by (1) continuing its active engagement with international regulators to work toward consistent regulatory requirements imposed on derivatives clearing organizations; (2) increasing its efforts to work toward consistent trading platforms rules aligned with those of Europe; (3) participating in the Financial Stability Board ("FSB") Resolution Steering Group ("ReSG"), and the work of the FMI Cross-Border Crisis Management Group; (4) participating in the FSB working group that is proposing the global governance framework for the UTI and UPI; (5) continuing its co-leadership role on the Committee on Payments and Market Infrastructure ("CPMI-IOSCO") Policy Standing Group (PSG); (6) continuing to lead the efforts of the CPMI-IOSCO regarding the potential global aggregation of over-the-counter derivatives trade repository data by continuing to co-chair the CPMI-IOSCO Working Group for harmonization of key over-the-counter derivatives data elements with staff of the European Central Bank; (7) continuing to participate in U.S. Treasury-organized financial regulatory dialogues with Europe, China, India, Canada, and Mexico, other FSB projects, and multilateral initiatives as they arise; (8) continuing its work with the Financial Stability Oversight Council's Designations Committee to monitor both designated financial market infrastructures (for continued systemic importance) and non-designated financial market utilities (to consider them for designation); and (9)coordinating its supervision of global entities with foreign authorities and negotiating cooperative arrangements regarding the supervision of regulated cross-border entities and market participants.

2. MOUs Between the CFTC and FERC

(a) Introduction

On January 2, 2014, the CFTC and FERC entered into two Memoranda of Understanding ("MOUs") to govern the two agencies' interactions in cases in which their authority may overlap. The first MOU addresses issues of jurisdiction, while the second concerns information requests between the two agencies.

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[430] *See* U.S. Commodity Futures Trading Comm'n, *CFTC President's Budget Fiscal Year 2017* (2017), https://www.cftc.gov/sites/default/files/reports/presbudget/2017/index.htm.

(b) Jurisdiction

(1) Notification of Activities

Pursuant to the MOU, each agency will notify the other of a request for, or the agency's *sua sponte* consideration of, an authorization or exemption permitting activities that arguably fall within the other agency's overlapping jurisdiction. Staff of the notifying agency will then assist the notified agency in determining whether the latter has an interest in the matter, including helping to obtain information that may be necessary to make such a determination. The notified agency will inform the notifying agency "promptly" of any determination that the notified agency (i) has no interest in the matter; (ii) has an interest in the matter and wishes to commence procedures for resolving overlapping jurisdiction (see below); or (iii) wishes to wait until a specified procedural step occurs (*e.g.*, the submission of a particular application) before determining whether it has an interest in the matter.

(2) Procedures for Resolving Overlapping Jurisdiction

Once notification has been made pursuant to the foregoing provisions, staff of the two agencies will meet to discuss the matter. Where both agencies determine that they have interests in the matter, their staff will "diligently and cooperatively communicate to coordinate and develop an approach that meets both agencies' regulatory concerns." Each agency has agreed to share information requested by the other to inform its determination of interest in the matter.

(3) Dispute Resolution

An agency asserting a dispute regarding the terms or implementation of the MOU will provide a written statement of the dispute, along with any supporting rationale and/or documents, to the other agency within 15 days.

If the initial agency contacts cannot resolve the issue within 10 working days, they will elevate the dispute in writing to each agency's Director-level contacts. If the Director-level officials cannot resolve the dispute within 10 working days of their receipt of the statement of dispute, each agency will promptly elevate the dispute to its Commission, "as appropriate." The staff of the agencies may agree, by e-mail or otherwise in writing, to extend the time limits for these dispute-resolution steps.

(4) Confidentiality

Both agencies have agreed to keep confidential, to the extent permitted by law, any non-public information provided pursuant to the MOU.

(c) Information Requests

The CFTC makes written requests to FERC for any and all requests for information from: (1) a Regional Transmission Organization ("RTO") or Independent System Operator ("ISO"); (2) the North American Electric Reliability Corporation ("NERC"), or interstate pipelines and storage facilities; or (3) market participants with information in FERC's possession. FERC will then take steps to promptly obtain requested information and furnish it to the CFTC. Any information

furnished by FERC to the CFTC will be kept confidential and non-public and will not be disclosed by the CFTC except in accordance with applicable restrictions.

To obtain information, FERC will make written requests to the CFTC for information from: (1) a designated contract market; (2) a registered swap execution facility; (3) a registered derivatives clearing organization; (4) any other board of trade, exchange, or derivatives market or swap data repository; or (5) market participants with information in the CFTC's possession. The CFTC will take steps to promptly obtain responsive information and furnish it to FERC. Any information furnished by the CFTC to FERC will be kept confidential and non-public and will not be disclosed by FERC, except in accordance with § 8 of the CEA.[431]

To the extent consistent with their respective missions and interests, the CFTC and FERC will attempt to accommodate each other's policies and regulations concerning disclosure of information to third parties. The MOU does not interfere with or affect the rights of either agency to obtain information directly from regulated entities. However, the agencies do take steps to avoid duplicative information requests and to coordinate oversight (including market surveillance), investigative, and enforcement activities of mutual interest.

The agencies will take all actions consistent with applicable law that are reasonably necessary to preserve all claims of privilege and confidentiality related to non-public information provided under the MOU. Unless otherwise required by law or a court order, neither agency may disclose information provided by the other pursuant to the MOU without the other agency's prior written consent. Each agency will promptly notify the other in writing of any legally enforceable demand or congressional request for privileged or confidential information provided by the other agency pursuant to the MOU. Each agency will refer to the other any FOIA request pertaining to information shared by the other agency pursuant to the MOU. The agencies have agreed that any privileged information shared pursuant to the MOU is shared on a common-interest basis.

On March 5, 2014, the CFTC and FERC announced the initial transmission of market data under the information-sharing MOU. In connection with the MOU, the agencies also announced the creation of a staff-level Interagency Surveillance and Data Analytics Working Group to coordinate information sharing between the agencies and focus on data security, data sharing infrastructure, and the use of analytical tools for regulatory purposes.

I. Consequences of CEA Violations

1. The CFTC may bring civil or administrative actions under the CEA.

Under § 6(c)(a) of the CEA, the CFTC can bring civil actions in federal courts whenever the CFTC believes that an entity or person "has engaged, is engaging, or is about to engage in any act or practice constituting a violation" of the CEA or is "restraining trading in any commodity for future delivery or any swap" to enjoin such act or practice or to enforce compliance. [432] Upon a proper showing of a CEA violation or restraint of trade, a court may grant a permanent or temporary

[431] 7 U.S.C. § 12.

[432] 7 U.S.C. § 13a-1(a)

injunction or restraining order without bond;[433] issue writs of mandamus or compliance orders;[434] and impose a civil penalty of not more than $165,227 ($1,191,842 for manipulation or attempted manipulation) or triple the monetary gain to the person for each violation."[435] A court may also impose equitable remedies including restitution and disgorgement of profits.[436]

The CFTC may also seek an asset freeze, monetary redress for consumers;[437] a bar or suspension of trading privileges;[438] or disqualification from registration.[439]

2. Injunctions & Restraining Orders

Given the totality of the circumstances, courts may grant injunctions against future violations if the CFTC can show that the actor violated the CEA or restrained trade and that there is a reasonable likelihood of future violations.[440] The CFTC need not show irreparable injury or inadequacy of other remedies, which are required in private injunctive suits, and courts have broad discretion to grant appropriate relief.[441] Previous violations suggest a likelihood of future violations, especially if the violation is based on systemic wrongdoing, [442] and courts have generally considered the following factors: egregiousness of the action, recurrent nature of the violations, degree of scienter involved, defendant's recognition of the wrongfulness, and likelihood of opportunities for future violations.[443] While some circuits, including the Second Circuit, have required a "more persuasive" and "more substantial showing" of the purported violation and risk of recurrence, other circuits, including the Seventh Circuit, require only a "reasonable likelihood" of recurrence.[444] However, the CFTC is required to show a "reasonable likelihood" of future violations only if it seeks injunction against future violations.[445] In other words, the CFTC need not show a "reasonable likelihood" of recurrence if it seeks only to prevent continuation of the same violation, such as further dissipation of funds already misappropriated, because the court has inherent power in equity to preserve the status quo.[446] No restraining order or injunction "shall be issued *ex parte* by [the] court," except for (1) restraining orders prohibiting any person from "destroying, altering or

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433 7 U.S.C. § 13a-1(b)

434 7 U.S.C. § 13a-1(c)

435 7 U.S.C. § 13a-1(d)(1).

436 7 U.S.C. § 13a-1(d)(3).

437 CEA § 6(c)(10)(D), 7 U.S.C. § 9(10)(D).

438 CEA § 6(c)(10)(B), 7 U.S.C. § 9(10)(B).

439 CEA § 8(a), 7 U.S.C. § 12a (2012).

440 *CFTC v. Hunt*, 591 F.2d 1211, 1220 (7th Cir. 1979).

441 *CFTC v. Muller*, 570 F.2d 1296, 1300 (5th Cir. 1978) ("A prima facie case of illegality is sufficient.).

442 *Hunt*, 591 F.2d at 1220.

443 *Sec. Exch. Comm'n v. Carriba Air, Inc*., 681 F.2d 1318, 1322 (11th Cir.1982).

444 *Oystacher*, 2016 WL 3693429, at *7; *SEC v. Unifund SAL*, 910 F.2d 1028, 1039 (2d Cir. 1990).

445 *Muller*, 570 F.2d at 1300.

446 *Id*.

disposing of, or refusing to permit" the CFTC to inspect any books and records; (2) restraining orders prohibiting any person from "withdrawing, transferring, removing, dissipating, or disposing of any funds, assets, or other property"; and (3) orders "appointing a temporary receiver to administer such restraining order and to perform such other duties as the court may consider appropriate."[447]

3. Asset Freeze

Given a court's broad discretion to use its equitable powers to "fashion appropriate relief," pre-judgment asset freezes are reasonable measures to preserve the status quo or grant interim relief that has the same character as the final relief granted.[448] A court will grant a pre-judgment asset freeze if the freeze bears a sufficient nexus to both the merits of the action and the particular property sought to be restored, meaning the CFTC must have an interest in particular assets in the possession of the defendant(s).[449] The CFTC can establish a sufficient nexus if the complaint "contains allegations which, if proved, entitle petitioners to some equitable relief."[450] Where the relief requested impacts the public interest, courts may, in equity, give and withhold further relief than it would only when private interests are involved.[451]

4. Civil Penalty & Disgorgement

Under CEA § 6(c)(10), the CFTC, or the courts, may impose a civil monetary penalty of up to three times the monetary gain to the defendant for each violation of the CEA. [452] For any manipulation or attempted manipulation in violation of CEA § 6(c) or 9(a)(2), the amount may be up to $1,191,842 or triple the monetary gain to the defendant, whichever is greater, "for each such violation." [453] This fine amount applies to (1) intentional manipulation, (2) fraud-based manipulation, and (3) reckless false reporting. For all other CEA violations, the CFTC may impose a civil penalty in the amount of up to $165,227 or triple the monetary gain to the person, whichever is greater, for each violation. However, in general, courts have not provided clear guidance on how to count manipulations or attempted manipulations as "violations" for purposes of the CEA's penalty provisions (*e.g.*, per trade, per series of transactions that leads to a change in price, etc.). In one case, a district court ruled that criminal counts based on separate trades were multiplicitous because the CEA "does not prohibit a sale at a manipulated price, but rather, the manipulation itself."[454] To determine the civil penalty, courts have "considered the general seriousness of the

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[447] 7 U.S.C. § 13a-1(a)

[448] *CFTC v. Next Fin. Servs. Unlimited, Inc*., No. 04-80562-CIV, 2005 WL 6292467, at *11 (S.D. Fla. June 7, 2005).

[449] *Id*. at *12.

[450] *Rahman v. Oncology Assocs*., 198 F.3d 489, 498 (4th Cir.1999).

[451] *Id.* at 497.

[452] *CFTC v. Gresham*, No. 3:09-CV-75-TWT, 2011 WL 8249266, at *7 (N.D. Ga. Sept. 8, 2011), *amended on reconsideration in part*, 2012 WL 2922548 (N.D. Ga. May 9, 2012).

[453] 7 U.S.C. § 9(10).

[454] *United States v. Radley*, 659 F. Supp. 2d 803, 814 (S.D. Tex. 2009), *aff'd*, 632 F.3d 177 (5th Cir. 2011).

violation as well as any particular mitigating or aggravating circumstances that exist."[455] For example, defrauding customers is a "very serious" violation because it violates the core provisions of the CEA.[456] Also, even where private parties settle their disputes without the CFTC's approval or consent, such settlements do not preclude the CFTC from later seeking additional or fuller restitution or any other remedy because the government is not bound by private litigation in seeking to enforce a federal statute implicating both public and private interests.[457] Although it is appropriate where the CFTC demonstrates violations of the CEA, disgorgement is unnecessary if the civil penalty is sufficient to ensure that defendants did not profit from their conduct.[458]

5. Undertakings

Finally, the CFTC may seek to impose undertakings as part of a settlement, including establishing extensive compliance programs and/or imposing a court-appointed independent monitor.[459] For example, as part of the LIBOR settlements, the CFTC required that settling banks enter into undertakings to ensure that their submissions were transaction-focused, based upon a rigorous and honest assessment of information, and not influenced by conflicts of interest. As part of these undertakings, settling banks agreed to: (i) make submissions based on certain specified factors; (ii) implement firewalls to prevent improper communications including between traders and submitters; (iii) prepare and retain certain documents concerning submissions, and retain relevant communications; (iv) implement auditing, monitoring and training measures concerning its submissions and related processes; (v) make regular reports to the CFTC concerning compliance with the undertakings; (vi) use best efforts to encourage the development of rigorous standards for benchmark interest rates; and (vii) continue to cooperate with the CFTC.

6. Non-Prosecution Agreements (NPAs)

The CFTC may also enter into non-prosecution agreements with individuals charged with violations who lack a history of prior misconduct and who show immediate willingness to accept responsibility for their misconduct and offer timely and substantial cooperation and material assistance to the CFTC's investigation.[460] The CFTC views the non-prosecution agreement as a powerful tool to reward extraordinary cooperation in the right cases, while providing individuals and organizations strong incentives to promptly accept responsibility for their wrongdoing and cooperate with the CFTC's investigation.

The first time the CFTC used its non-prosecution authority was in June 2017, when the CFTC entered into non-prosecution agreements with Jeremy Lao ("Lao"), Daniel Liao ("Liao") and Shlomo Salant ("Salant"). In their non-prosecution agreements Lao, Liao, and Salant each

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455 *CFTC v. Wilshire Inv. Mgmt. Corp.*, 531 F.3d 1339, 1346 (11th Cir.2008).

456 *Id.*

457 *CFTC v. Com. Hedge Serv., Inc.*, 422 F.Supp.2d 1057, 1060-61 (D. Neb. 2006).

458 *CFTC v. Gibraltar Monetary Corp.*, No. 04-80132-CIV, 2006 WL 1789018, at *28 (S.D. Fla. May 30, 2006).

459 *See, e.g.*, Consent Order, *CFTC v. BP Prods. North Am., Inc.*, No. 06-C-3503 (N.D. Ill. Oct. 25, 2007).

460 U.S. Commodity Futures Trading Comm'n, *CFTC Enters into Non-Prosecution Agreements with Former Citigroup Global Markets Inc. Traders Jeremy Lao, Daniel Liao, and Shlomo Salant* (June 29, 2017), https://www.cftc.gov/PressRoom/PressReleases/pr7581-17.

admitted their engagement in spoofing in U.S. Treasury futures markets while trading for Citigroup Global Markets Inc. ("Citigroup") in 2011 and 2012. Lao, Liao, and Salant employed a spoofing strategy that involved entering a large brief order with the intent to cancel the large order before execution on the opposite side of a smaller order that each wanted to trade in the same or a correlated market. They used the spoofing strategy to get their smaller orders filled at the prices they wanted. The non-prosecution agreements emphasize Lao's, Liao's, and Salant's timely and substantial cooperation, immediate willingness to accept responsibility for their misconduct, material assistance provided to the CFTC's investigation of Citigroup, and the absence of a history of prior misconduct.

7. Criminal Prosecutions for CEA Violations

Willful violations of the CEA or CFTC rules or regulations promulgated under the CEA are punishable by a fine of not more than $1.192 million or imprisonment for not more than 10 years, or both, together with the costs of prosecution. [461] The CFTC has no criminal prosecutorial authority but regularly refers matters to the DOJ, as well as state criminal prosecutors.

The DOJ may also bring charges under other federal criminal statutes, including wire fraud (18 U.S.C. § 1343), bank fraud (18 U.S.C. § 1344), securities and commodities fraud (18 U.S.C. § 1348), and/or attempt or conspiracy to commit securities, commodities, bank, or wire fraud (18 U.S.C. § 1349).

In the absence of a strong case for manipulation or attempted manipulation under the CEA, the DOJ will in many cases seek wire-fraud charges based upon the same underlying conduct. The federal wire-fraud statute states:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both.[462]

The elements of a wire fraud charge are (1) a scheme to defraud; (2) involving money, property, or honest services; (3) that used wires in furtherance of the scheme; (4) with fraudulent intent.[463]

In relation to corporations, DOJ investigations may result in (1) a non-prosecution agreement, (2) a deferred-prosecution agreement, or (3) criminal charges against an entity, parent, or subsidiary. Under its Principles of Federal Prosecution of Business Organizations, the DOJ will assess whether criminal charges should be brought against an entity after considering nine factors which include, for example, the nature and seriousness of the offense, the corporation's willingness to cooperate in the investigation, the pervasiveness of wrongdoing within the corporation, and the collateral

[461] 7 U.S.C. § 13(a)(5).

[462] 18 U.S.C. § 1343.

[463] *See United States v. Brooks*, No. 06-CR-550 (S–1)(JS), 2009 WL 3644122, at *3 (E.D.N.Y. Oct. 27, 2009).

consequences arising from a prosecution. The factors can serve either to aggravate or mitigate the underlying offense and will guide the DOJ in formulating its position on a fine amount and the form of a resolution.

Several criminal actions have arisen out of CFTC investigations or have involved conduct related to futures or swaps trading.

Example Case: *United States v. BP America Inc.*, No. 07-cr-00683 (N.D. Ill. filed Oct. 25, 2007).

In October 2007, BP America and certain affiliates entered into a three-year Deferred Prosecution Agreement with the DOJ, which charged BP in a Criminal Information with wire fraud in violation of 18 U.S.C § 1343 and manipulating and attempting to manipulate the price of February 2004 TET Propane in violation of the CEA in violation of CEA § 13(a)(2). BP America admitted the facts supporting the Information and agreed: (i) to pay a total of approximately $173 million in fines, restitution, and contributions to the United States Postal Inspection Service Consumer Fraud Fund; and (ii) to the appointment of a monitor.

Example Case: *United States v. Dooley*, No. 10-cr-0335 (N.D. Ill. 2010).

In December 2012, Evan Dooley, a former authorized person of MF Global, pled guilty to two counts of exceeding speculative position limits in connection with his trading of wheat futures in February 2008 in violation of CEA §§ 6a and 13(a)(5). Dooley admitted as part of the plea agreement that on February 27, 2008, he exceeded the one-month speculative and all-months speculative position limits for wheat futures. Dooley was originally charged with 16 counts of wire fraud and 2 counts of exceeding position limits in connection with his trading at MF Global, which caused a $141 million loss for the company. Dooley was sentenced to 5 years in prison.

Example Case: *United States v. Brooks et al.*, 681 F.3d 678 (5th Cir. 2012).

Three former employees of El Paso Merchant Energy Corporation (James Patrick Phillips, Wesley C. Walton, and James Brooks) were convicted of conspiracy in violation of 18 U.S.C § 371, false reporting in violation of CEA § 13(a)(2), and wire fraud in violation of 18 U.S.C § 1343 in connection with a conspiracy to report false information related to natural gas prices to *Inside FERC* and *NGI* to manipulate the index prices reported in those magazines. Following their conviction, the defendants were sentenced to between 11 years 3 months and 14 years in prison. In May 2012, the Fifth Circuit Court of Appeals affirmed the conviction and the sentences.

Example Case: *United States v. Wasendorf*, No. 12-CR-2021 (N.D. Iowa filed Oct. 9, 2012).

In September 2012, Russell Wasendorf, Sr., the chief executive of the now-defunct brokerage firm Peregrine Financial Group ("PFG"), pled guilty to one count of mail fraud in violation of 18 U.S.C. § 1341, one count of embezzlement under in violation of CEA § 13(a)(1), one count of making false statements to the CFTC and one count of making false statements to a futures association in violation of CEA § 13(a)(4). The DOJ alleged that, beginning in the early 1990s and continuing through 2012, Wasendorf routinely stole PFG customer funds and created false bank statements and other documents to conceal the embezzlement. Wasendorf also submitted false reports to the CFTC and the National Futures Association overstating the value of PFG's customer segregated funds. Wasendorf was sentenced to 50 years in prison. In a parallel civil suit initiated by the

CFTC against Wasendorf and PFG, the court, referencing Wasendorf's plea agreement, found that the defendants committed fraud by misappropriating customer funds, violated customer fund segregation laws, and made false statements in financial statements filed with the CFTC

Example Case: *United States v. Taylor*, No. 13-CR-00251 (S.D.N.Y. filed Apr. 4, 2013).

In April 2013, Matthew Taylor, a former proprietary trader at Goldman Sachs, pled guilty to one count of wire fraud in violation of 18 U.S.C §1343, in connection with entering into an unauthorized position in electronic futures contracts and attempting to conceal it. The DOJ alleged that in December 2007, Taylor accumulated, through electronic trading, an $8.3 billion notional long position in futures contracts tied to the Standard & Poor's 500 Stock Index, exceeding Goldman risk limits. In order to conceal his position, Taylor then made false trade entries in a manual trade entry system that appeared to take the opposite side of his bet. Taylor was sentenced in December 2013 to nine months' imprisonment, three years of supervised release, and 400 hours of community service.

Example Case: *United States v. Martin-Artajo*, No. 13-CR-707 (S.D.N.Y. filed Aug. 14, 2013).

In August 2013, a grand jury indicted two former JPMorgan traders in relation to JPMorgan's "London Whale" trading losses. Defendant Martin-Artajo supervised Bruno Iksil, the former trader known as the London Whale, while defendant Grout worked for Iksil. The government alleged that the defendants artificially inflated the value of securities "to hide the true extent of significant losses" in a credit derivatives trading portfolio. The traders were charged with five criminal counts for securities fraud, wire fraud in violation of 18 U.S.C § 1343, conspiracy in violation of 18 U.S.C §371, making false SEC filings in violation of 15 U.S.C 78m(a) and 78ff, and falsifying books and records in violation of 15 U.S.C §§ 78(b)(2)(A), 78(b)(5), 78ff. The United States attempted to extradite Defendant Martin-Artajo from Europe, but a Spanish court rejected the U.S. request. The case is still pending.

Example Case: *United States v. Coscia*, No. 14-0551 (N.D. Ill. filed Oct. 1, 2014).

In October 2014, a grand jury in Chicago indicted a high-frequency trader for allegedly manipulating commodities futures prices, charging six counts of commodities fraud in violation of 18 U.S.C § 1348 and six counts of "spoofing" in violation of §§ 6c(a)(5)(C) and 13(a)(2) of the CEA. The indictment marks the first federal prosecution under the new statutory offenses for disruptive trading practices created under the DFA. On November 3, 2015, a jury convicted Coscia on six counts of spoofing and six counts of commodities fraud. In July 2016, Coscia, who had argued that probation was an appropriate sentence, was sentenced to three years in federal prison for his conduct.

Example Case: *United States v. Sarao*, No. 15-CR-75 (N.D. Ill. unsealed Apr. 21, 2015).

In February 2015, the DOJ filed under seal a Criminal Complaint charging Navinder Singh Sarao with a four-count indictment for allegedly attempting to manipulate the price of the E-mini S&P for over five years through a variety of spoofing tactics in violation of 18 U.S.C §§ 1343, 1348(1) and (2), and CEA §§ 6c(a)(5)(C) and 13(a)(2). At the request of the DOJ, Sarao was arrested by English officials in London on April 2015 and extradited to the United States in October 2016. In

November 2016, Sarao pleaded guilty to one count of spoofing and one count of wire fraud in a related criminal action.

8. Private Civil Actions following CFTC Investigations

Section 22(a) of the CEA provides a right of action against anyone (other than a registered entity or registered futures association) who violates the CEA or willfully aids or abets a CEA violation, provided that the plaintiff suffered actual damages and there exists a certain relationship between the plaintiff and the defendant (strict privity of contract is not required).[464] In addition, the CEA provides a broader private right of action in relation to manipulation violations, which also does not require privity.[465]

The DFA extended private rights of action to include swaps. In addition, the DFA extended the broader private right of action for manipulation violations to include a private right of action for violations of the new provisions for fraud-based and false-reporting-based manipulation.[466]

In any action arising from a willful and intentional violation in the execution of an order on the floor of a registered entity, a plaintiff may seek punitive or exemplary damages equal to no more than two times the amount of such actual damages.[467]

The private right of action has a two-year statute of limitations.[468]

A large number of civil suits are currently pending, which stem from the benchmark rate investigations that the CFTC and DOJ conducted.

Example Case: *Hershey v. Energy Transfer Partners, L.P.*, 610 F.3d 239, 246 (5th Cir. 2010).

The plaintiffs, purchasers and sellers of NYMEX natural-gas futures contracts that obligated delivery at the Henry Hub, alleged that the defendants used their market power to depress the price of natural gas delivered at the Houston Ship Channel ("HSC") hub and then provided artificially low price information to Platts, knowing the prices would be reflected in HSC's monthly price index. The plaintiffs alleged that defendants intended to drive the HSC price down against the Henry Hub price so that the defendants could profit from the difference between the two hubs. Plaintiffs filed a Consolidated Class Action Complaint, alleging commodity futures market manipulation and aiding and abetting under CEA §§ 6(c), 13(a) and 25(a).

The court noted that the CEA's private right of action allows claims against individuals '"who purchased or sold a [futures] contract' if those individuals 'manipulate[ed] the price of any such contract or the price of the commodity underlying such contract.'" The court found that the contracts at issue were NYMEX natural-gas futures contracts and the "commodity underlying"

[464] *See* 7 U.S.C. § 25(a)(1).

[465] 7 U.S.C. § 25(a)(1)(D).

[466] *Id*.

[467] 7 U.S.C. § 25(a)(3).

[468] 7 U.S.C. § 25(c).

those contracts was not natural gas wherever bought or sold, but rather natural gas delivered at the Henry Hub. Therefore, the plaintiffs were required to allege specific intent "to manipulate the underlying of that contract, not [a] hypothetical natural gas contract."[469]

The plaintiffs argued that the defendants "knew or should have known" that manipulation of HSC gas prices would result in the artificial suppression of NYMEX natural-gas futures contract prices.[470] The court rejected this argument, finding that the effect on the Henry Hub and NYMEX futures contracts was "merely an unintended consequence of the Defendants' manipulative trading."[471] Under the CEA's specific-intent standard, the court found that "mere knowledge is not enough; Defendants must have specifically intended to impact the NYMEX natural gas futures market."[472]

Example Case: *In re Dairy Farmers of America, Inc. Cheese Antitrust Litigation*, 801 F.3d 758 (7th Cir. 2015).

The plaintiffs, purchasers of CME Class III milk futures contracts, CME spot cheese contracts, cheese and milk contracts which were based on the CME price or a government minimum price, and wholesale cheese and raw milk, alleged that the defendants manipulated the price of the CME's Class III milk futures contracts through purchases of block cheese on the CME Cheese Spot Call market. The plaintiffs alleged that defendants engaged in this action to stabilize cheese prices and that when defendants stopped purchasing cheese it caused the price of cheese to crash. The plaintiffs further alleged that the defendants unwound their futures purchases at a profit. The complaint alleged violations of the Sherman Act 15 U.S.C §§ 1 and 2, CEA §25(a)(1), and unjust enrichment.

Relying on the Fifth Circuit's decision in *Hershey v. Energy Transfer Partners, LP*,[473] the court affirmed summary judgment for the defendants. The court noted that the commodity underlying Class III milk futures was milk, rather than cheese, meaning that plaintiffs needed to show that the defendants "specifically intended to manipulate the price of milk."[474] The court found that there was no evidence in the record that defendants were "interested in milk futures, let alone any evidence showing specific intent to cause an artificial price."[475]

The court also addressed plaintiffs' claim that defendants had aided and abetted the manipulation of CME Class III milk futures. The court held that plaintiffs' "evidence simply does not support

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469 *Hershey v. Energy Transfer Partners, LP*, 610 F.3d 239, 247 (5th Cir. 2010).

470 *Id.*

471 *Id.* at 249.

472 *Id.*

473 *Hershey*, 610 F.3d at 239.

474 *In re Dairy Farmers of Am., Inc. Cheese Antitrust Litig.*, 801 F.3d 758, 764 (7th Cir. 2015)

475 *Id.* at 765.

an inference that anyone" was "aware of the alleged plan to affect Class III milk futures market," and affirmed summary judgment for defendants.[476]

Example Cases: *Aspire Commodities, LP v. GDF Suez Energy North America, Inc.*, No. CIV.A. H-14-1111, 2015 WL 500482, at *1 (S.D. Tex. Feb. 3, 2015), aff'd sub nom. *Aspire Commodities, L.P. v. GDF Suez Energy North America, Inc.*, 640 F. App'x 358 (5th Cir. 2016), reh'g denied sub nom. *Aspire Commodities, L.P. v. GDF Suez Energy North America, Inc.*, No. 15-20125, 2016 WL 3211288 (5th Cir. Mar. 25, 2016)

Plaintiffs alleged that the GDF Suez Energy North America and its U.S. subsidiaries ("GDF Suez") manipulated Locational Marginal Price ("LMP") electricity on the Electric Reliability Council of Texas ("ERCOT") grid in order to benefit its financial positions on electricity futures on ICE in violation of CEA § 9(1) and (3). Plaintiffs allege that GDF Suez accomplished this by increasing the price on the offer curve that it produces to ERCOT throughout the day to levels that exceed the LMP, which made GDF Suez's energy unavailable for purchase. The plaintiffs further alleged that the increased prices that GDF Suez demanded far exceeded the prices it had offered in the previous day's Day–Ahead Market,[477] making GDF Suez's economic withholding difficult to predict and likely intentional. The district court, in a decision that was affirmed by the Fifth Circuit Court of Appeals, dismissed the case, finding that the plaintiffs' claims were precluded by a March 2013 CFTC order, which had exempted certain transactions offered or sold in Regional Transmission Organizations and Independent System Operators from select provisions of the CEA and the CFTC's regulations. In particular, the district court found that because the order did not explicitly permit private rights of action under § 22 of the CEA,[478] the plaintiff's claims were precluded by the March Order.

As a result of the *Aspire* decision, the CFTC proposed an amendment to the March 2013 order, which would ensure that private litigants would be able to bring claims pursuant to § 22.

9. Potential Collateral Consequences of CEA Violations

(a) Consequences under the CEA

Under CEA §§ 8(a)(2)-(4), a CEA violation may result in the CFTC's refusing to register a market participant or suspending or revoking futures-commission-merchant or swaps-dealer registration.[479]

Under CEA § 8(a)(4), the CFTC can suspend or revoke registration for any person if that person could be refused registration under § 8(a)(3). Section 8(a)(3), in turn, states that the CFTC can

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[476] *Id.*

[477] The Day-Ahead Market is a forward market where GDF Suez and other producers commit to selling electricity at a certain price on the next day.

[478] 7 U.S.C. § 25(b)(5).

[479] 7 U.S.C. §§ 12(a)(2)-(4).

refuse registration of anyone if it (or its principal) consented to a finding of a violation of the CEA.[480]

CEA § 8(a)(2) defines the term "principal" to include a corporation, any officer, director, or beneficial owner of at least 10% of the voting shares of the corporation, and any other person that the CFTC by rule, regulation, or order determines has the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the activities of such person.[481]

CEA violations may also result in loss of relief from the CFTC introducing broker registration requirements under CFTC No-Action Letter 12-70.

CEA violations may also result in loss of CFTC "Qualified Independent Representative" status for making swap trading decisions on behalf of a special entity.

(b) Consequences under Securities Laws

Under certain circumstances, a CEA violation may cause collateral consequences under U.S. securities laws. In particular, several consequences may be triggered by a felony conviction of a subsidiary or affiliate, including:

1. Disqualification under § 9(a) of the Investment Company Act of 1940;
2. Loss of "Well-Known Seasoned Issuer" status in relation to the SEC's shelf registration process under the Securities Act of 1933;
3. Loss of investment adviser registration under the Investment Advisers Act of 1940;
4. Loss of SEC broker-dealer registration under § 15 of the Securities Exchange Act.

(c) Consequences under Exchange and SRO Rules

Self-Regulatory Organizations ("SROs") can monitor, investigate, and penalize their members for violations of the CEA, and CEA violations may raise SRO notification requirements. In addition, certain felony convictions can result in a statutory disqualification under the Exchange Act, which may lead to ineligibility for continued membership in an SRO or continued association with a disqualified party.[482]

(d) Consequences under Banking Laws

Under certain circumstances, CEA violations by a bank or its affiliates could have carry-over effects on the bank vis-à-vis its banking regulators. Banking regulators have the ability to revoke

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480 *Id.*

481 *Id.*

482 *See, e.g.*, FINRA Bylaws art. III, § 1 (a)-(b).

Financial Holding Company ("FHC") status, terminate FDIC insurance, impose civil monetary fines, issue cease-and-desist orders, and take other measures against banks.

(e) Consequences under ERISA

A felony conviction for "any felony arising out of the conduct of the business of a broker, dealer, investment adviser, bank, insurance company or fiduciary" by a corporation or its affiliate will result in loss of Qualified Professional Asset Manager ("QPAM") status.[483] Loss of QPAM status may preclude a financial institution from providing services to Employee Retirement Income Security Act ("ERISA") plans.

(f) Other Consequences under Federal and State Law

Several additional potential consequences may arise out of CEA violations. These include (1) debarment from federal and state government contracts, (2) breaches of representations under commercial contracts, (3) ineligibility to serve as a fiduciary, and (4) state insurance-law consequences.

[483] *See* PTCE 84-14 § I(g).

III. U.S. DEPARTMENT OF JUSTICE JURISDICTION AND MARKET ENFORCEMENT REGIME

A. Introduction

Derivatives and commodities market abuse and fraud has been prohibited and subject to criminal charges for many years. However, criminal prosecution by the DOJ was rare until after the 2002 creation of the Financial Fraud Enforcement Task Force, comprised of several government authorities, including, among others, the DOJ, CFTC and SEC. The Task Force has a working group that includes the Enforcement Directors of the CFTC and SEC as well as the head of the DOJ Criminal Division and the U.S. Attorney for the Southern District of New York. In recent years, cooperation of those organizations has supported numerous and substantial criminal prosecutions in the area of derivatives and commodities market fraud and abuse. Indeed, the CFTC reported that 95% of the major fraud cases it filed in 2014 included parallel criminal proceedings.

Criminalization of market abuse and fraud may have also been facilitated by the greater ease of gathering and analyzing evidence that has resulted from the growth of electronic markets and communications. Since DOJ criminal charges must be proven "beyond a reasonable doubt," in contrast to the civil law "preponderance of the evidence" standard applicable to CFTC enforcement cases, DOJ was historically limited in its ability to successfully prosecute cases involving complex market activities. Today, however, the common use of electronic markets which record orders and trades to the microsecond, and availability to investigators of computer programs that can near instantly reconstruct markets, has made analysis of complex, fast-moving market activity susceptible to a level of precision not previously possible. Further, traders' use of electronic communications in the form of emails, texts and chat rooms, all of which are regularly recorded, retained, and electronically searchable has provided new sources of evidence. Similarly, the use by traders of digitally recorded, retained, and searchable telephone lines has been helpful in building criminal cases.

B. Statutory Basis of Jurisdiction

1. CEA

The CEA expressly provides that any willful violation of that statute or CFTC rules is a felony prosecutable by the DOJ. [484] Willful violations of the CEA or CFTC rules or regulations promulgated under the CEA are punishable by a fine of not more than $1 million or imprisonment for not more than 10 years, or both, together with the costs of prosecution.[485] In addition, the CEA imposes criminal liability for making knowingly false statements to the CFTC. In addition to false statements made to CFTC investigators and staff, CEA § 9(a)(3) prohibits making knowingly false statements in any report or document required to be filed under the CEA, and CEA § 9(a)(4) prohibits making willfully false statements to regulating entities such as futures associations. The

[484] The Dodd-Frank amendments added criminal sanctions for "knowing" violations of the statute of up to 10 years imprisonment and a fine of not more than $1 million. CEA § 9(a)(2); 7 U.S.C. § 13(a)(2).

[485] 7 U.S.C. § 13(a)(5).

CFTC has no criminal prosecutorial authority but regularly refers matters to the DOJ, as well as state criminal prosecutors.

The CFTC has referred several types of commodities law violations to the DOJ in recent years. For example, CFTC has referred cases against both companies and individuals arising out of the manipulation of LIBOR and other benchmark interest rates,[486] manipulation of propane prices,[487] spoofing and other prohibited trading practices,[488] and embezzlement.[489]

2. Energy Policy Act of 2005

Under the EPAct, willful violations of the Federal Power Act ("FPA"), Natural Gas Act ("NGA"), and Natural Gas Policy Act ("NGPA") are punishable by penalties of up to $1 million and up to five years' imprisonment.[490] While FERC is limited to civil enforcement of its statutes, orders, rules, and regulations, it may refer matters to the DOJ for criminal prosecution. While criminal prosecutions are rare, in March 2016, the U.S. Attorney's Office for the District of Massachusetts filed a Criminal Information charging Power Plant Management Services LLC with felonies of conspiring to violate and violating the FERC prohibition of energy market manipulation, marking the first time a party has been criminally charged with violating FERC's anti-manipulation rule.[491]

3. FTC Act

The FTC has similar authority to refer criminal violations to the DOJ for prosecution. [492] In addition, the DOJ may appoint FTC attorneys as special U.S. Attorneys to represent the United States in litigation conducted by the DOJ. For example, the Telemarketing and Consumer Fraud and Abuse Prevention Act provides for the appointment of FTC attorneys to prosecute criminal contempt.[493]

4. Other Fraud-Based Criminal Provisions

The DOJ may also bring charges for market abuse and fraud under other federal criminal statutes, including wire fraud (18 U.S.C. § 1343), bank fraud (18 U.S.C. § 1344), securities and

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[486] *See, e.g.*, *United States v. Deutsche Bank AG*, 15-cr-61 (D. Conn. filed April 23, 2015); *United States v. Robson*, No. 1:14-cr-00272 (S.D.N.Y. filed April 28, 2014); *United States v. UBS AG.*, No. 15-cr-00076 (D. Conn. filed May 20, 2015).

[487] *See, e.g.*, *United States v. BP Am. Inc.*, No. 07-cr-00683 (N.D. Ill. filed Oct. 25, 2007); *United States v. Radley*, 659 F. Supp. 2d 803 (S.D. Tex. 2009), *aff'd*, 632 F.3d 177 (5th Cir. 2011).

[488] *See, e.g.*, *United States v. Sarao*, No. 15-cr-75 (N.D. Ill. unsealed Apr. 21, 2015); *United States v. Coscia*, No. 14-0551 (N.D. Ill. filed Oct. 1, 2014); United States v. Taylor, No. 13-cr-00251 (S.D.N.Y. filed Apr. 4, 2013); *United States v. Dooley*, No. 10-cr-0335 (N.D. Ill. filed Apr. 27, 2010).

[489] *See, e.g.*, *United States v. Wasendorf*, No. 12-cr-2021 (N.D. Iowa filed Oct. 9, 2012).

[490] Energy Policy Act of 2005 (Pub. L. 109-58) §§ 314; 1284.

[491] *United States v. Berkshire Power Co. LLC*, No. 3:16-cr-30021 (D. Mass. filed Mar. 30, 2016).

[492] Federal Trade Commission Act of 1914 § 16(b), 15 U.S.C. § 56(b).

[493] 15 U.S.C. § 6107(b).

commodities fraud (18 U.S.C. § 1348), and/or attempt or conspiracy to commit commodities, bank, or wire fraud (18 U.S.C. § 1349).

The DOJ has frequently brought mail fraud or wire fraud charges based upon the same underlying conduct as might support a charge of willful violation of the CEA. There are two elements in mail fraud: (1) a scheme to defraud, and (2) the use of the mail for the purpose of executing the scheme.[494] The elements of wire fraud under 18 U.S.C. § 1343 directly parallel those of the mail fraud statute but require the use of an interstate telephone call or electronic communication made in furtherance of the scheme.[495] The federal wire fraud statute states:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both.[496]

Regarding commodities fraud, 18 U.S.C. § 1348 provides that "[w]hoever knowingly executes, or attempts to execute, a scheme or artifice (1) to defraud any person in connection with any commodity for future delivery… or (2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any commodity for future delivery…; shall be fined under this title, or imprisoned not more than 25 years, or both." The elements of a commodities fraud violation include (1) fraudulent intent; (2) a scheme or artifice to defraud (or obtain money or property through misrepresentations); and (3) a nexus with a commodity.[497]

5. Competition-Based Criminal Provisions

(a) Sherman Act

The Sherman Act (15 U.S.C. § 1 *et seq.*) outlaws "every contract, combination . . . or conspiracy in restraint of trade." The U.S. Supreme Court has limited the application of the Sherman Act to only *unreasonable* restraints of trade. In determining what restraints are unreasonable, courts generally apply a "rule of reason" test, which "requires the factfinder to decide whether under all

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[494] 18 U.S.C. § 1341; *see also* U.S. Dep't of Just., CRIM. RESOURCE MANUAL § 940 (2009) [*hereinafter* Crim. Manual]; *Schmuck v. United States*, 489 U.S. 705, 721 (1989) ("There are two elements in mail fraud: (1) having devised or intending to devise a scheme to defraud (or to perform specified fraudulent acts), and (2) use of the mail for the purpose of executing, or attempting to execute, the scheme (or specified fraudulent acts).").

[495] Crim. Manual, § 941; *see also United States v. Briscoe*, 65 F.3d 576, 583 (7th Cir. 1995); *Brooks*, 12009 WL 3644122, at *3.

[496] 18 U.S.C. § 1343.

[497] *See United States v. Motz*, 652 F.Supp.2d 284, 295 (E.D.N.Y. 2009) (citing *United States v. Mahaffy*, No. 05-CR-613, 2006 WL 2224518, at *11-12 (E.D.N.Y. 2006)).

the circumstances of the case the restrictive practice imposes an unreasonable restraint on competition."[498]

The penalties for violating the Sherman Act can be severe. Although most enforcement actions are civil, the Sherman Act is also a criminal provision, and thus individuals and businesses that violate it may be criminally prosecuted by the DOJ. Criminal prosecutions are typically limited to intentional and clear violations, such as when competitors fix prices or rig bids. The Sherman Act imposes criminal penalties of up to $100 million for a corporation and $1 million for an individual, along with up to a 10-year sentence in prison. Under federal law, the maximum fine may be increased to twice the amount the conspirators gained from the illegal acts or twice the money lost by the victims of the crime, if either of those amounts is over $100 million.

Example Case: *United States v. Deutsche Bank AG*, 15-CR-61 (D. Conn. filed on April 23, 2015)

As part of its settlement of the DOJ and CFTC's investigation into LIBOR and EURIBOR manipulation, under the deferred prosecution agreement with the DOJ, Deutsche Bank was charged with one count of wire fraud, 18 U.S.C. § 1343and one count of price fixing in violation of the Sherman Act, 15 U.S.C. § 1. The DOJ alleged that Deutsche Bank violated the Sherman Act due to its participation in a scheme by Deutsche Bank traders to coordinate their EURIBOR requests with traders at other banks to benefit their trading positions from at least June 2005 through October 2008.

Other Sherman Act charges are found in several of the cases described in section G below.

(b) CEA Restraining Trade Provision

CEA § 6(c) authorizes CFTC enforcement action against any person who engages in any practice that is "restraining trading in any commodity for future delivery or any swap."[499] Furthermore, swap dealers, among others, are prohibited from adopting any process or taking any action that "results in any unreasonable restraint of trade"[500] unless it is necessary or appropriate to achieve the purposes of the CEA. Violations that are wilful can be prosecuted by the DOJ as felonies.

There is no published report of charges being brought by the CFTC under this restraining trading provision, and there is no CFTC or judicial guidance explaining its boundaries. However, this language is nearly identical to that found in § 1 of the Sherman Act. Given the fact that antitrust laws continue to have a major impact on CEA market manipulation jurisprudence (e.g. the

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[498] *Arizona v. Maricopa Cty. Med. Soc.*, 457 U.S. 332, 343 (1982); *see also Am. Needle, Inc. v. Nat'l Football League*, 560 U.S. 183, 203 (2010) (noting that Justice Brandeis provided the classic formulation of the Rule of Reason in *Bd. of Trade of Chicago v. United States*, 246 U.S. 231, 238 (1918), "[t]he true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.").

[499] 7 U.S.C. § 9(1)(A).

[500] 15 U.S.C. § 78o-10.

definitions of terms such as "corner" are derived primarily from antitrust litigation[501]) and the DOJ has pursued Sherman Act charges in recent commodities cases, it is likely that Sherman Act cases and its "rule of reason" doctrine (see (a) above) will act as precedent for the CFTC in this area. Thus, because restraint of trade in the Sherman Act context means restraint of competition, it is likely that the defendants must engage in a conspiracy to restrain or eliminate competition in the relevant market to establish liability under CEA § 6(c).

C. Extraterritorial Reach

In cases alleging a criminal violation of the CEA, a court is likely to apply the same extraterritorial analysis that it would apply to a claim by the CFTC. Therefore, in light of the Supreme Court's holding in *Morrison v. National Australia Bank*, 130 S.Ct. 2869 (2010),[502] it is unlikely that the "conduct and effects" tests,[503] which was traditionally used to determine whether the CEA applied, would be used to determine whether a criminal prosecution was improperly extraterritorial. Also, given the Supreme Court's holding in *RJR Nabisco, Inc. v. European Community*,[504] in determining the scope of U.S. statutes such as the CEA, a court may apply a "presumption against extraterritoriality" – i.e., the presumption that "legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."[505] Despite the presumption, however, the U.S. authorities justify their investigations and prosecutions outside of the United States by arguing that the use of the U.S. financial system or other limited contact with the United States renders the conduct at issue domestic rather than extraterritorial.[506] Whether

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[501] *See Peto*, 101 F.2d at 357-58 (antitrust case defining corners in the commodities market).

[502] In *Morrison*, a private civil suit alleging securities fraud under the Exchange Act of 1934, the Supreme Court rejected the conduct and effects tests and instead imposed a transactional test limiting the reach of Section 10(b) of the Exchange Act to (i) transactions in securities listed on domestic exchanges and (ii) domestic transactions in other securities. Morrison, 130 S.Ct. at 2884.

[503] In the past, courts applied the CEA extraterritorially where either the conduct or effects test was satisfied. The conduct test applied where a plaintiff alleged that manipulative conduct in the United States caused harm abroad. *See, e.g.*, *CFTC v. Lake Shore Asset Mgmt. Ltd.*, No. 07 C 3598, 2007 WL 2659990, at *26-27 (N.D. Ill. Aug. 28, 2007) (exercising subject matter jurisdiction over the CFTC's claim under the conduct test because the foreign defendant used a U.S. futures exchange to defraud foreign investors), vacated in part on other grounds, 511 F.3d 762 (7th Cir. 2007). The effects test applied where a plaintiff alleged that foreign activities caused "foreseeable and substantial harm to interests in the United States." *Id*. at *26.

[504] 136 S. Ct. 2090 (2016).

[505] *EEOC v. Arabian Am. Oil Co*., 499 U.S. 244, 248 (1991) (quoting *Foley Bros. v. Filardo*, 336 U.S. 281, 285 (1949)) (hereinafter "Aramco"); see also *Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F. 3d 198, 201 (2d Cir. 2014) (holding that Exchange Act §10(b) does not reach security-based swap agreements valued based on the price movements of foreign securities where claim is based on "largely" foreign conduct and foreign defendants had no alleged involvement in plaintiffs' transactions).

[506] *See, e.g.*, Arthur B. Laby, *Regulation of Global Financial Firms After Morrison v. National Australia Bank*, 87 St. John's L. Rev. 561, 580-81, 590 (2014) (According to the SEC, "any use of the U.S. jurisdictional means, such as a single phone call or email into the United States, could trigger the application of the statute," and "a determination of extraterritorial application hinges on 'whether there is sufficient use of U.S. jurisdictional means.'").

a sufficient U.S. nexus exists to render the conduct at issue "domestic" will turn on the focus and language of the statutes at issue.[507]

1. Extraterritorial Application of Wire Fraud Statute

The wire fraud statute is one of the most widely used U.S. criminal statutes that prohibits the use of a wire transmission in "interstate or foreign commerce" as part of a scheme to defraud. The DOJ is often able to establish jurisdiction, even if the conduct at issue occurred largely, or entirely, overseas based on its Title 18 authority to prosecute mail or wire fraud. To prove wire fraud, the DOJ only needs to show that one participated in a scheme with the intent to defraud another out of money or property, involving material deception and interstate or foreign wire transmission (i.e., phone call or email). [508] Consequently, neither *intrastate* transmission nor transmission between two foreign countries without passing through the United States would establish wire fraud.[509] However, so long as there was a wire communication (e.g., email or bank transfer) that passed through the United States in furtherance of fraud, the DOJ could potentially establish jurisdiction to prosecute. [510]

In the context of wire fraud, several courts have ruled that it is not necessary for a defendant to have sent the wire transmission himself, provided that the use of the wires was a reasonably foreseeable result of his acts.[511] Further, case law holds that the transmission need not be essential to the scheme, provided that it was incidental to the accomplishment of an essential part of the scheme.[512] Thus, the material deception need not have been transmitted over the wires. Each wire communication constitutes a separate offense and can serve as a separate count in the indictment.[513]

Facially, the wire fraud statute appears to have broad extraterritorial applicability to any wires that pass through the United States. However, the judicial circuits are divided as to whether the wire fraud statute applies extraterritorially under the principles articulated in *Morrison*. Whereas the Third Circuit has expressly held that the wire fraud statute applies extraterritorially and the Second Circuit has held that it does not, a number of other circuits—including the Sixth and Ninth Circuits—have avoided answering the question directly by finding that simply using U.S. wires is sufficient for domestic application of the statute.[514] Despite the varied approaches, where a scheme

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507 *Aramco*, 499 U.S. at 248.

508 To prove wire fraud, the DOJ must show that (1) the defendant participated in a scheme to defraud another person out of money or property; (2) the defendant had an intent to defraud; (3) the relevant scheme involved a material deception; and (4) the scheme involved an interstate or foreign wire transmission (i.e. a phone call or e-mail). 18 U.S.C. § 1343.

509 *See United States v. Sidorenko*, 102 F. Supp. 3d 1124, 1132 (N.D. Cal. 2015) (dismissing a wire fraud claim where the scheme involved wire transmissions sent between foreign countries, but no use of U.S. wires); *see also* discussion *infra* Part II.B.2.

510 *See Sidorenko*, 102 F. Supp. 3d at 1132 (dismissing wire fraud claim that did not include the use of U.S. wires).

511 *United States v. Gill*, 909 F.2d 274, 278 (7th Cir. 1990).

512 *United States v. Mann*, 884 F.2d 532, 536 (10th Cir. 1989).

513 *United States v. Castillo*, 829 F.2d 1194, 1199 (1st Cir. 1987).

514 *Compare United States v. Georgiou*, 777 F.3d 125, 137–38 (3d Cir. 2015) (finding that Congress intended the wire fraud statute to apply extraterritorially, as evidenced by its inclusion of the phrase "foreign commerce"), *with*

involves the use of U.S. wires and additional U.S. contacts, a court will likely find that no extraterritorial concerns exist in applying the wire fraud statute.

The Second Circuit gave one of the most extensive discussions on the extraterritorial reach of the wire fraud statute in *European Community v. RJR Nabisco*,[515] which was subsequently reversed by the Supreme Court on other grounds. The Second Circuit held that the wire fraud statute lacks extraterritorial effect because references to "foreign commerce" in the statute are derived from the Commerce Clause of the U.S. Constitution and related to Congress's authority to regulate commerce between the United States and foreign nations, not a congressional intent that the statute apply extraterritorially.[516] However, the Second Circuit did not discuss the second stage of the analysis, concluding that, "wherever the line should be drawn [between domestic and extraterritorial applications of the wire fraud statute], the conduct alleged here clearly states a domestic cause of action"[517] because the plaintiffs had alleged domestic conduct satisfying each of the essential elements of a wire fraud claim.[518]

Following the *European Community* decision, the lower courts are divided as to how much domestic conduct is necessary for a domestic application of the wire fraud statute. A court in New York examined this issue in *United States v. Prevezon Holdings Ltd.*,[519] a civil money laundering suit in which wire fraud was the underlying unlawful activity. In *Prevezon*, the court held that use of U.S. wires plus some additional domestic contacts are necessary for wire fraud to be domestic.[520] The defendants were accused of orchestrating a scheme to steal the corporate identities of Russian companies, use artificial losses to secure tax refunds from the Russian government, and launder money through shell companies.[521] During the process, a wire transfer between two European bank accounts was routed through New York.[522] Despite the use of New York wires, the court held that the domestic contact "was not sufficiently central to the overall fraud scheme to convert this foreign scheme into a domestic one."[523] In particular, the court noted that the Government "[did] not plead that the wire fraud scheme here was formed in the United States, let alone that all of the elements of wire fraud were completed in the United States," and only involved a single U.S. contact—one wire transfer routed through New York.[524] The court rejected the DOJ's contention that a domestic application of the wire fraud statute was appropriate because the proceeds of the

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United States v. Coffman, 574 F. App'x 541, 558 (6th Cir. 2014) (refraining from deciding the issue by finding that the statute was being applied domestically because U.S. wires had been used as part of the scheme).

[515] 764 F.3d 129 (2d Cir. 2014), *rev'd on other grounds*, 136 S. Ct. 2090.

[516] *Id*. at 140–41.

[517] *Id.* at 142

[518] *Id*.

[519] 122 F. Supp. 3d 57 (S.D.N.Y. 2015).

[520] *Id.* at 71.

[521] *Id.* at 62.

[522] *Id.* at 63.

[523] *Id.* at 71–72.

[524] *Id.*

scheme were used to invest in New York real estate, finding that this argument improperly conflated the conduct constituting wire fraud with subsequent money laundering conduct.[525]

On the other hand, in *United States v. Hayes*, a criminal wire fraud case arising from the LIBOR scandal, the trial court focused only on whether the scheme involved the use of U.S. wires.[526] In *Hayes*, the court concluded that, despite the accusation of the defendant manipulating a foreign interest rate benchmark (the Yen London Interbank Offered Rate) from foreign locations (London and Tokyo), wire fraud charges were appropriate because he "caused the publication of the manipulated interest rate information in New York, New York."[527] The court found that this conduct was the focus of the wire fraud statute because "Congress's legislative concern was 'to prevent the use of [U.S. wires] in furtherance of fraudulent enterprises[, and thus] the location of the wires is the Court's primary concern."[528]

Other courts have imposed relatively high standards for establishing a domestic wire fraud violation. For example, in *Laydon v. Mizuho Bank, Ltd.*, [529] the court rejected the plaintiff's attempted use of wire fraud as a predicate for a civil RICO claim. The conduct at issue, manipulation of benchmark interest rates, was substantially similar to the conduct alleged in *Hayes*.[530] However, in *Laydon*, the court held that the plaintiff must make "extensive factual allegations" beyond the mere use of U.S. wires to establish a domestic violation and required allegations detailing that the fraudulent scheme was managed from and directed at the United States.[531] The court concluded that the alleged acts of "foreign and international institutions that submitted false information to [benchmark rate administrators], located in London and Tokyo," were insufficient to support a RICO claim predicated on wire fraud.[532]

In sum, much uncertainty remains regarding the extraterritorial application of the wire fraud statute. Nonetheless, it is clear that many schemes based outside the United States may be subject to U.S. jurisdiction.

2. Extraterritorial Reach of the Antitrust Law

As the principal U.S. antitrust law, the Sherman Act § 1 prohibits "every contract, combination . . . or conspiracy in restraint of trade."[533] A court's examination of a particular antitrust violation depends on the nature of the agreement or conspiracy. A horizontal agreement or conspiracy –

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525 *Prevezon*, 122 F. Supp. 3d at 72.

526 99 F. Supp. 3d 409 (S.D.N.Y.), *aff'd on other grounds,* 118 F. Supp. 3d 620 (S.D.N.Y. 2015), *appeal dismissed*, (Mar. 15, 2016).

527 *Id.* at 629.

528 *Id.* at 628 (quoting *United States v. Kim*, 246 F.3d 186, 191 (2d Cir. 2001)).

529 No. 12 Civ. 3419 (GBD), 2015 WL 1515487, at *9 (S.D.N.Y. Mar. 31, 2015).

530 *Id.* at *1.

531 *Id.*

532 *Id.*

533 Sherman Act, 15 U.S.C. § 1 (2004).

i.e., a price-fixing arrangement between or among competitors – is a *per se* violation.[534] Other conduct (e.g. vertical agreements or conspiracies) that may restrain trade is illegal only if it constitutes an *unreasonable* restraint of trade.[535] Although the antitrust laws are often enforced civilly, the DOJ Antitrust Division can bring criminal prosecutions for antitrust violations, typically limited to *per se* violations (e.g. fixing prices or rigging bids).[536]

In addressing the extraterritoriality of the U.S. antitrust laws in 2004, the Supreme Court refused to infer a congressional intent to authorize actions based on wholly extraterritorial conduct with purely extraterritorial effects under the Sherman Act and the Foreign Trade Antitrust Improvements Act ("FTAIA").[537] Nonetheless, the DOJ often enforces the U.S. antitrust laws against foreign actors. Pursuant to the FTAIA, the U.S. antitrust laws apply to any violation that "significantly harms imports, domestic commerce, or American exporters," even if the relevant trade or commerce occurs outside the United States.[538] Moreover, the laws can also reach wholly foreign conduct if it has a "direct, substantial, and reasonably foreseeable" effect on U.S. commerce.[539] In practice, courts have set the "direct effects" standard fairly low. For example, the Ninth Circuit recently upheld convictions for foreign price fixing conspiracy in which the conspirators fixed the prices of components that were later included in products imported into the United States because there was a "direct effect."[540]

Therefore, if the conduct at issue has a direct effect on trade with or within the United States, it will likely be subject to the U.S. antitrust laws.

As part of the settlements in the benchmark interest rate investigations conducted by the CFTC and DOJ, many of the defendants admitted in their deferred prosecution agreements that the underlying conduct also constituted a violation of the Sherman Act. For example, during the LIBOR and EURIBOR manipulation investigations, the DOJ charged Deutsche Bank with one count of wire fraud and one count of price fixing in violation of the Sherman Act § 1.[541] The DOJ alleged that Deutsche Bank violated the Sherman Act through its participation in a scheme to coordinate their EURIBOR requests with traders at other banks to benefit their trading positions.[542] The parties agreed in the deferred prosecution agreement that Deutsche Bank traders' conduct

534 *Leegin Creative Leather Prods., Inc.v. PSKS, Inc*., 551 U.S. 877, 893 (2007).

535 *Id*. at 885 (quoting *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) ("[T]he Court has repeated time and again that § 1 [of the Sherman Act] 'outlaw[s] only unreasonable restraints.'")).

536 Fed. Trade Comm'n, The Antitrust Laws, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/antitrust-laws (last visited April 30, 2017).

537 *See F. Hoffman-LaRoche Ltd. v. Empagran S.A*., 542 U.S. 155, 169 (2004).

538 *Id*. at 158.

539 15 U.S.C. §6a.

540 *See, e.g., United States v. Hui Hsiung*, 778 F.3d 738, 746-49 (9th Cir. 2015) (affirming criminal conviction of foreign company and executives in connection with price-fixed LCD panels sold abroad).

541 *United States v. Deutsche Bank AG*, 15-CR-61 (D. Conn. filed on April 23, 2015); *United States v. DB Group Services UK Limited*, 15-CR-62 (D. Conn. filed on April 23, 2015) (DB Group Services UK Limited, a London-based affiliate, pled guilty to one count of wire fraud.).

542 *Id.*

based outside the United States was nonetheless subject to U.S. antitrust jurisdiction because it affected U.S. commerce, given the fact that Deutsche Bank's counterparties were based in the United States.[543]

D. DOJ Organization

1. Criminal Division

The DOJ's Criminal Division in Washington, through its Fraud Section, has responsibility for investigating and prosecuting matters involving price manipulation, market abuse, and schemes to defraud. Fraud Section trial attorneys typically work in conjunction with prosecutors from a U.S. Attorney's office on a given matter, but Fraud Section attorneys often play a leading role, particularly in matters involving corporate liability of large financial institutions.[544] In recent years, the Fraud Section has becoming increasingly prominent due to a series of high-profile settlements with global banks arising from widespread interest rate and currency manipulation. Notably, unlike in certain other subject areas (such as Foreign Corrupt Practices Act cases), the Fraud Section does not have mandatory approval authority in cases to be brought by a U.S. Attorney involving commodities and derivatives fraud or other market abuse. Nonetheless, as a matter of practice, cases that have broad geographic reach, or that implicate one or more large institutions, are often led by the Fraud Section.

2. Antitrust Division

DOJ's Antitrust Division has sole responsibility for investigating and prosecuting criminal violations of the Sherman Act.[545] In cases involving commodities or derivatives manipulation, the Antitrust Division often operates in tandem with the Criminal Division. The Antitrust Division maintains a staff in Washington D.C. and several regional field offices in major U.S. cities which operate independently and are generally physically separate from the U.S. Attorney's Offices.

3. U.S. Attorneys

The 94 U.S. Attorney's Offices located through the U.S. function as the primary field offices of the Justice Department.[546] Each office is led by a U.S. Attorney, who is a Presidential appointee. While the U.S. Attorney and his or her top staff will generally change whenever a new Presidential administration comes to power, the bulk of the attorneys in the office are career prosecutors. These Assistant U.S. Attorneys typically begin their careers as generalists, but in larger offices they will often ultimately specialize in certain areas such as securities and commodities fraud. Certain large urban offices, such as the U.S. Attorney's Office for the Southern District of New York in Manhattan and the U.S. Attorney's Office for the Northern District of Illinois in Chicago, which

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543 *Id.*

544 *See* U.S. Dep't of Justice, *Fraud Section Year in Review 2015*, https://www.justice.gov/criminal-fraud/file/833301/download.

545 *See* U.S. Dep't of Justice, ANTITRUST DIVISION MANUAL (2017), https://www.justice.gov/atr/file/761126/download.

546 *See* U.S. Dep't of Justice, *Mission* (September 22, 2016), https://www.justice.gov/usao/mission.

have established dedicated securities and commodities fraud units, are particularly known for bringing sophisticated and aggressive commodities and derivatives prosecutions.[547]

E. Cooperation, Investigation, and Procedure

1. Cooperation with the DOJ Generally

Whether and to what extent a company cooperates with the DOJ directly affects the DOJ's likely treatment and the outcome of the investigation.

The potential benefits of cooperation are significant. The United States Attorneys' Manual's ("USAM") "Principles of Federal Prosecution of Business Organizations" explains that "[c]ooperation is a mitigating factor, by which a corporation . . . can gain credit in a case that otherwise is appropriate for indictment and prosecution." [548] Such credit can lead to reduced charges and penalties, or avoidance of charges altogether.

Although the USAM does not formally define "cooperation," it identifies how a company can be eligible for cooperation credit. Of utmost importance, "the company must identify all individuals involved in or responsible for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all facts relating to that misconduct."[549] These relevant facts include: "[H]ow and when did the alleged misconduct occur? Who promoted or approved it? Who was responsible for committing it?"[550]

The amount of credit earned will depend on the proactive nature of the cooperation, and the diligence, thoroughness, and speed of any internal investigation. But the USAM also clarifies that waiver of attorney-client privilege or work-product protection is not required for credit so long as the relevant facts concerning misconduct are disclosed.[551]

Notwithstanding the increased responsibility on the part of companies to make "extensive efforts" in their internal investigations, counsel should be aware that the DOJ will often conduct its own parallel investigation "to pressure test" a company's efforts, and if the DOJ concludes through its own investigation that the internal investigation's efforts "spread corporate talking points rather than secure facts related to individual culpability," companies will "pay a price when they ask for

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547 *See* U.S. Dep't of Justice, Southern District of New York Criminal Division (May 14, 2015), https://www.justice.gov/usao-sdny/criminal-division.

548 U.S. Dep't of Justice, UNITED STATES ATTORNEYS' MANUAL § 9-28.710 (1997), https://www.justice.gov/usam/united-states-attorneys-manual.

549 *Id*.

550 *Id*. at § 9-28.720.

551 *Id*. at § 9-28.710.

cooperation credit."[552] Thus, any attempt to cooperate and seek credit should be taken on diligently and with the full commitment of all involved.

Under the Trump Administration, companies may see continued incentives from the DOJ to cooperate and voluntarily self-disclose as a means to avoid prosecution or minimize fines. [553] According to Trevor McFadden, the DOJ's former Acting Principal Deputy Assistant Attorney General for the criminal division, one of the DOJ's goals is to work with companies "transparently and in partnership" and to continue to "take[] into consideration voluntary self-disclosures, cooperation and remedial efforts when making charging decisions," at least with respect to the enforcement of the Foreign Corrupt Practices Act ("FCPA").[554] The DOJ's general stance on cooperation appears to be reflected in McFadden's statements that the FCPA Pilot Program, which sets forth guidance about what the DOJ requires from companies seeking mitigation credit for voluntarily self-disclosing misconduct, will "continue in full force."[555] However, Deputy Attorney General Rod Rosenstein recently stated that the DOJ is reviewing its policies on prosecuting white collar crimes.[556]

2. Individual Accountability

On November 29, 2018, Deputy Attorney General Rod J. Rosenstein announced updates to the DOJ policy for criminal and civil enforcement, making important adjustments to the policy announced in September 2015 by then-Deputy Attorney Sally Yates, as well as prior DOJ guidance.[557] The revised guidance continues to place pressure on corporations to cooperate fully with investigations while at the same time creating incentives to identify culpable executives and other employees. Under the revised policy, the DOJ will now award cooperation credit where a corporation identifies every individual "substantially involved" in, or responsible for, the misconduct. Identification of all involved employees, regardless of level of seniority or culpability is no longer a precondition for cooperation credit.

What qualifies as "substantially involved," however, remains unclear. Moreover, the revised policy is meant to expedite resolution of investigations and does not create a right to refuse to identify employees whose involvement the company deems insignificant. In his remarks, Mr.

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552 Marshall L. Miller, Principal Deputy Ass't Att'y Gen., Crim. Div., U.S. Dep't of Just., *Remarks before the Global Investigation Review Program* (Sept. 17, 2014), https://www.justice.gov/opa/speech/remarks-principal-deputy-assistant-attorney-general-criminal-division-marshall-l-miller.

553 Melinda Haag and Betsy Popken, *DOJ Telegraphs Top FCPA Priorities Under Trump Administration*, The Recorder (July 17, 2017), http://www.law.com/therecorder/almID/1202793195967/.

554 *Id*.

555 *Id*.

556 Sarah N. Lynch, *Justice Department Mulls Changing Corporate Prosecution Policy*, Reuters, Sep. 14, 2017, https://www.reuters.com/article/us-usa-justice-whitecollar/justice-department-mulls-changing-corporate-prosecution-policy-idUSKCN1BP2KD.

557 Rod J. Rosenstein, Deputy Attorney Gen., U.S. Dep't of Justice, *Remarks at the American Conference Institute's 35th International Conference on the Foreign Corrupt Practices Act* (Nov. 29, 2018), https://www.justice.gov/opa/speech/deputy-attorney-general-rod-j-rosenstein-delivers-remarks-american-conference-institute-0.

Rosenstein emphasized that an increased focus on prosecuting individuals may be more effective than imposing record-setting financial penalties on corporations. The emphasis on individual prosecutions was not matched, however, by any suggestion of reduced penalties for the corporations that employ these individuals.

Since at least September 2015, when Ms. Yates issued a memorandum on "Individual Accountability for Corporate Wrongdoing" (commonly known as the Yates Memo and now referred to as the "Prior Policy"), [558] the DOJ has focused on individuals' misconduct when resolving corporate enforcement matters. The Prior Policy conditioned corporate cooperation credit on companies' willingness and ability to "provide to the Department all relevant facts about the individuals involved in corporate misconduct."[559] This condition became a significant factor considered by companies when making voluntary disclosure decisions and responding to government investigations, and it has continued to shape every phase of internal investigations. The policy's requirement that all individuals – no matter their level of involvement – be identified has generated debate, however, about efficiency and delay, and has not been consistently followed.

In response to these concerns "about the inefficiency of requiring companies to identify every employee involved regardless of relative culpability," Mr. Rosenstein announced that, going forward, "any company seeking cooperation credit in criminal cases must identify every individual who was substantially involved in or responsible for the criminal conduct."[560]

The change applies in both criminal and civil matters. In his remarks, Mr. Rosenstein acknowledged that civil prosecutors felt constrained by the "all or nothing" approach mandated by the Prior Policy and that "when criminal liability is not at issue, our attorneys need flexibility to accept settlements that remedy the harm and deter future violations[] so they can move on to other important cases."[561] Instead of demanding the disclosure of every person at every level involved in the wrongdoing, the revised policy now requires companies to "identify all wrongdoing by senior officials" to earn any cooperation credit in a civil case, with maximum credit available after the company "identif[ies] every individual person who was substantially involved in or responsible for the misconduct."[562]

What remains unclear, however, is what qualifies as "substantial involvement." While decision makers and those directing misconduct would qualify, it is unclear whether managers whose failure to supervise arguably allows misconduct to continue would be deemed to be substantially involved.

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558 Sally Quillian Yates, *U.S. Dep't of Justice, Individual Accountability for Corporate Wrongdoing* (2015), https://www.justice.gov/archives/dag/file/769036/download.

559 *Id.* at 3.

560 Rosenstein, *supra* note 557. The Justice Manual has been updated to reflect these priorities at §§ 9-28.210, 9-28.300, 9-28.700. U.S. Dep't of Justice, Justice Manual §§ 9-28.210, 9-28.300, 9-28.70 (2018), https://www.justice.gov/jm/jm-9-28000-principles-federal-prosecution-business-organizations?utm_medium=email&utm_source=govdelivery#9-28.700.

561 *Id.*

562 *Id.*

The enhanced policy may bolster the DOJ's ability to bring successful cases by identifying witnesses who could provide valuable testimony in a prosecution of the company or its officers. Paradoxically, however, if the DOJ defines "substantial involvement" to require reporting on more junior employees who were "involved" in, but not culpable for, potential misconduct, it could impede internal whistleblowers and reduce the volume of voluntary disclosures. This is particularly true in complex regulatory contexts, such as export controls and sanctions, where compliance depends on employees across the company spotting potential breaches and flagging them for assessment by the compliance function. No matter how good the compliance culture, line-level operational employees are less likely to flag an issue to the compliance function if they know their names will be given to the DOJ.

Companies that cooperate will nonetheless have powerful incentives to identify those employees with "substantial involvement," however that nebulous concept is defined. The day before Mr. Rosenstein's announcement, on Wednesday, November 28, 2018, Principal Deputy Assistant Attorney General John P. Cronan emphasized the importance of individual accountability by highlighting two declinations against companies in 2018 under the FCPA Corporate Enforcement Policy that involved prosecutions of individuals.[563] He pointed out: "While the involvement of senior management is an aggravating factor that can weigh against a declination, it did not preclude declinations in these cases in light of the companies' overall efforts to do the right thing. And that included cooperation with law enforcement that enabled the Department to bring charges against culpable individuals in both of these cases."[564]

3. DOJ Antitrust Division Leniency Program

(a) DOJ Policy and Program Benefits

Since the mid-1990's, the U.S. Department of Justice's Antitrust Division has concentrated its enforcement resources on international cartels that "victimize" U.S. consumers. The Antitrust Division engages in a "carrot and stick" enforcement strategy by coupling rewards for voluntary disclosure and timely cooperation with penalties for failing or refusing to do so. Under this carrot and stick approach, the Antitrust Division grants leniency to the first corporation reporting its illegal antitrust activity and meeting certain conditions. "Leniency" means not charging a company criminally for the activity being reported. Only one company in a price fixing conspiracy can obtain leniency, and it is often a race to the front steps of the Antitrust Division.[565]

The benefits of leniency are significant. If a company obtains leniency:

1. the company will not be charged criminally provided that certain conditions are met;
2. cooperating employees will also not be criminally charged; and

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[563] John P. Cronan, Assistant Attorney Gen., U.S. Dept' of Justice, *Remarks at Practising Law Institute Event* (Nov. 28, 2018), https://www.justice.gov/opa/speech/principal-deputy-assistant-attorney-general-john-p-cronan-delivers-remarks-practising-law.

[564] *Id.*

[565] Further information, including the full leniency policy, can be found at http://www.justice.gov/atr/public/criminal/leniency.html.

3. no criminal or administrative fines will be assessed.

(b) Timing Considerations

There are two types of leniency: Type A and Type B. Type A leniency is only available when the government has not begun an independent investigation of the subject conduct. Type B leniency occurs after the government has begun its investigation. That being said, there is little practical difference between the two. Both types involve a leniency umbrella covering directors, officers and employees. Type A is a mandated umbrella and Type B leaves room for discretion, but in almost every case the discretion not to offer the umbrella is not exercised.

Leniency is only granted to the first qualifying company to come forward. In addition to co-conspirators, a leniency applicant is racing against individual whistleblowers. In order to qualify, the company must not be the leader of the alleged conspiracy and the Antitrust Division must not yet have evidence against the company that is likely to result in a sustainable conviction.

(c) Leniency Application

The leniency applicant must commit to providing full cooperation and, where possible, restitution to injured parties. Full cooperation entails using best efforts to secure cooperation of employees and former employees. Restitution is typically achieved in resolving civil litigation and generally does not include parties whose injuries are independent of the effects on U.S. commerce. The applicant must also take prompt action to halt the offending conduct and confess its wrongdoing as a corporate act.

An application for leniency is initiated by counsel for the company by calling the Division to secure a "marker," which generally requires disclosing the nature of the potential violation, identification of the industry and product involved, and the client's name. A marker is held in place for a finite period (typically 30 days) to give the company time to further investigate the conduct and complete its application for leniency. The Division may grant an extension if the company shows that it is acting in good faith. The initial grant of leniency is only conditional and the final grant of leniency will not be made until prosecution of the entire conspiracy is complete.

(d) First and Second-In the Door

The DOJ's leniency program provides immunity from prosecution for only one company. However, the "second-in the door" company frequently obtains substantial benefits. The Division's "second-in" policy is not set forth in writing, but, in practice, the Division rewards "second-in" companies that come forward early in the investigation and provide information that meaningfully advances the investigation. The rewards can include up to a 30-35% reduction in fines. Even after leniency has been granted to another company, post-leniency offers to cooperate and settle may significantly reduce fines.

It is important to remember that leniency only applies to prosecution by the Antitrust Division and does not prevent other divisions of the DOJ or other government agencies from prosecuting the company. Furthermore, once a company enters the leniency program, they must confess all their antitrust violations or face significantly higher fines for subsequently revealed violations.

4. DOJ Investigative Procedures

(a) Voluntary Cooperation Generally

Irrespective of any antitrust leniency program, a subject or target of an investigation may voluntarily cooperate with DOJ to advance DOJ's understanding of the issues at hand. DOJ has emphasized a focus on proactive corporate cooperation and voluntary disclosure with the enticement of cooperation credit as a benefit for companies. Conversely, DOJ officials have stated that the lack of proactive cooperation will result in reduced benefits (or potentially no benefit at all) when it comes to resolution of matters being investigated. Full cooperation normally entails providing all relevant information about the potential misconduct and individuals involved in it.

(b) Grand Jury Investigation

The U.S. is one of the few countries that use grand juries to gather evidence and determine whether a prosecutor has sufficient evidence to bring a case against an individual or corporate entity. The grand jury is made up of ordinary citizens whose sole task while serving on the grand jury is to determine whether probable cause exists to believe that a person or entity committed a crime (as opposed to determining ultimate guilt or innocence), and therefore whether indictment is appropriate. While a grand jury shields the accused from unfounded charges, it can also be used as a sword for prosecutors. The grand jury process allows the DOJ to advance its investigation by compelling corporations and individuals to produce documents and provide witness testimony. Prosecutors serve as the presiding officers for grand juries and instruct the grand jury on the law, which provides prosecutors with the ability to guide the process.

Federal grand juries have broad powers to initiate investigations, and DOJ prosecutors may initiate an investigation simply to satisfy themselves that no criminal violation has occurred. Federal grand juries are also given wide discretion to conduct investigations, which rely on subpoenas for witness testimony and document productions. These subpoenas, while issued in the name of the grand jury, are actually issued by a prosecutor, often without the grand jury's knowledge. Nonetheless, federal courts are usually reluctant to quash a subpoena for overbreadth. However, there are circumstances in which courts will decline to enforce a subpoena. For instance, in *United States v. Microsoft Corp.* ("*Microsoft*"),[566] the Second Circuit Court of Appeals recently declined to enforce a subpoena because it sought documents held outside the United States, which was beyond the scope of the particular statute authorizing the issuance of the subpoena.

Productions made pursuant to grand jury subpoenas are generally treated as confidential. Moreover, grand jurors, federal prosecutors, and others aware of the grand jury's deliberations are also forbidden from disclosing matters that occur before a grand jury. Nonetheless, the company can request that the government treat materials as confidential under exceptions to laws such as the Freedom of Information Act. The DOJ also generally resists requests for disclosure from third parties such as civil litigants.

In addition to compelling document productions, grand juries also have the ability to subpoena individuals. Witnesses who appear before a grand jury do not have a right to be accompanied by

[566] 829 F.3d 197 (2d Cir. 2016).

counsel during the testimony but do have a right to consult with counsel during their testimony. As a result, the DOJ will typically seek a voluntary appearance before issuing a subpoena to a "target"[567] – an individual "as to whom the prosecutor or the grand jury has substantial evidence linking him or her to the commission of a crime and who, in the judgment of the prosecutor, is a putative defendant."[568] If the target will not make a voluntary appearance, a grand jury subpoena may then be issued if "the grand jury and the United States Attorney agree to insist on the appearance."[569]

The DOJ cannot rely on its grand jury subpoena power to compel testimony from foreign witnesses.[570] And, to compel a witness to appear using subpoena powers, a court must establish personal jurisdiction over a witness. To establish personal jurisdiction, a court must find that the witness has "certain minimum contacts with [the forum state] such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice."[571]

(c) DOJ Cooperation with CFTC

A trend in recent years has been the increasing cooperation between the CFTC and the DOJ in investigations. For example, according to the CFTC, approximately 95% of the major fraud cases it filed in 2014 included a parallel criminal proceeding. During that period, judgments were entered in 12 of these federal criminal proceedings, resulting in prison sentences against 17 persons and restitution totaling $793 million. Previously, in fiscal year 2012, the CFTC worked actively with federal and state criminal and civil law enforcement authorities, including by assisting them in more than 200 investigations and prosecutions, 50 of which were related to separate actions commenced by the CFTC. Parallel proceedings for commodities fraud will likely continue to increase given the April 2014 establishment of a Securities and Commodities Fraud Section in the U.S. Attorney's Office for the Northern District of Illinois. Illinois is home to more than two-thirds of all U.S. futures market registrants.[572]

CFTC-DOJ cooperation is also facilitated by a number of task forces. In the wake of the Enron collapse, an Enron Task Force was created in January 2002. This Task Force led the federal government's investigation of Enron and included the CFTC. In July 2002, the Corporate Fraud Task Force was created. Led by the Deputy Attorney General, the Corporate Fraud Task Force included, among other agencies, the CFTC and the SEC. Currently, the CFTC is part of the Financial Fraud Enforcement Task Force. The Task Force includes a Securities and Commodities Fraud Working Group, which is co-chaired by the U.S. Attorney for the Southern District of New

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567 U.S. Attorney's Manual, *supra* note 427, at § 9-11.150.

568 *Id*. at § 9-11.151.

569 *Id*. at § 9-11.154.

570 *See United States v. Johnpoll*, 739 F.2d 702, 709 (2d Cir. 1984) (witness' presence in Switzerland precluded service of process); *United States v. Germann*, 370 F.2d 1019, 1022-23 (2d Cir. 1967) (grand jury cannot compel a foreign person over whom the court has no jurisdiction), *vacated on pet'rs death*, 389 U.S. 329 (1967).

571 *Int'l Shoe Co. v Washington*, 326 U.S. 310, 316 (1945).

572 U.S. Commodity Futures Trading Comm'n, *Futures Industry Registrants by Location* (2010), http://www.cftc.gov/ucm/groups/public/@educationcenter/documents/file/registrantsbylocation.pdf.

York, the Assistant Attorney General for the Criminal Division, the Director of Enforcement for the SEC, and the Director of Enforcement for the CFTC.

As discussed above at § II(F)(3), on November 8, 2017, Deputy Attorney General Rod Rosenstein announced that the DOJ is planning to improve coordination with foreign and domestic law enforcement agencies to lessen the amount of "piling on" that can result from multiple settlements in parallel enforcement actions and multi-department investigations for same or similar behavior.[573]

However, the CFTC's willingness to cooperate with other enforcement authorities is not absolute. Notably, the CFTC has taken actions to protect its exclusive jurisdiction to regulate transactions involving or conducted on regulated markets, such as the NYMEX.[574]

F. DOJ Charging Decisions

1. General Principles for Charging

Although civil regulators such as the CFTC, FERC, and the FTC do not themselves bring criminal charges against entities or individuals, they can refer criminal violations of U.S. law to the DOJ for prosecution. Charging for the offenses described in this chapter are often provided by grand jury indictment.[575]

Charging decisions are made pursuant to prosecutorial discretion. In a January 2012 memorandum, the DOJ provided that "[t]here may be matters that come to the attention of the Department's civil attorneys or attorneys of other agencies in the first instance that would be appropriate for the Department's prosecutors to investigate and pursue to ensure culpable individuals and entities are held criminally accountable. Early and effective communication and coordination will help avoid many problems and enhance the overall result for the United States."[576]

On May 9, 2018, Deputy Attorney General Rod Rosenstein announced a new non-binding DOJ policy regarding "Piling On" – the simultaneous imposition of multiple penalties for the same underlying misconduct by different regulatory or criminal authorities. Rosenstein explained, "our new policy discourages 'piling on' by instructing Department components to appropriately

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[573] Rod Rosenstein, Deputy Attorney General, *Remarks to the Clearing House's 2017 Annual Conference* (8 Nov 2017), https://www.justice.gov/opa/speech/deputy-attorney-general-rosenstein-delivers-remarks-clearing-house-s-2017-annual.

[574] *See Hunter v. Fed. Energy Reg. Comm'n*, 711 F.3d 155 (D.C. Cir. 2013).

[575] An indictment may be obtained when a prosecutor presents evidence to a federal grand jury that, according to the government, indicates that a person or entity committed a crime. If the grand jury agrees, it issues an indictment. An information can be filed in place of an indictment when a defendant waives indictment by a grand jury.

[576] *See* U.S. Dep't of Justice, *Coordination of Parallel Criminal, Civil, Regulatory, and Administrative Proceedings* (2012) (hereinafter Parallel Proceedings), https://www.justice.gov/usam/organization-and-functions-manual-27-parallel-proceedings.

coordinate with one another and with other enforcement agencies in imposing multiple penalties on a company in relation to investigations of the same misconduct.[577] He further noted:[578]

> In highly regulated industries, a company may be accountable to multiple regulatory bodies. That creates a risk of repeated punishments that may exceed what is necessary to rectify the harm and deter future violations.
>
> Sometimes government authorities coordinate well. They are force multipliers in their respective efforts to punish and deter fraud. They achieve efficiencies and limit unnecessary regulatory burdens.
>
> Other times, joint or parallel investigations by multiple agencies sound less like singing in harmony, and more like competing attempts to sing a solo.

Of particular importance for multi-national corporations is the directive that DOJ attorneys should "coordinate with other federal, state, local, and foreign enforcement authorities seeking to resolve a case with a company for the same misconduct."[579] The DOJ will consider a number of factors when applying the policy, including the "egregiousness of the wrongdoing; statutory mandates regarding penalties; the risk of delay in finalizing a resolution; and the adequacy and timeliness of a company's disclosures and cooperation with the Department."[580] While the actual impact of the new policy has yet to be seen, members of the defense bar have already voiced their skepticism over whether the policy will result in a notable reduction in DOJ penalties. Where the policy may have the most significant impact is in cases where foreign entities are subject to enforcement actions in their home or other non-U.S. jurisdictions.

2. Declination, Non-Prosecution Agreement, and Deferred Prosecution Agreement

Potential resolutions are numerous and can range from a decision not to charge a corporation or individual (a Declination) to a guilty plea to felony charges. Declinations can be coupled with disgorgement of profits. In these situations, companies can voluntarily self-disclose misconduct, cooperate with DOJ, remediate any related compliance issues and fully disgorge ill-gotten profits. In contrast with a Non-Prosecution Agreement or Deferred-Prosecution Agreement, under a Declination, the company does not have corresponding obligations and undertakings that carry forward in time. In a Non-Prosecution Agreement ("NPA"), in exchange for cooperation, DOJ will agree not to prosecute the corporation. In a Deferred-Prosecution Agreement ("DPA"), criminal charges are filed along with an agreement to dismiss the charges within a specific time period if the defendant fulfills the DPA requirements. This simultaneous filing of charges and settlement of the matter is a unique hallmark of DPAs. Notably, DOJ generally requires an admission of wrongdoing to resolve an investigation of a corporation. Although trial is rare,

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[577] Rosenstein, *supra* n. 426.

[578] *Id*.

[579] *Id*.

[580] *Id*.

companies and individuals can refuse to cooperate with a DOJ investigation and instead try to contest the charges on the merits.

3. Principles for Charging Companies

Under its Principles of Federal Prosecution of Business Organizations, the DOJ will assess whether criminal charges should be brought against an entity after considering nine factors, which include, for example, the nature and seriousness of the offense, the corporation's willingness to cooperate in the investigation, the pervasiveness of wrongdoing within the corporation, and the collateral consequences arising from a prosecution.[581] Cooperation is particularly emphasized. The factors can serve either to aggravate or mitigate the underlying offense and will guide the DOJ in formulating its position on a fine amount and the form of a resolution.

4. Focus on Individual Charges

As discussed above, "any company seeking cooperation credit in criminal cases must identify every individual who was substantially involved in or responsible for the criminal conduct."[582] Pursuant to this policy, companies must "identify all wrongdoing by senior officials" to earn any cooperation credit in a civil case, with maximum credit available after the company "identif[ies] every individual person who was substantially involved in or responsible for the misconduct."[583]

(a) Arrests

Recently publicized arrests of unsuspecting non-U.S. citizens for fraud, market manipulation, and corruption-related offenses allegedly committed outside the United States have reignited interest in the extraterritorial reach of U.S. criminal statutes, as well as the procedures for secret charging instruments and surprise arrests at borders or overseas. These cases cover a wide range of sectors including allegations of "front-running" by FX traders, interest rate manipulation by derivatives traders, and corruption at FIFA, the governing body of international soccer.

After a criminal case has been filed, it is normal practice to arrest any individuals who have been charged. U.S. authorities' power to arrest is generally limited by their territorial jurisdiction; however, the U.S. has bilateral extradition treaties in place with more than 100 countries – roughly two-thirds of the world's nations.[584] Indictments and criminal complaints are usually filed under seal when the defendant is outside of the United States. Indictments may remain sealed indefinitely and are often kept sealed until the defendant is apprehended. The filing of a sealed indictment will

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581 U.S. Attorney's Manual, *supra* note 427, at § 9-28.300; Mark Filip, U.S. Dep't of Justice, Principles of Federal Prosecution of Business Organizations (2008), https://www.justice.gov/sites/default/files/dag/legacy/2008/11/03/dag-memo-08282008.pdf.

582 Rosenstein, *supra* note 557. The Justice Manual has been updated to reflect these priorities at §§ 9-28.210, 9-28.300, 9-28.700. U.S. Dep't of Justice, Justice Manual §§ 9-28.210, 9-28.300, 9-28.70 (2018), https://www.justice.gov/jm/jm-9-28000-principles-federal-prosecution-business-organizations?utm_medium=email&utm_source=govdelivery#9-28.700.

583 *Id.*

584 18 U.S.C. § 3181 note (listing countries with which the U.S. has an extradition treaty).

pause, or "toll," the expiration of the statute of limitations, which ordinarily prohibits the prosecution of crimes after a certain period of time (usually five years).[585] The government may also toll the statute of limitations by making a request for information from another nation pursuant to a Mutual Legal Assistance Treaty ("MLAT"), which has become more common in the context of cross-border investigations.[586]

Although some countries will not extradite their own nationals, in the event that the U.S. does not have an extradition treaty with a particular country, or the treaty does not allow for extradition in a particular case, American authorities may seek an Interpol "red notice," which typically serves to trigger an alert at border crossings when an individual who is subject to a sealed arrest warrant travels internationally.[587] U.S. authorities may also wait until a suspect travels to or transits through the United States, and then execute the arrest warrant when he or she arrives at the border.

The DOJ is often able to establish jurisdiction despite the fact that the conduct at issue occurred largely, if not entirely, overseas. For example, the broad wire fraud statute criminalizes any scheme to defraud that affects interstate or foreign commerce, and may be prosecuted in the United States whenever an electronic communication, such as a telephone call or email, in furtherance of the alleged scheme travels through the United States.[588] In July 2016, Mark Johnson, a citizen of the United Kingdom and the global head of FX trading at HSBC, was arrested at New York's John F. Kennedy airport while attempting to board a flight to London. Following his arrest, the DOJ unsealed a criminal complaint that had previously been filed in secret against Johnson and one of his colleagues in the U.K., Stuart Scott. The complaint alleged that the defendants conspired to defraud an HSBC client using a scheme commonly known as "front running."[589] While most of the trading activity occurred in London, related trading activity and wires used to settle accounts were routed through New York.[590]

In some instances, arrests have followed large-scale public resolutions of criminal investigations by the institutions that employed the individuals who were secretly charged. In October 2015, Paul Thompson, an Australian citizen and former Singapore-based derivatives trader at Rabobank, was arrested in Australia pursuant to an extradition request from the United States. Before he was arrested abroad, Thompson was charged in the U.S. with conspiracy to commit wire fraud and bank fraud, an offense that arose from the global LIBOR manipulation scandal.[591] Notably, in October 2013, two years before Thompson was arrested, Rabobank resolved its own LIBOR

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585 *See, e.g.*, *United States v. Wright*, 343 F.3d 849, 857 (6th Cir. 2003); *United States v. Srulowitz*, 819 F.2d 37, 40 (2d Cir. 1987); *United States v. Bracy*, 67 F.3d 1421, 1426 (9th Cir. 1995); *United States v. Thompson*, 287 F.3d 1244, 1251–52 (10th Cir. 2002).

586 18 U.S.C. § 3292(a).

587 *See* INTERPOL, *Red Notices*, https://www.interpol.int/INTERPOL-expertise/Notices/Red-Notices.

588 18 U.S.C. § 1343.

589 Complaint and Affidavit in Support of Application for Arrest Warrants, *United States v. Johnson*, No. 16M0674 (E.D.N.Y. filed July 19, 2016).

590 *Id.*

591 *United States v. Allen*, No. 1:14-cr-00272 (S.D.N.Y. filed Oct. 16, 2014) (Indictment).

liability by entering into a deferred prosecution agreement with the DOJ and paying a $325 million penalty.[592]

While criminal investigations in the U.S generally are conducted in secret, prosecutors may disclose, when asked, if a particular individual is a "subject" or "target" of an ongoing investigation. Prosecutors do this, among other reasons, to encourage cooperation by individuals under investigation – particularly when those individuals are located outside the subpoena power of the prosecutor.

5. Constitutional Challenges Based on Compelled Testimony

Under the U.S. Constitution, the DOJ may be subject to a constitutional challenge if an individual claims that his or her indictment was based on compelled testimony. [593] In September 2017, Matthew Connolly and Gavin Black – two former Deutsche Bank traders who were accused of manipulating the London Interbank Offered Rate ("LIBOR") to benefit their own trading positions – requested a New York federal district judge to grant a *Kastigar* hearing during which the DOJ would have to show that its case was not shaped by testimony Black was compelled to give to the U.K.'s Financial Conduct Authority ("FCA").[594] Based on a recent precedent in which the Second Circuit held that statements by individuals compelled to speak to the FCA under threat of imprisonment cannot be used in U.S. prosecutions, Connolly and Black argued in their motion to dismiss that the government violated their Fifth Amendment rights by relying on Black's FCA testimony, citing the DOJ's failure to properly redact information regarding Black's testimony as one instance in which potential witnesses could have read his compelled statements.[595] Finding that a lawyer may have tainted the case, the judge granted Black's motion for a hearing, while denying Connolly's motion, because the government failed to provide sworn evidence that no member of the DOJ prosecution team was exposed to Black's FCA testimony.[596] The judge also ruled that the government must testify it did not use Black's FCA testimony to build the case against him, given that the FCA lawyer who conducted Black's compelled interview sat in during the DOJ's interview with a potential witness.[597] In March 2018, the judge denied Black's motion to dismiss, crediting the measures DOJ took from the start of its case to ensure that the prosecution team would not be exposed to Mr. Black's compelled testimony.[598] Connolly and Black were subsequently convicted in October 2018.

G. Recent DOJ Derivative and Commodity Market Prosecutions

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592 *United States v. Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.* ("Rabobank"), No. 3:13-cr-00200 (D. Conn. filed Oct. 29, 2013) (Deferred Prosecution Agreement).

593 RJ Vogt, *Deutsche Bank Trader Scores Hearing On DOJ Case Taint*, Law360 (Oct. 20, 2017), https://www.law360.com/whitecollar/articles/976787/deutsche-bank-trader-scores-hearing-on-doj-case-taint.

594 *Id.*

595 *Id.*

596 *Id.*

597 *Id.*

598 Christopher Crosby, *DOJ Won't Interview Ex-UK Official For Libor Trial*, LAW360 (May 30, 2018), https://www.law360.com/articles/1048314.

United States v. Sindzingre, No. 17-cr-464 (E.D.N.Y. filed Aug. 24, 2017)

On August 24, 2017, two French bankers—Danielle Sindzingre and Muriel Bescond—were indicted for participating in a scheme to transmit false and misleading information related to LIBOR. As the Global Head of Treasury and the Head Treasury Paris at French financial institution Société Générale, S.A., Sindzingre and Bescond, respectively, allegedly caused Société Générale to submit falsified USD LIBOR rates, which in turn affected financial transactions across markets worldwide. They were charged with one count of conspiring to transmit false reports concerning market information that tends to affect a commodity and four counts of transmitting such false reports.

According to the indictment, between May 2010 and October 2011, Sindzingre and Bescond allegedly instructed their subordinates at Société Générale's Paris treasury desk to submit inaccurately low LIBOR contributions to create the appearance that Société Générale was able to borrow money at more favorable rates, while knowing that the true rates were higher. The DOJ alleged that the false information submitted on numerous occasions altered the days' final USD LIBOR calculation and thus affected all financial transactions tied to USD LIBOR on those days, including Eurodollar futures which are a commodity that was traded on the Chicago Mercantile Exchange. The DOJ estimated that Sindzingre and Bescond's misconduct caused over $170 million in harm to the global financial markets. The case is still pending.

United States v. DB Group Services UK Limited, No. 15-CR-62 (D. Conn. filed Apr. 23, 2015); *United States v. Deutsche Bank AG*, No. 15-CR-61 (D. Conn. filed Apr. 23, 2015) *United States v. Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.*, No. 13-CR-200 (D. Conn. filed Oct. 29, 2013); *United States v. Read*, No. 13-MAG-2224 (S.D.N.Y. filed Sept. 13, 2013); *United States v. The Royal Bank of Scotland Group plc*, No. 13-CR-74 (D. Conn. filed Feb. 6, 2013); *United States v. RBS Securities Japan*, No. 13-CR-073 (D. Conn. filed Feb. 5, 2013); *United States v. UBS Securities Japan Co., Ltd.*, No. 12-CR-268 (D. Conn. filed Dec. 19, 2012); *United States v. Hayes*, No. 12-MAG-3229 (S.D.N.Y. filed Dec. 12, 2012)

The CFTC's benchmark interest rate investigations launched DOJ investigations resulting in criminal convictions for wire fraud,18 U.S.C. § 1343, for subsidiaries of The Royal Bank of Scotland PLC ("RBS"), Deutsche Bank AG, and UBS AG. The DOJ also filed charges against two former UBS traders and three former ICAP brokers for conspiracy,18 U.S.C. § 1349, wire fraud, 18 U.S.C. § 1343, and price fixing arising from conduct related to the manipulation of Japanese yen ("JPY") LIBOR. The DOJ has entered into deferred prosecution agreements with RBS, Rabobank, and Deutsche Bank.

United States v. Yunchun ("Bruce") Mao, No. 18-cr-00606 (S.D. Texas, filed October 10, 2018).

In October 2018, Yunchun Mao, a citizen of the People's Republic of China, was charged with conspiracy to commit securities fraud, two counts of securities fraud and two counts of spoofing for allegedly engaging in an over $60 million commodities fraud and spoofing conspiracy. According to the indictment, from in or around March 2012 through in or around March 2014, Mao and others conspired to mislead the markets for E-Mini S&P 500 and E-Mini NASDAQ 100 CME futures contracts, and E-Mini Dow CBOT futures contracts. Mao and his co-conspirators allegedly engaged in this conduct by placing thousands of orders that they did not intend to execute

in order to create the false and misleading appearance of increased supply or demand. Market participants that traded futures contracts in these three markets while the spoof orders distorted market prices were alleged to have incurred market losses of over $60 million.

At the same time as Mao was indicted, two of his alleged co-conspirators -- Kamaldeep Gandhi and Krishna Mohan – both pled guilty to criminal informations charging them with participating in the conduct.

Separately, in August 2018, Mao settled charges with the CBOT alleging that Mao engaged in disruptive trading activity in E-mini Dow Futures market by entering orders without the intent to trade. As part of his settlement with the CBOT, Mao agreed to pay a penalty of $125,000 and to a two year suspension from trading on CME owned or controlled trading and clearing platforms.

United States v. James Vorley & Cedric Chanu, No. 18-cr-00035 (N.D. Ill. filed July 24, 2018).

In July 2018, two former Deutsche Bank AG traders, James Vorley, a citizen of the United Kingdom, and Cedric Chanu, a citizen of France and the United Arab Emirates, were each charged in the Northern District of Illinois with one count of conspiracy to commit wire fraud affecting a financial institution and one count of wire fraud affecting a financial institution.

According to the indictment, Vorley and Chanu – who were both based outside of the United States – engaged in a long-running conspiracy to defraud other traders on a CME Group market by placing fraudulent orders that they did not intend to execute in order to create the appearance of false supply and demand and to induce other traders to trade at prices, quantities and times that they otherwise would not have traded. The indictment further alleged that Vorley, Chanu and others placed such fraudulent and manipulative orders by themselves and in coordination with other traders at Deutsche Bank AG, including each other.

United States v. Harris Landgarten, No. 18-cr-00328 (E.D.N.Y. filed June 28, 2018).

In June 2018, Harris Landgarten was charged with commodities fraud andwire fraud in violation of 18 U.S.C. § 1348and attempt to obstruct an official proceeding in violation of 18 U.S.C. § 1512(c)(2) in connection with an alleged commodity pool fraud. According to the indictment, between July 2014 and March 2017, Landgarten managed a $150,000 fund. Landgarten allegedly used fund assets for personal expenses, such as cell phone and cable payments and allegedly hid this misappropriation by sending investors false balance statements. After the CFTC began investigating Landgarten, he allegedly pressured a defrauded investor to submit a false statement to the CFTC and to withdraw the complaint the investor filed with the agency. Landgarten conditioned the return of what remained of the investor's money upon the investor's withdrawal of his complaint.

United States v. Mark Johnson & Stuart Scott, No 16-cr-00457 (E.D.N.Y. filed July 19, 2016).

In July 2016, Mark Johnson, a citizen of the United Kingdom and the global head of FX trading at HSBC, was arrested at the John F. Kennedy airport in New York while attempting to board a flight to London. Following his arrest, the DOJ unsealed a criminal complaint that had previously been filed in secret against Johnson and one of his colleagues in the U.K., Stuart Scott, charging them with wire fraud, attempted wire fraud, and conspiracy to commit wire fraud.

According to the complaint, in November and December 2011, Mark Johnson and Stuart Scott, who were employed by HSBC at the time, misused information provided to them by a client that hired HSBC to execute a foreign exchange transaction related to a planned sale of one of the client's foreign subsidiaries, which was going to require converting approximately $3.5 billion in sales proceeds into British Pound Sterling. Johnson and Scott allegedly misused confidential information they received about the client's transaction by purchasing Pound Sterling for HSBC's "proprietary" accounts, which they held until the client's planned transaction was executed. The complaint further alleged that both Johnson and Scott made misrepresentations to the client about the planned foreign exchange transaction that concealed the self-serving nature of their actions. Specifically, the complaint alleged that Johnson and Scott caused the $3.5 billion foreign exchange transaction to be executed in a manner that was designed to spike the price of the Pound Sterling for the benefit of HSBC and at the expense of their client. In total, HSBC allegedly generated profits of roughly $8 million from its conduct.

After a month-long trial, Johnson was convicted in October 2017 on nine of ten fraud and conspiracy counts. Scott is still contesting extradition and in August 2018, an intermediate appeals court in England ruled that Scott should not be extradited to the United States because "most of the harm took place" in the UK and extradition was not in the interests of justice."

United States v. The Royal Bank of Scotland plc, No. 15-cr-00080 (D. Conn. filed May 20, 2015); *United States v. Barclays PLC,* No. 15-cr-00077 (D. Conn. filed May 20, 2015); *United States v. JP Morgan Chase & Co*, No. 15-cr-00079 (D. Conn. filed May 19, 2015); *United States v. Citicorp*, No. 15-cr-00078 (D. Conn. filed May 19, 2015).

In May 2015, Citicorp, JPMorgan Chase & Co., Barclays PLC, and The Royal Bank of Scotland PLC ("RBS") agreed to plead guilty to conspiring to manipulate the price of U.S. dollars and euros exchanged in the FX spot market and to pay criminal fines totaling more than $2.5 billion in violation of the Sherman Act, 15 U.S.C. § l. According to the plea agreements, between December 2007 and January 2013, traders at Citicorp, JPMorgan, Barclays and RBS —self-described members of "The Cartel"—used an electronic chat room and coded language to manipulate benchmark exchange rates. Traders coordinated their trading of U.S. dollars and euros to manipulate the benchmark rates set at the 1:15 p.m. and 4:00 p.m. fixes in an effort to increase their profits. The traders used their exclusive electronic chats to manipulate the euro-dollar exchange rate in other ways, including agreeing to withhold bids or offers for euros or dollars to avoid moving the exchange rate in a direction adverse to open positions held by co- conspirators. Citicorp, Barclays, JPMorgan, and RBS each agreed to plead guilty to one-count felony charge of conspiring to fix prices and rig bids for U.S. dollars and euros exchanged in the FX spot market in the United States and elsewhere.

United States v. UBS AG, No. 15-CR-00076 (D. Conn. filed May 20, 2015).

In May 2015, UBS pled guilty to a one-count felony charge of wire fraud in connection with a scheme to manipulate LIBOR and other benchmark interest rates. UBS's guilty plea came after the DOJ determined that UBS's deceptive currency trading and sales practices in conducting certain FX market transactions, as well as its collusive conduct in certain FX markets, violated its December 2012 non-prosecution agreement resolving the LIBOR investigation. UBS agreed to pay a criminal penalty of $203 million.

United States v. Deutsche Bank AG, 15-CR-61 (D. Conn. filed on April 23, 2015).

As part of its settlement of the DOJ and CFTC's investigation into LIBOR and EURIBOR manipulation, Deutsche Bank was charged with one count of wire fraud and one count of price fixing in violation of the Sherman Act, pursuant to a deferred prosecution agreement with the DOJ. The DOJ alleged that Deutsche Bank violated the Sherman Act due to its participation in a scheme by Deutsche Bank traders to coordinate their EURIBOR requests with traders at other banks to benefit their trading positions from at least June 2005 through October 2008.

United States v. Sarao, No. 15-CR-75 (N.D. Ill. unsealed Apr. 21, 2015).

In February 2015, the DOJ filed under seal a criminal complaint charging Navinder Singh Sarao with a four-count indictment charging wire fraud, commodities fraud, commodity price manipulation, and spoofing for allegedly attempting to manipulate the price of the E-mini S&P for over five years through a variety of spoofing tactics At the request of the DOJ, Sarao was arrested by English officials in London on April 2015 and extradited to the United States in October 2016. In November 2016, Sarao pled guilty to one count of spoofing and one count of wire fraud in a related criminal action.

United States v. The Royal Bank of Scotland plc, No. 15-CR-00080 (D. Conn. filed May 20, 2015); *United States v. Barclays PLC,* No. 15-CR-00077 (D. Conn. filed May 20, 2015); *United States v. JP Morgan Chase & Co*, No. 15-CR-00079 (D. Conn. filed May 19, 2015); *United States v. Citicorp*, No. 15-CR-00078 (D. Conn. filed May 19, 2015)

In May 2015, Citicorp, JPMorgan Chase & Co., Barclays PLC, and The Royal Bank of Scotland PLC ("RBS") agreed to plead guilty to conspiring to manipulate the price of U.S. dollars and euros exchanged in the FX spot market and to pay criminal fines totaling more than $2.5 billion in violation of the Sherman Act,15 U.S.C. § 1 . According to plea agreements between December 2007 and January 2013, traders at Citicorp, JPMorgan, Barclays, and RBS—self-described members of "The Cartel"—used an electronic chat room and coded language to manipulate benchmark exchange rates. According to the plea agreements, traders coordinated their trading of U.S. dollars and euros to manipulate the benchmark rates set at the 1:15 p.m. and 4:00 p.m. fixes in an effort to increase their profits. The plea agreement also alleged that traders used their exclusive electronic chats to manipulate the euro-dollar exchange rate in other ways, including agreeing to withhold bids or offers for euros or dollars to avoid moving the exchange rate in a direction adverse to open positions held by co-conspirators. Citicorp, Barclays, JPMorgan, and RBS each agreed to plead guilty to a one-count felony charge of conspiring to fix prices and rig bids for U.S. dollars and euros exchanged in the FX spot market in the United States and elsewhere

United States v. Coscia, No. 14-0551 (N.D. Ill. filed Oct. 1, 2014).

In October 2014, a grand jury in Chicago indicted a high-frequency trader, Coscia, for allegedly manipulating commodities futures prices, charging six counts of commodities fraud and six counts of "spoofing" under the CEA). The indictment marks the first federal prosecution under the new statutory offenses for disruptive trading practices created under the DFA. On November 3, 2015, a jury convicted Coscia on six counts of spoofing and six counts of commodities fraud. In July

2016, Coscia, who had argued that probation was an appropriate sentence, was sentenced to three years in federal prison for his conduct.

United States v. Paul Robson, *et al.*, No. 14-CR-00272 (S.D.N.Y. filed April 28, 2014).

The DOJ brought charges of wire fraud and bank fraud against seven former Rabobank traders in relation to a scheme to manipulate and attempt to manipulate LIBOR. The DOJ alleged that Anthony Allen, the manager of Rabobank's money market desk in London, put a system in place where traders of derivative products linked to LIBOR regularly communicated their positions to Rabobank's submitter, who made contributions consistent with the traders' or the bank's financial interest. Prior to the filing of a superseding indictment in October 2014, two of the traders pled guilty. A third trader pled guilty in March 2015. Two of the traders were then found guilty after a jury trial in November 2015. On July 7, 2016, a sixth trader pled guilty. Charges against one of the defendants, Tetsuya Motomura, are still pending.

United States v. Martin-Artajo, No. 13-CR-707 (S.D.N.Y. filed Aug. 14, 2013).

In August 2013, a grand jury indicted two former JPMorgan traders in relation to JPMorgan's "London Whale" trading losses. Defendant Martin-Artajo supervised Bruno Iksil, the former trader known as the London Whale, while defendant Grout worked for Iksil. The government alleges that the defendants artificially inflated the value of securities "to hide the true extent of significant losses" in a credit derivatives trading portfolio. The traders were charged with five criminal counts for securities fraud, wire fraud, conspiracy, making false SEC filings and falsifying books and records. The United States attempted to extradite Defendant Martin-Artajo from Europe, but a Spanish court rejected the U.S. request. Prosecutors decided to drop the charges in 2017 after they determined that Iksil's testimony was not reliable.

United States v. Taylor, No. 13-CR-00251 (S.D.N.Y. filed Apr. 4, 2013).

In April 2013, Matthew Taylor, a former proprietary trader at Goldman Sachs, pled guilty to one count of wire fraud in connection with entering into an unauthorized position in electronic futures contracts and attempting to conceal it. The DOJ alleged that, in December 2007, Taylor accumulated an $8.3 billion long position in electronic futures contracts tied to the Standard & Poor's 500 Stock Index, exceeding Goldman risk limits. In order to conceal his position, Taylor then made false trade entries in a manual trade entry system that appeared to take the opposite side of his bet. Taylor was sentenced in December 2013 to nine months' imprisonment, three years of supervised release, and 400 hours of community service.

United States v. Wasendorf, No. 12-CR-2021 (N.D. Iowa filed Oct. 9, 2012).

In September 2012, Russell Wasendorf, Sr., the chief executive of the now-defunct brokerage firm Peregrine Financial Group ("PFG"), pled guilty to one count of mail fraud, one count of embezzlement under the CEA, one count of making false statements to the CFTC, and one count of making false statements to a futures association. The DOJ alleged that, beginning in the early 1990s and continuing through 2012, Wasendorf routinely stole PFG customer funds and created false bank statements and other documents to conceal the embezzlement. Wasendorf also submitted false reports to the CFTC and the National Futures Association overstating the value of PFG's customer segregated funds. Wasendorf was sentenced to 50 years in prison. In a parallel

civil suit initiated by the CFTC against Wasendorf and PFG, the court, referencing Wasendorf's plea agreement, found that the defendants committed fraud by misappropriating customer funds, violated customer fund segregation laws, and made false statements in financial statements filed with the CFTC.

United States v. Brooks et al., 681 F.3d 678 (5th Cir. 2012); *United States v. Phillips*, 2010 WL 1544297 (S.D. Tex. Apr. 19, 2010).

Three former employees of El Paso Merchant Energy Corporation (James Patrick Phillips, Wesley C. Walton, and James Brooks) were convicted of conspiracy, false reporting, and wire fraud in connection with a conspiracy to report false information related to natural gas prices to *Inside FERC* and *NGI* to manipulate the index prices reported in those magazines. Following their conviction, the defendants were sentenced to between 11 years 3 months and 14 years in prison. In May 2012, the Fifth Circuit Court of Appeals affirmed the conviction and the sentences.

United States v. Dooley, No. 10-CR-0335 (N.D. Ill. 2010).

In December 2012, Evan Dooley, a former authorized person of MF Global, pled guilty to two counts of exceeding CFTC speculative position limits in connection with his trading of wheat futures in February 2008. Dooley admitted as part of the plea agreement that on February 27, 2008, he exceeded the one-month speculative and all-months speculative position limits for wheat futures. Dooley was originally charged with 16 counts of wire fraud and 2 counts of exceeding position limits in connection with his trading at MF Global, which caused a $141 million loss for the company. Dooley was sentenced to 5 years in prison.

United States v. BP America Inc., No. 07-CR-00683 (N.D. Ill. filed Oct. 25, 2007).

In October 2007, BP America and certain affiliates entered into a three-year Deferred Prosecution Agreement with the DOJ, which charged BP in a Criminal Information with wire fraud and manipulating and attempting to manipulate the price of February 2004 TET Propane in violation of the CEA. BP America admitted the facts supporting the Information and agreed: (i) to pay a total of approximately $173 million in fines, restitution, and contributions to the United States Postal Inspection Service Consumer Fraud Fund; and (ii) to the appointment of a monitor.

United States v. Radley, 659 F. Supp. 2d 803 (S.D. Tex. 2009), *aff'd*, 632 F.3d 177 (5th Cir. 2011).

In a criminal case against four former BP traders, the DOJ alleged that the defendants committed a criminal manipulation offense under CEA§ 13(a)(2) by conditioning BP's participation in a trade on the counterparty's agreement not to report it. The court rejected the government's argument that the traders' attempt to conceal "the truth about their purchasing of TET propane" could support the finding of an artificial price. The court found that, "[e]ven though the government allege[d] specific instances of defendants attempting to conceal their actions, it never allege[d] that defendants lied about their activity. Mere concealment is not sufficient to show that their actions were not legitimate forces of supply and demand."

IV. U.S. FEDERAL ENERGY REGULATORY COMMISSION JURISDICTION AND MARKET ENFORCEMENT REGIME

A. Introduction

October 1, 2017 marked the 40th anniversary of the establishment of FERC. However, FERC enforcement is a much more recent phenomenon, as FERC only received enforcement authority in the aftermath of the 2000–2001 California electricity crisis, when shortages of energy in California caused by market manipulation and shutdowns of energy pipelines caused significant increases in wholesale energy prices in California as well as a series of rolling blackouts.

FERC used its existing authority to respond to the crisis and brought a number of enforcement actions related to the crisis, but Congress deemed these efforts insufficient. As a result, the EPAct gave FERC significant anti-manipulation authority patterned on the Exchange Act.

Based on this grant of authority, FERC promulgated regulations under both the NGA and the FPA, which are designed to prohibit market abuse. FERC modeled its anti-manipulation authority on SEC Rule 10b-5 and at the time stated that these regulations should "be interpreted consistently with analogous SEC precedent."[599]

Under the NGA and FPA, FERC has jurisdiction over the interstate transmission of electric energy, electric energy sold at wholesale in interstate commerce, and interstate natural-gas pipeline transportation (collectively, "jurisdictional transactions").

B. Enforcement Figures

1. In fiscal year 2016, FERC obtained settlements totaling more than $12 million in civil penalties (approximately 2% of the value of CFTC penalties imposed the same year) and nearly $5 million in disgorgement (approximately 11% of the value of disgorgements obtained by the CFTC in the same year).

2. In fiscal year 2014, FERC obtained settlements of nearly $25 million in civil penalties (less than 2% of the value of CFTC penalties imposed the same year) and $4 million in disgorgement (less than 1% of the value of disgorgements obtained by the CFTC in the same year).[600]

3. In fiscal year 2013, FERC obtained settlements totaling more than $304 million in civil penalties (approximately 20% of the value of CFTC penalties imposed the same year)

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599 Prohibition of Energy Mkt. Manipulation, 114 FERC ¶ 61,047 at PP 2, 30 (Jan. 19, 2006) (Order No. 670).

600 *See* Fed. Energy Regulatory Comm'n, *FERC Issues Annual Enforcement Report* (Nov. 20, 2014); U.S. Commodity Futures Trading Comm'n, *CFTC Releases Annual Enforcement Results for Fiscal Year 2014* (Nov. 6, 2014).

and nearly $141 million in disgorgement (approximately 70% of the value of disgorgements obtained by the CFTC in the same year).[601]

4. In fiscal year 2012, FERC obtained settlements totaling more than $148 million in civil penalties (approximately 35% of the value of penalties imposed by the CFTC the same year) and more than $119 million in disgorgement (approximately 70% of the value of disgorgements obtained by the CFTC in the same year).[602]

5. In fiscal year 2011, FERC obtained settlements totaling more than $2.9 million in civil penalties (approximately 1% of the value of penalties imposed by the CFTC the same year) and more than $2.75 million in disgorgement (approximately 2% of the value of disgorgements obtained by the CFTC in the same year).[603]

C. NGA AND FPA Market Abuse Violations

1. NGA Market Abuse

Section 4A of the NGA makes it illegal for "any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance . . . in contravention of such rules and regulations as the Commission may prescribe."[604]

Under this statutory authority, FERC has promulgated regulations that prohibit "market transactions [that] send false signals to market participants with the intention of creating an artificial price."[605]

In order for FERC to prove market manipulation, it must show: (1) fraudulent or deceptive conduct; (2) with scienter; and (3) in connection with the purchase or sale of natural gas subject to FERC's jurisdiction.[606]

- Fraudulent or deceptive conduct may take the form of price manipulation—i.e., engaging in trades that are "not intended to be at the prevailing price and are not conducted for legitimate business reasons."[607]

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601 *See* Fed. Energy Regulatory Comm'n, *FERC Office of Enforcement Releases Fiscal 2013 Report* (Nov. 21, 2013); U.S. Commodity Futures Trading Comm'n, *CFTC Releases Enforcement Division's Annual Results* (Oct. 24, 2013).

602 *See* Fed. Energy Regulatory Comm'n, *FERC Reviews Fiscal 2012 Enforcement Activities* (Nov. 15, 2012); U.S. Commodity Futures Trading Comm'n, *CFTC Releases Enforcement Division's Annual Results* (Oct. 5. 2012).

603 *See* Fed. Energy Regulatory Comm'n, 2011 Report on Enforcement, Docket No. AD07-13-004 (Nov. 17, 2011); U.S. Commodity Futures Trading Comm'n, *CFTC Releases Annual Enforcement Results* (Oct. 6, 2011).

604 15 U.S.C. § 717c-1.

605 Prohibition of Natural Gas Market Manipulation, 18 C.F.R. § 1c.1 (2015).

606 *FERC v. Brian Hunter*, 130 FERC ¶ 63,004 at 35 ¶ 85 (2010).

607 *Id.* ¶ 83.

- Scienter may be proven by evidence that the conduct at issue was willful, deceitful, or reckless.[608]

- Jurisdictional natural-gas transactions are interstate transactions resulting in the physical delivery of natural gas.[609]

Example Case: *Federal Energy Regulatory Commission v. Brian Hunter*, 130 FERC ¶ 63,004 (2010) (Initial Decision), *reh'g denied*, 137 FERC ¶ 61,146 (2011)

FERC's Office of Enforcement charged Brian Hunter, an employee of Amaranth Advisors, with violating § 4A of the NGA and § 1c.c. of the regulations promulgated thereunder by engaging in "market transactions [that] send false signals to market participants with the intention of creating an artificial price." Specifically, the Office of Enforcement alleged that Hunter manipulated the price of natural gas by instructing traders working for him to sell futures contracts on NYMEX at the prevailing bid rate, rather than waiting for buyers to pay the higher offer price. FERC concluded that this practice "almost guarantees a lower price (again consistent with a manipulation scheme), and generally traded at prices below those of other markets." At the same time Hunter's traders were accepting these bids, Hunter held large opposite positions on other exchanges, which benefited from the lower prices achieved through the alleged manipulation. FERC found that this practice was consistent with manipulation of prices in the underlying market.

Hunter appealed to the D.C. Circuit, which concluded that FERC lacked jurisdiction to regulate the challenged transactions on a futures market that is within the exclusive jurisdiction of the CFTC. *See* discussion of limitations on FERC's authority, *infra*.

2. FPA Market Abuse

Under § 222 of the FPA, it is illegal for "any entity . . . directly or indirectly, to use or employ, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance . . . in contravention of such rules and regulations as the Commission may prescribe."[610]

Section 221 prohibits the "willful[ ] and knowing[ ] report [of] any information relating to the price of electricity sold at wholesale or the availability of transmission capacity, which information the person or any other entity knew to be false at the time of the reporting, to a Federal agency with intent to fraudulently affect the data being compiled by the Federal agency."[611]

FERC Rule 1c.2, which was promulgated under its § 824v authority, prohibits the use of "(1) . . . any device, scheme, or artifice to defraud, (2) . . . any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) . . . any act, practice, or course

608 *See id.* at 36-37 ¶ 85.

609 *See id.* at 75-75 ¶ 208.

610 16 U.S.C. § 824v.

611 16 U.S.C. § 824u.

of business that operates or would operate as a fraud or deceit upon any entity" in connection with the purchase or sale of energy."[612]

Example Case: *In re Barclays Bank PLC, Daniel Brin, Scott Connelly, and Karen Levine*, 161 FERC ¶ 61,147 (2017); 144 FERC ¶ 61,041 (2013)

In a long-running case against Barclays and four of its employees, FERC's Office of Enforcement alleged that Barclays and its employees violated 18 C.F.R. § 1c.2, which, like CFTC Rule 180.1, is patterned on SEC Rule 10b-5. According to FERC, between November 2006 and December 2008, Barclays engaged in manipulation by developing substantial monthly physical positions simultaneously with swap positions in the opposite direction and then buying or selling physical positions in order to "flatten" the daily index of physical trades.

According to the Office of Enforcement, Barclays benefited from this conduct because the swaps it held were tied to the same index, and Barclays "traded fixed price products not in an attempt to profit from the relationship between the market fundamentals of supply and demand, but instead for the fraudulent purpose of moving the Index price at a particular point so that Barclays' financial swap positions at that same trading point would benefit."[613]

Barclays argued that its conduct could not be manipulative because (1) its cash-market transactions were conducted at arm's length in a transparent market, and thus could not have defrauded any counterparty; (2) its cash-market transactions were profitable, and thus could not have been intentionally manipulative; and (3) the influence of cash-market prices on the swaps at issue was too uncertain to enable Barclays to determine *ex ante* that any attempt at manipulation would succeed.

FERC rejected this argument, noting that "[t]he difference between legitimate open-market transactions and illegal open-market transactions may be nothing more than a trader's manipulative purpose for executing such transactions." FERC found that the necessary scienter – recklessness – was established by several pieces of evidence, including e-mails and instant messages, evidence of suspicious trading patterns, and evidence of trading without a legitimate economic rationale. Notably, FERC rejected Barclays' argument that scienter could not be established unless the "sole" purpose behind the trading was manipulative and held that "[a] manipulative purpose, even if mixed with some non-manipulative purpose, satisfies the scienter requirement." FERC ordered $470 million in penalties and disgorgement against Barclays, along with monetary penalties against several individuals.[614]

In rejecting these contentions, FERC appeared to conclude that (1) its own mandate to ensure the fairness and reasonableness of prices in the markets under its jurisdiction eliminates the need to show that any particular person was defrauded, and (2) manipulation need not be the sole purpose of a challenged transaction.

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[612] 18 C.F.R. § 1c.2.

[613] Order Assessing Civil Penalties, 144 FERC ¶ 61,041 at 2 (Jul. 16, 2013), https://www.ferc.gov/eventcalendar/Files/20130716170107-IN08-8-000.pdf.

In July 2013, FERC ordered Barclays to pay $435 million in civil monetary penalties and levied a total of $18 million in civil monetary penalties against Barclays traders.

On November 7, 2017, FERC issued an Order Approving Stipulation and Consent Agreement against Barclays Bank PLC ("Barclays"), Daniel Brin, Scott Connelly, and Karen Levine (collectively "Defendants") to resolve (1) FERC's claims for violations of § 222 of the FPA and the Commission's Anti-Manipulation Rule, 18 C.F.R. § lc (2017), and (2) FERC's action in *FERC v. Barclays Bank PLC et al*., No. 2:13-CV-02093-TLN-DB (E.D. Cal.) (the "Federal Court Lawsuit"). Specifically, FERC alleged that Barclays traders manipulated electricity prices in Western U.S. markets by scheming to trade day-ahead fixed-price electricity to improve the bank's financial swap positions between November 2006 and December 2008. As part of the agreement, Barclays agreed to pay $105 million, which constitutes $70 million in penalty, $35 million in disgorgement, and $20 million in restitution to those claimed to have been harmed.

Example Case: *Deutsche Bank Energy Trading, LLC*, 142 FERC ¶ 61,056 (2013)

In this power case, FERC determined that Deutsche Bank violated FERC's anti-manipulation rule, 18 C.F.R. § 1c.2, by engaging in a scheme to enter into physical transactions to benefit its financial position by trading physical exports of Silver Peak intertie that were not profitable with the intent to benefit its Congestion Revenue Rights between January 29, 2010, and March 24, 2010. FERC concluded that Deutsche Bank's physical transactions were not consistent with market fundamentals and were instead undertaken to change the value of CRRs.

FERC also determined that Deutsche Bank violated FERC regulations by designating its Silver Peak intertie as wheeling-through transactions without meeting CAISO's tariff requirements for such transaction. According to FERC, these false designations violated FERC's regulation requiring the submission of accurate information to ISOs.[615]

As part of its settlement with FERC, Deutsche Bank admitted the facts set forth in the stipulation and consent agreement attached to the Order, but neither admitted nor denied the violation. Deutsche Bank agreed to pay $1.5 million in civil penalties and $172,645 in disgorgement and to implement enhanced compliance measures and procedures.

Example Case: *In re Houlihan Chen and Powhatan Energy Fund, LLC*, 149 FERC ¶ 61,261 (2014)

On May 29, 2015, FERC issued an Order Assessing Civil Penalties against Dr. Houlihan Chen, Powhatan Energy Fund, LLC, and its affiliates (collectively "Powhatan") for violating FERC's anti-manipulation rule. Specifically, FERC found Powhatan violated FERC's anti-manipulation rule, 18 C.F.R. § 1c.2, by engaging in a complex trading strategy of wash trades in the PJM "Up to Congestion" ("UTC") product. Powhatan's strategy was to place a significant number of "round-trip" trades that were essentially wash trades, which canceled out by placing the first leg of the trade from locations A to B, and simultaneously placing a second leg from locations B to A. While admitting to engaging in the conduct, Powhatan argued that this was a legitimate pattern of trades

[615] Market Behavior Rules, 18 C.F.R. § 35.41(b) (2012).

that was admittedly designed to exploit a PJM "loophole," but not in violation of any tariff provision or rule.

FERC determined that the round-trip trades were contrary to the market design purpose of the UTC product because the purpose of the UTC product was to promote market efficiency through the convergence between market prices, while Powhatan's strategy deprived the market of these benefits. FERC found that this conduct was fraudulent and done without regard to market fundamentals and that Powhatan's conduct constituted wash trades, which are *per se* fraudulent and manipulative.

The order suggests that following the tariff rules is insufficient to avoid FERC scrutiny. The order, also suggests that FERC will penalize both explicit violations of the Rules and violations that go against the spirit of the Rules, suggesting an almost principles-based approach to enforcement. This raises question over whether market participants have an obligation to report, ignore or otherwise not act upon market design flaws, and whether trading that is responsive to market signals and complies with tariff rules may be prohibited.

FPA § 31(d), FERC offered the Defendants two options for contesting Enforcement's findings. First, the Defendants could proceed by a hearing—facilitated by discovery—before an Administrative Law Judge ("ALJ") before an assessment of a penalty under § 31(d)(2). Second, the Defendants were told they could elect an immediate penalty assessment by FERC under § 31(d)(3)(A). As the District Court noted in its order, the Defendants were advised that if they chose the "immediate penalty assessment" route, and if the Commission assessed a penalty that Defendants failed to pay within 60 days, "the Commission will commence an action in a United States district court for an order affirming the penalty, in which the district court may review the assessment of the civil penalty de novo." The Defendants elected the immediate penalty assessment option, after which FERC sought the District Court's affirmance in an action filed in October 2013.

A Petition for an Order Affirming FERC's Order Assessing Civil Penalties has been filed by FERC in the U.S. District Court, Eastern District of Virginia, Richmond Division.[616] The case is still pending, and FERC did not issue any orders to show cause or orders assessing civil penalties for 2017.

<u>Example Case:</u> *FERC v. Coaltrain Energy, L.P.*, 2:16-cv-732 (S.D. Ohio)

In 2016, FERC brought charges against Coaltrain Energy and certain individual owners and employees alleging that the defendants traded "Up-To-Congestion" (UTC) financial products for the purpose of collecting out-of-market rebates rather than for the intended purpose of speculating on and arbitraging locational price differences in violation of FPA Section 222, 16 C.F.R. § 1c.2 and 16 C.F.R. § 35.41 (b) According to FERC, UTC instruments are designed to allow market participants to hedge their portfolio or speculate for profit on the difference between prices at two energy trading points— the "congestion" component of how electricity prices are determined at "nodal" trading points.

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[616] *FERC v. Powhatan Energy Fund, LLC*, 3:15-CV-00452-MHL (E.D. Va. filed Jul. 31, 2015).

FERC alleged that Coaltrain's trading in UTC financial products during the summer of 2010 was not intended to find price differences but rather to find locations where there were minimal or no price differences, because the true goal of the trading was not arbitrage (as FERC says it should have been) but rather to get rebates. According to FERC, trading UTC financial products in this way was a manipulative gaming of the PJM market rules, as market participants should only trade UTC financial products for their intended purpose rather than as a mechanism to collect rebates designed for other market participants engaged in legitimate trading.

In March 2018, the court denied Coaltrain's motion to dismiss finding that FERC had adequately alleged fraudulent trading because Coaltrain's UTC trading was alleged to be deceptive and deceptive trading could be fraudulent.

Example Case: *ETRACOM LLC and Michael Rosenberg*, 163 FERC ¶ 61,022 (April 10, 2018)

In April 2018, FERC approved a stipulation and consent settlement resolving allegations that ETRACOM and Michael Rosenberg (the "Respondents") violated Section 222 of the Federal Power Act (FPA) and FERC's rule 18 C.F.R. lc.2 against anti-manipulation in the California Independent System Operator Corp. ("CAISO") wholesale electric market The Respondents were alleged to have submitted virtual supply offers at the New Melones intertie in CAISO in order to affect power prices to benefit ETRACOM's CRRs – a financial product that settles off the difference in the day-ahead market – at that location. According to FERC's allegations, ETRACOM submitted and cleared uneconomic virtual supply offers with the intent to benefit its New Melones-sourced CRRs by creating import congestion and lowering the day-ahead price at New Melones. FERC claimed that ETRACOM's virtual supply transactions during the relevant time consistently lost money, but that ETRACOM's profits on its New Melones CRR positions more than doubled. According to FERC, ETRACOM's virtual trading activities lost $42,481, but enabled ETRACOM to earn an estimated $315,072 in unjust profits related to its CRR positions.

As part of the settlement, ETRACOM agreed to pay a $1.9 million penalty.

3. Civil Penalties

Through the EPAct, Congress enhanced FERC's authority to assess civil penalties for violations of the NGA and FPA.[617] EPAct expanded FERC's civil penalty authority to cover violations of any provision of Part II of the FPA, as well as of any rule or order issued thereunder, and violations of the NGA or any rule, regulation, restriction, condition, or order made or imposed by FERC under NGA authority. Regarding maximum civil penalty, FERC may assess $1,000,000 per violation for each day that it continues. Where possible, FERC will negotiate civil penalties as part of a Stipulation and Consent Agreement resolving compliance issues, imposing through a FERC order approving the negotiated agreement and obviating the need for an assessment process.

D. Challenges to FERC's Jurisdiction and Procedure

[617] Fed. Energy Regulatory Comm'n, Revised Policy Statement on Penalty Guidelines (2010), https://www.ferc.gov/whats-new/comm-meet/2010/091610/M-1.pdf; Fed. Energy Regulatory Comm'n, *Civil Penalties* (2015), https://www.ferc.gov/enforcement/civil-penalties.asp.

FERC has faced a number of significant challenges to both its jurisdiction and procedures in its short time as an enforcement agency. Its authority has been complicated by the need to provide advance notice to markets regarding its statutory and regulatory interpretations. In addition, its ability to charge violations can be and has been limited by conflicting and exclusive jurisdiction of other agencies, such as the CFTC. Lastly, FERC's attempt to limit full discovery in federal district court proceedings has been recently rejected.

Example Case: *Stoller v. Commodity Futures Trading Commission*, 834 F.2d 262 (2d Cir. 1987)

As noted above, in *Stoller v. Commodity Futures Trading Commission*, the complaint charged Stoller and others with engaging in wash sales in violation of CEA § 4c(a)(A). The Second Circuit Court of Appeals held that the CFTC may not charge a statutory or regulatory violation unless it has first notified the market that it interprets the activity at issue as constituting a violation.[618]

The rationale underlying the *Stoller* holding appears equally applicable to FERC's interpretations of newly issued statutory or regulatory requirements.[619]

Example Case: *Hunter v. Federal Energy Regulatory Commission*, 711 F.3d 155, 156 (D.C. Cir. 2013)

Following FERC's decision that Brian Hunter had engaged in market manipulation in violation of § 4A of the Natural Gas Act. Hunter appealed the decision to the D.C. Circuit. Hunter argued that FERC had exceeded its authority under the EPAct by fining him for manipulating prices in the natural-gas futures market because the CFTC has exclusive jurisdiction over transactions involving commodity futures contracts. The CFTC intervened in the appeal in support of Hunter.

After examining the statutory bases for both regulators' claims of jurisdiction, the D.C. Circuit agreed with Hunter, holding that the CFTC had exclusive jurisdiction over Hunter's conduct because "Hunter's scheme . . . involved transactions of a commodity futures contract," over which CEA § 2(a)(1)(A)[620] vests the CFTC with exclusive jurisdiction.[621] The court rejected FERC's argument that "where, as here, there is manipulation in one market that directly or indirectly affects the other market, both agencies have an enforcement role." [622] It agreed with the CFTC that accepting this argument would "eviscerate the CFTC's exclusive jurisdiction over commodity

[618] *See Stoller v. CFTC*, 834 F.2d 262, 267 (2d Cir. 1987) ("The Commission may well have the power to construe the statute in such a subtle and refined way, but the public may not be held accountable under this construction without some appropriate notice."; *id,* "Because we find that the public was not adequately apprised that the Commission views 'roll forward' trading to be encompassed within the 'wash sale' prohibition, we conclude that Stoller may not be held liable under that interpretation for his alleged violations with respect to the Contracts at issue herein.").

[619] *Cf. Transnor (Bermuda) Ltd. v. BP N. Am. Petroleum*, 738 F. Supp. 1472, 1495-96 (S.D.N.Y. 1990) (citing *Stoller* in determining whether UK law provided sufficient advance notice to support the plaintiff's claim of a violation). Accordingly, FERC's ability to charge violations will depend upon its provision of advance notice to the markets regarding its statutory and regulatory interpretations.

[620] 7 U.S.C. § 2(a)(1)(A).

[621] *Hunter v. FERC*, 711 F.3d 155, 158 (D.C. Cir. 2013).

[622] *Id.*

futures contracts and defeat Congress's very clear goal of centralizing oversight of futures contracts."[623]

Example Case: *In re Barclays Bank PLC, et al.*, No. IN08-8-000, 144 FERC ¶ 61,041 (July 16, 2013)

Unlike *Hunter*, which involved alleged manipulation of a futures market to realize a gain in a futures market, *Barclays* involved alleged manipulation of a cash market within FERC's jurisdiction to realize a gain in an over-the-counter swap market in violation of 18 C.F.R. § 1c.2.

Barclays argued in its brief in the district court that Hunter mandates a finding that FERC lacks jurisdiction because the alleged motivation for the manipulation was to influence prices in a market reserved to the CFTC's exclusive jurisdiction—*i.e.*, a swaps market.

It contended that FERC lacks jurisdiction over wholesale electric-energy transactions unless they result in the physical delivery of electric energy, and the positions at issue did not result in physical delivery.

Barclays also argued that FERC's complaint was deficient because it failed to allege an effect on any jurisdictional transaction. Additionally, Barclays contended that FERC may not bring manipulation claims against individual traders because the anti-manipulation provision of the FPA refers only to "any entity," even though FERC had interpreted the quoted language to include "any person or form of organization, regardless of its legal status, function or activities."[624]

While this case was pending, the District Court's May 2015 decision on Barclays' motion to rejected all of Barclays' arguments.

Example Case: *Federal Regulatory Energy Commission v. Barclays Bank PLC*, 247 F. Supp. 3d 1118 (E.D. Ca. 2017)

Another challenge to FERC procedure was raised in *Federal Regulatory Energy Commission v. Barclays Bank PLC*, 247 F. Supp. 3d 1118 (E.D. Ca. 2017). Seeking to have a federal district court affirm its order imposing penalties, FERC argued that Barclays was not entitled to discovery. Barclays had elected to receive an immediate penalty in order to receive de novo review of the charges against them by a federal court. FERC asserted that the court's inquiry should be confined to the administrative record, preventing the defendants from raising new arguments or introducing additional evidence. Barclays responded by arguing that, in a de novo proceeding, they should be entitled to discovery and that the administrative record referenced by FERC contained cherry picked evidence by the agency. Additionally, Barclays noted that due process and the applicable statute, 16 U.S.C. § 823b(d)(3)(B) (interpreted by FERC itself in a policy statement, as calling for a "de novo" trial), entitled them to discovery.

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[623] *Id.*

[624] Prohibition of Energy Mkt. Manipulation, 114 FERC ¶ 61,047 (Jan. 19, 2006) (codified at 18 C.F.R. pt. 1c).

The court found that Barclays was entitled to discovery and rejected FERC's assertion that its inquiry should be confined to the administrative record. The court reasoned that Barclays' previous opportunity to submit evidence was in conjunction with FERC's investigation, and, in that context, Barclays was only able to respond to FERC's requests for information and was unable to build an affirmative case as to its innocence.[625]

Additionally, the court concluded that, pursuant to U.S.C. § 823b(d)(3)(B) which orders a "review de novo" of FERC assessment orders, courts should not be confined to the administrative record. It rejected FERC's argument that, by using the term "review," Congress meant to confine courts to the administrative record as having no authoritative backing.[626] Indeed, the court noted that FERC had previously made an internal determination, based on the statute, that defendants should be entitled to full discovery.[627] Ultimately, the court concluded that Congress was clear in its intention for courts to take a "de novo" review, as opposed to a review limited to the administrative record, and to implicitly give defendants the opportunity for discovery.

1. Future FERC Activity

A potential FERC manipulation enforcement action on the horizon involves allegations that Eversource Energy and Avangrid price manipulation cost New England consumers $3.6 billion in higher energy prices. An Environmental Defense Fund report accuses Eversource and Avangrid of reducing the effective capacity of the Algonquin Pipeline, a major supplier of energy to New England, between August 2013 and August 2016. The report states that Eversource and Avangrid accomplished this through down scheduling, which involves the significant last-minute reduction of previously placed large orders of gas, preventing the supply from being resold. Senator Richard Blumenthal of Connecticut and the Consumer Counsel in Connecticut have called for an investigation into the allegations. Blumenthal has sent a letter to FERC requesting examination of Eversource and Avangrid's behavior. Eversource criticized the report and denies the allegations.[628] State regulators in Connecticut and Massachusetts have already opened investigations to look into the allegations.[629]

E. Examples of Proceedings Against Large Traders

1. Constellation Energy Commodities Group, Inc., 138 FERC ¶ 61,168 (2012)

In this 2012 power case, FERC determined that, from September 2007 through December 2008, Constellation Energy Group ("CCG") violated FERC's anti-manipulation rule, 18 C.F.R. § 1c.2,

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625 *FERC v. Barclays Bank PLC*, 247 F. Supp. 3d at 1129.

626 *Id.* at 1130-34.

627 *Id.* at 1131.

628 Michael Phillis, *Sen. Asks FERC to Prober $3.6B Market Manipulation Claims,* LAW360 (Oct. 18, 2017), https://www.law360.com/articles/975740/sen-asks-ferc-to-probe-3-6b-market-manipulation-claims; Keith Goldberg, *Eversource, Avangrid Squeezed NE Pipelines, Reprt Says,* LAW360 (Oct. 11, 2017), https://www.law360.com/articles/973287/eversource-avangrid-squeezed-pipelines-report-says.

629 Mary C. Serreze, *Mass. AG to Review Allegations That Eversource and Avangrid Throttled Pipeline Capacity; Conn. Senator Asks FERC to Investigate*, MASSLIVE.COM (Oct. 19, 2017), http://www.masslive.com/news/index.ssf/2017/10/mass_ago_conn_regulators_looki.html.

by entering into virtual transactions and day ahead ("DA") physical schedules without regard for their profitability, but with the intent of impacting DA prices in the New York ISO and ISO-NE to the benefit of certain swap positions held by CCG. OE also determined that CCG violated FERC regulations requiring the submission of accurate information to ISOs.

CCG neither admitted nor denied the violation but agreed to pay a civil penalty of $135,000,000, to disgorge $110,000,000, and to implement new compliance measures.

2. Gila River Power, LLC 141 FERC ¶ 61,136 (2012)

In this 2012 power case, FERC determined that, between July 2009 and October 2010, Gila River, a subsidiary of Entegra Power Group LLC, violated FERC's anti-manipulation rule, 18 C.F.R. § 1c.2, by designing its transactions importing energy from its power plant in Arizona to California to avoid creating congestion receive a higher price on a higher quantity of energy imports. Gila River implemented this scheme by submitting falsely designated wheeling-through transactions. Gila River's conduct also violated FERC regulations requiring the submission of accurate information to ISOs.

Gila River admitted both the facts and the violations alleged, namely that its wheeling-through transactions violated FERC's regulation requiring the provision of accurate information to the CAISO (18 C.F.R. § 35.41(b)) and FERC's anti-manipulation rule (18 C.F.R. § 1c.2) because it was not wheeling power through the region. Gila River agreed to a fine of $2.5 million and to disgorge $911,553 to CAISO.

The Gila River settlement was the first FERC settlement with a market participant who admitted to a violation of FERC's anti-manipulation rule in an energy trading case. [630]

1. In re Make-Whole Payments and Related Bidding Strategies, 144 FERC ¶ 61,068 (July 30, 2013)

In this 2013 power case, FERC determined that JP Morgan Ventures Energy Corporation ("JMEVC") violated FERC's anti-manipulation rule, 18 C.F.R. § 1c.2, by engaging in twelve manipulative bidding schemes in the California Independent System Operator ("CAISO") and the MISO. According to FERC, these schemes distorted a well-functioning market by misleading CAISO and MISO into paying JPMVEC at rates far above market prices; submitting bids that were expected to, and did, lose money at market rates, as they were not driven by the market forces of supply and demand; defrauding the ISOs by obtaining payments for benefits that JPMVEC did not deliver; and displacing other generating and influencing energy and congestion prices.

As part of its settlement with FERC, JPMVEC admitted to the facts set forth in the stipulation and consent agreement attached to the Order, but neither admitted nor denied the violations. JPMVEC paid $285 million in civil penalties, $124 million in disgorgement to CAISO and $1 million in disgorgement to MISO. JPMVEC also agreed to waive its claims that CAISO owed it money from

[630] Fed. Energy Regulatory Comm'n, *FERC Approves Market Manipulation Settlement with Gila River* (Nov. 19, 2012), https://www.ferc.gov/media/news-releases/2012/2012-4/11-19-12.asp.

two of the strategies that OE staff had investigated and to conduct a comprehensive external assessment of its policies and practices in the power business.

2. Rumford Paper Co., 142 FERC ¶ 61,218 (2013)

In this 2013 power case, FERC determined that Rumford had engaged in fraud in ISO New England's ("ISO-NE") Day-Ahead Load Response Program ("DALRP") by inflating its load baseline and then repeatedly offering load reductions at the minimum offer price in order to maintain the inflated baseline in violation of FERC's anti-manipulation rule, 18 C.F.R. § 1c.2. Through this scheme, Rumford misled ISO-NE to pay for load reductions that never occurred.

Rumford neither admitted nor denied committing the violation, but agreed to pay a civil penalty of $10 million, to disgorge $2,836,419.08, and to implement new compliance measures.

3. Richard Silkman, 144 FERC ¶ 61,164 (2013); Competitive Energy Services, LLC, 144 FERC ¶ 61,163 (2013); Lincoln Paper and Tissue, LLC, 144 FERC ¶ 61,162 (2013)

In this 2013 power case, FERC determined that Lincoln Paper and Tissue, Competitive Energy Services, LLC ("CES"), and Richard Silkman (the CES managing partner) violated FERC's anti-manipulation rule, 18 C.F.R. § 1c.2, by engaging in a fraudulent scheme in 2007 to artificially inflate its baseline load in the ISO-NE DALRP in order to obtain compensation for demand-response load reductions without actually having to reduce load. FERC imposed penalties of $5 million against Lincoln Paper and Tissue, $7.5 million against CES, and $1.25 million against Silkman.

In December 2013, FERC petitioned the U.S. District Court for the District of Massachusetts, seeking affirmation of the penalties, which Lincoln Paper, CES, and Silkman had failed to pay within 60 days. The respondents moved to have the cases dismissed. On April 11, 2016, the district court denied the respondents' motions to dismiss and transferred the cases to the U.S. District Court for the District of Maine for further proceedings. The petition remains pending.

4. MSO Virtual and FTR Trading, 146 FERC ¶ 61,072 (2014)

In this 2014 power case, FERC determined that Louis Dreyfus Energy Services violated FERC's anti-manipulation rule, 18 C.F.R. § 1c.2, between November 2009 and February 2010 by placing virtual trades[631] in the Midcontinent (formerly Midwest) Independent System Operator ("MISO") at a node in North Dakota to affect the value of its nearby Financial Transmission Rights during the period of November 2009 to February 2010.

Dreyfus neither admitted nor denied the violations, but agreed to pay a civil penalty of $4.1 million and to disgorge $3.3 million plus interest. Xu Cheng, a Dreyfus energy trader, also agreed to pay a civil penalty of $310,000.

[631] A virtual trade is one involving no obligation to buy or sell physical power; rather, "the trade's profits or losses come from settlement of the difference between day-ahead price and the real-time price." *MSO Virtual and FTR Trading*, 146 FERC ¶ 61,072 at ¶ 8, (2014).

5. BP America, Incorporated, et al. *v. FERC*, 16-60604 (5th Cir.); *BP America, Inc.*, 156 FERC ¶ 61,031 (July 11, 2016)

In this natural gas case, FERC found that BP America engaged in cross-market manipulation by losing money on physical transactions to benefit financial positions. BP challenged FERC's allegations, claiming that FERC lacks jurisdiction because the transactions at issue were intrastate and that the physical and financial data did not support a charge of manipulation.

The matter was originally heard by an ALJ who found that BP violated § 1c.1 of the Commission's regulations and § 4A of the Natural Gas Act. FERC issued an order affirming the ALJ's Initial Decision in July 2016 and ordered BP to pay $20,160,000 in civil penalties and disgorge unjust profits in the amount of $207,169.

On September 9, 2016, BP appealed to the Fifth Circuit, challenging only FERC's refusal to reconsider the May 2014 decision to set aside the ALJ hearing in the first instance. According to BP, FERC erred in accepting the initial decision's "categorical determination" that all of BP's witnesses were not credible, while all of the investigators' witnesses were, and that all of BP's expert testimony was entitled to "no weight." BP also argued that FERC "presume[d] rather than prove[d] the existence of specific intent to manipulate and manipulative conduct by BP." The request for rehearing before the Commission is currently pending, and the Fifth Circuit case is held in abeyance pending that request.

6. Maxim Power Corporation, et al., Order Approving Stipulation and Consent Agreement, 156 FERC ¶ 61,223 (2016)

In September 2016, pursuant to a settlement, FERC issued an Order Assessing Civil Penalties for violations of the Commission's Anti-Manipulation Rule 18 C.F.R. § 1c.2., which ordered Maxim Power to disgorge $4,000,000 and pay a civil penalty of $4,000,000. [632] Previously, on May 1, 2015, FERC assessed civil penalties of $5 million against Maxim Power Corporation, its affiliate, and $50,000 in civil penalties against Kyle Mitton, a Maxim employee.[633] FERC found that Maxim and Mitton had violated the Commission's Anti-Manipulation Rule through a scheme to collect $3 million in inflated payments from ISO-New England by charging the ISO for costly oil when it actually burned much less expensive natural gas. In addition, FERC found that Maxim had made false and misleading statements and material omissions in its communications with the ISO-NE Market Monitor. Commissioner Clark dissented from FERC's Order because he believed that FERC staff "failed to meet its burden of proof" and FERC's "decision to penalize and hold accountable just one individual . . . when management itself embraces and takes ownership of the actions" was incorrect.

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632 *In re Maxim Power Corporation*, 156 FERC ¶ 61,223 (Sept. 26, 2016) (Order Approving Stipulation and Consent Agreement).

633 *In re Maxim Power Corporation*, 151 FERC ¶ 61,094 (May 1, 2015) (Order Assessing Civil Penalties).

Case Study: Total Gas & Power North America, Inc., et al. v. FERC, No. 16-20542 (5th Cir. 2017; Total Gas & Power North America, Inc., et al., 155 FERC ¶ 61,105 (2016)

In this 2016 natural gas case, FERC alleged that Total Gas & Power North America was engaging in a scheme to manipulate natural gas prices in the southwest United States to benefit related financial positions between June 2009 and June 2012 in violation of § 4A of the Natural Gas Act. According to the Order to Show Cause, Total Gas manipulated natural gas monthly index settlement prices at four major trading hubs during monthly settlement periods known as "bid-week." FERC alleged that Total Gas attempted to manipulate monthly index settlement prices of natural gas through their physical fixed-price trading during bid weeks.

The order to show cause follows a December 2015 settlement with the CFTC, where Total Gas and a trader agreed to jointly pay a $3.6 million civil monetary penalty. However, FERC sought significantly greater penalties—civil penalties of $213.6 million against Total Gas, $1 million and $2 million against the two traders, and disgorgement of $9.18 million, plus interest.

According to FERC, during these periods Total Gas accounted for more than half of the fixed-price trades by volume during bid-weeks, even though Total Gas had no material customer business, assets, or transportation at the hubs. According to the order, Total Gas engaged in this trading in an attempt to favorably affect the monthly index settlement prices to benefit its related financial positions. The order further alleges that, before and during each relevant bid-week, Total Gas would accumulate large positions of physical and financial natural gas products tied to monthly index prices. It would then trade monthly physical fixed-price natural gas to either inflate or suppress prices and then report the trades for inclusion in the calculation of monthly index prices.

In addition to proposing civil penalties against Total Gas and the two traders, the order to show cause also directed Total Gas's parent company and affiliate, both of which are foreign companies, to show cause why they should not be held liable for the civil penalties and disgorgement. According to FERC enforcement staff, holding these entities liable "[was] necessary to prevent them from allowing their undercapitalized Houston office to manipulate United States natural gas markets for years and then avoid the consequences due to insufficient funds." On July 12, 2016, Total Gas filed a 201-page answer, which contained numerous factual and legal arguments including FERC's lack of jurisdiction to enforce the Natural Gas Act (NGA), opposed the imposition of any penalty, and urged that FERC summarily dismiss the claims without a hearing. On September 23, 2016, FERC enforcement filed a reply, opposing Total Gas's request for summary disposition and requesting FERC to set the matter for a hearing before an ALJ to resolve certain disputes of material fact, to decide certain undisputed facts without a hearing, and to reject Total Gas's legal and jurisdictional challenges to the proceeding in their entirety. FERC has neither ordered the matter to be heard before an ALJ nor taken any other action on these pending motions.

In parallel to the FERC proceeding, after receiving a notice of intention to initiate enforcement proceedings, Total Gas filed a declaratory judgment action in federal district court on January 27, 2016. It argued that FERC lacked authority to adjudicate violations and assess civil penalties under the NGA through in-house administrative proceedings because such authority lies exclusively in federal district courts. Total Gas also argued that FERC's adjudication and imposition of a penalty would violate the Appointments Clause, the Fifth Amendment's Due Process Clause, and the

Seventh Amendment's guarantee of a jury trial. In response, FERC moved to dismiss for lack of subject matter jurisdiction due to lack of ripeness. Total Gas, in turn, filed a motion for summary judgment.

On July 15, 2016, the district court granted FERC's motion to dismiss and dismissed Total Gas's motion for summary judgment under three alternative grounds. First, the district court held that the case was not justiciable because the relief requested would not completely resolve the dispute and lack of a final order issued by FERC rendered the case not yet ripe. Second, the court found that the NGA permitted FERC to adjudicate NGA violations and assess civil penalties through in-house administrative proceedings. Third, the court declined to exercise its discretion in entertaining the declaratory action. Total Gas moved for reconsideration and sought leave to amend its complaint, but the district court denied both the motion and leave to amend. Total Gas timely appealed.

On June 8, 2017, the Fifth Circuit held that claims were not ripe and affirmed the district's court granting of FERC's motion to dismiss. The Fifth Circuit found that Total Gas's claims did not present an actual, concrete controversy for review because FERC (1) has neither conclusively determined Total Gas's liability nor imposed civil penalties against it and (2) any future actions, which can be terminated at any point, by FERC are only a possibility. Finding Total Gas's constitutional arguments unavailing, the Fifth Circuit held that the arguments assumed that FERC would ultimately schedule a hearing before an ALJ and issue a final order assessing civil penalties and that FERC's jurisdiction is a nonissue unless and until FERC determines an NGA violation and assesses a penalty.

Total Gas appealed to the Supreme Court, but the Court refused to hear the case, denying Total Gas' cert petition on June 18, 2018.

F. FERC Market Manipulation Investigatory and Enforcement Process

1. Types of Investigations

Investigations are often initiated when the Office of Enforcement ("OE") staff receives information regarding misconduct through internal and external referrals, industry tips, self-reports, and hotline calls.[634] FERC's policy is not to disclose the name of a person or entity requesting an investigation except when required by law or where such disclosure will aid the investigation.[635]

(a) Preliminary Investigations

Preliminary investigations are conducted without the formal authorization of FERC. The OE may conduct such investigations as it deems appropriate to determine whether a formal investigation is

[634] *Revised Policy Statement on Enforcement*, 123 FERC 61,156 ¶ 23 (May 15, 2008) (hereinafter "Enforcement Policy Statement") (Appendix E).

[635] Rules Relating to Investigations, 18 C.F.R. § 1b.8 (2011).

warranted.[636] The OE cannot use its subpoena power or compel testimony during a preliminary investigation.[637] As a result, preliminary investigations rely on voluntary disclosures.

(b) Formal Investigations

Formal investigations can be commenced (or converted from a preliminary investigation) by FERC's discretionary Order of Investigation. In formal investigations, the Investigating Officer appointed by FERC has the authority to "administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, contracts, agreements or other records relevant or material to the investigation."[638]

Formal investigations are conducted by the OE, which submits a request asking that FERC authorize an investigation. FERC will then issue a formal order of investigation, which generally provides a description of the basis of the investigation and the matters to be investigated and will designate the officers who will conduct the investigation. These officers are generally given subpoena power.

(c) Confidentiality

Investigations are conducted on a confidential basis. All investigative proceedings "shall be treated as nonpublic by the Commission and its staff," except to the extent that (1) FERC directs that the information be disclosed; (2) the information is made a matter of public record in an adjudicatory proceeding; or (3) disclosures are required under the Freedom of Information Act ("FOIA").[639]

2. FERC's Compulsion Powers

A formal order of FERC is required to authorize the use of subpoenas.[640] Any person who is "compelled or requested to furnish documentary evidence or testimony in a formal investigation, shall, upon request, be shown the Commission's Order of Investigation."[641]

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636 *Id.* § 1b.6.

637 *Id.* § 1b.19.

638 *Id.* § 1b.13.

639 *Id.* § 1b.9.

640 Rules Relating to Investigations, 18 C.F.R. § 1b.13 (2011).

641 *Id.* § 1b.16(a).

3. Testimony and Document Production

(a) Contacting the OE

During the investigation stage, the subject of an investigation is free to contact the OE staff to provide information and explanations.[642] The OE staff also frequently communicates with the subject of an investigation and its representatives to discuss relevant factual and legal issues.[643]

(b) Communications with FERC

Subjects of an investigation may also make written submissions directly to FERC. However, oral communications (either in person or by telephone) with Commissioners or their assistants concerning the ongoing investigation are prohibited.[644]

(c) Testimony Transcripts

Witnesses are entitled to obtain copies of the transcripts of their testimony, "except that in a non-public formal investigation, the office responsible for the investigation may for good cause deny such request."[645]

(d) Right to Counsel

Witnesses may be accompanied, represented, and advised by counsel.[646] A witness has the right to have counsel present during any aspect of an investigatory proceeding and is entitled to advice of counsel before, during, and after the conclusion of an examination.[647] Counsel for a witness also has the right to question the witness during the interview.[648]

(e) Legal Representation of Multiple Parties

Counsel can represent more than one party, including serving as counsel to a witness and the witness's employer. However, "counsel shall inform the Investigating Officer and each client of said counsel's possible conflict of interest in representing that client and, if . . . counsel appears with a witness giving testimony on the record in an investigation, counsel shall state on the record all persons said counsel represents in the investigation."[649]

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642 *See* Enforcement Policy Statement ¶ 28 (Appendix E).

643 *See id*.

644 *See id.* ¶ 27.

645 Transcripts, 18 C.F.R. § 1b.12 (2012).

646 Rights of Witnesses, 18 C.F.R. § 1b.16 (2012).

647 *Id.*

648 *Id*.

649 *Id*.

(f) Confidentiality and Disclosure

All information and documents obtained during the course of an investigation are to be treated as non-public by FERC and its staff, unless (1) FERC directs that the information be disclosed; (2) the information is made a matter of public record in an adjudicatory proceeding; or (3) disclosures are required under FOIA.[650] Parties must submit a written request that FERC afford confidential treatment under FOIA to any information submitted.[651]

4. How FERC Actions are Resolved

(a) Wells Submissions and Settlement Efforts

FERC has a process similar to the Wells process used in SEC actions. If the OE determines that an entity should be subject to FERC proceedings or a civil action, the entity must be given notice and may submit a non-public response showing why a proceeding should not be instituted against it.[652]

FERC requires the OE staff to attempt to settle a matter before recommending an enforcement proceeding. Prior to entering into settlement negotiations, OE staff request settlement authority, including the range for negotiation, from FERC which determines the proper range of remedies by considering the views of both the OE staff and the target.

(b) Factors

In determining whether an entity has an effective compliance program and whether a penalty is warranted for an instance of noncompliance, FERC considers the following factors:

1. Actions of senior management, including allocation of adequate funds and resources for compliance, formal and informal internal communications regarding compliance, involvement of compliance personnel in new transactions and initiatives, and designation of internal compliance officials;

2. Effective preventive measures, including hiring, training, accountability, and supervision policies;

3. Prompt detection, cessation, and reporting of an offense, with an emphasis on internal detection through strong compliance measures; and

4. Remediation, with an emphasis on the particular steps taken by the entity to remedy misconduct, including discipline of employees involved.

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650 Confidentiality of Investigations, 18 C.F.R. § 1b.9 (2012).

651 *Id*.

652 Submissions, 18 C.F.R. § 1b.19 (2012).

Applied on a fact-specific and case-by-case basis, these factors may lead FERC to reduce or even eliminate the civil penalty assessed for a violation.

FERC's approach to civil penalties mirrors those applied by the EPA and under the Federal Sentencing Guidelines:

> Where a violation is not serious, that is, the violation does not involve significant harm, risk of significant harm, or damage to the integrity of the Commission's regulatory program, and all four elements of vigorous compliance are present, the Commission may reduce the level of civil penalty that otherwise would be imposed to zero. . . . On the other hand, where there is an inadequate or incomplete compliance program, or where despite a demonstrated commitment to compliance serious violations occur, a civil penalty will be imposed. In such circumstances, however, the Commission will consider whether, in light of all the circumstances, a reduction in the civil penalty is warranted.

FERC will completely eliminate an otherwise applicable civil penalty only upon a showing that (1) the violation was not serious and (2) the entity's senior management has made a commitment to compliance, adopted effective preventive measures, ceased violations upon detection, self-reported violations to FERC, and taken appropriate remediation steps.[653]

(c) Determining Penalty: Settlements and Cooperation

FERC's Penalty Guidelines are modeled on the United States Sentencing Guidelines. As with the Sentencing Guidelines, the total monetary penalty is determined using a base penalty amount and a multiplier and is capped by a statutory maximum of $1 million per day per violation.

The base penalty is the greatest of the "Violation Level" penalty, determined based on a number of factors about the offense and the pecuniary gain or loss from the violation.[654]

The multiplier is determined based on the "Culpability Score." Cooperation, self-reporting, acceptance of responsibility, and resolution "without need for a trial-type hearing" will all be considered in determining an entity's culpability score.[655] The initial culpability score is 5, and, if an entity takes advantage of all of the possible deductions related to this factor, it can reduce the culpability score by five points.[656]

5. Orders to Show Cause and Contested Actions

If the parties are unable to settle, the OE staff may recommend enforcement proceedings. However, before the OE staff makes the recommendation, it must allow the target entity to make

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653 *Policy Statement on Compliance*, 125 FERC ¶ 61,058 (Oct. 16, 2008) (Appendix D).

654 FERC Penalty Guidelines § 1C2.2.

655 *Id.* § 1C2.3.

656 *Id.*

a Wells Submission, except in exigent circumstances. The OE staff will then submit its report and the target entity's submissions to FERC for consideration.[657]

Based on the OE report and the target entity's Wells Submission, FERC will determine whether to issue an Order to Show Cause. Issuance of such an order does not indicate that FERC has found any violation, but instead commences a Part 385 proceeding.[658]

Once FERC issues an Order to Show Cause, the target has the option of having an ALJ hold a hearing on the matter or requesting an immediate penalty assessment if FERC finds a violation. If the target entity opts for a hearing, the ALJ will issue an Initial Decision following that hearing, recommending penalties for any violation. FERC will then determine whether a violation occurred and assess penalties in a final order based on the ALJ's Initial Decision and the parties' briefs concerning that decision.

6. Appeals

The target entity may request a rehearing within 30 days after FERC issues an order assessing a penalty. FERC may grant or deny a rehearing and may abrogate or modify its order without further hearing.[659]

Following a decision on a request for a rehearing, the target entity can appeal FERC's judgment to a federal Court of Appeals within sixty days after FERC's order.[660]

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[657] *See id.* ¶ 35.

[658] 18 C.F.R. § 385.

[659] 16 U.S.C. § 825l(a).

[660] *See* 16 U.S.C. § 825l(b).

V. U.S. FEDERAL TRADE COMMISSION ("FTC") JURISDICTION AND MARKET ENFORCEMENT REGIME

A. Statutory Basis of Authority

1. Energy Independence and Security Act of 2007 ("EISA")

Section 811 of EISA authorizes the FTC to issue regulations to prohibit manipulative or deceptive conduct in wholesale petroleum markets:

> It is unlawful for any person, directly or indirectly, to use or employ, in connection with the purchase or sale of crude oil gasoline or petroleum distillates at wholesale, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the [FTC] may prescribe as necessary or appropriate in the public interest or for the protection of United States citizens.[661]

Section 813 of EISA authorizes the FTC to enforce the prohibition on manipulation:

> (a)Enforcement. This subtitle shall be enforced by the [FTC] in the same manner, by the same means, and with the same jurisdiction as though all applicable terms of the Federal Trade Commission Act[662] were incorporated into and made a part of this subtitle.
>
> (b)Violation is Treated as Unfair or Deceptive Act or Practice. The violation of any provision of this subtitle shall be treated as an unfair or deceptive act or practice proscribed under a rule issued under § 18(a)(1)(B) of the Federal Trade Commission Act (15 U.S.C. § 57a(a)(1)(B)).[663]

B. Manipulation

1. Petroleum Market Manipulation Rule ("Anti-Manipulation Rule") The FTC adopted its Anti-Manipulation Rule in 2009.[664] which prohibits:

> any person, directly or indirectly, in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale, from (a) knowingly engaging in any act, practice, or course of business – including the making of any untrue statement of material fact – that operates or would operate as a fraud or deceit upon any person, or (b) intentionally failing to state a material fact that under the circumstances renders a statement made by such person misleading, provided that such omission distorts or is likely to distort market conditions for any such product.

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[661] 42 U.S.C. § 17301.

[662] 15 U.S.C. § 41 et seq.

[663] 42 U.S.C. § 17303.

[664] Prohibitions on Market Manipulation, 74 Fed. Reg. 40686 (Nov. 4, 2009) (to be codified at 16 C.F.R. pt. 317).

Covered products include gasoline, gasoline blendstock, jet fuels, diesel fuels, and fuel oils (other than heavy fuel oils). Natural gas is not a covered product.

The FTC's Rule was loosely modeled after the SEC Rule 10b-5, which prohibited conduct made unlawful by § 10(b) of the Exchange Act ("§ 10(b)"), including manipulation of the U.S. securities markets. However, the FTC rule was "tailored to account for significant differences between wholesale petroleum markets and securities markets."[665] It provides the FTC a cause of action against anyone who either (1) knowingly makes a false or misleading statement of material fact in connection with wholesale purchases or sales of crude oil, gas, or petroleum distillates; or (2) intentionally fails to state a material fact when the omission (a) makes the statement misleading and (b) distorts or is likely to distort market conditions for any of the covered products.

Deviating from the Rule 10b-5 template, the FTC "sought to achieve the appropriate balance between the flexibility needed to prohibit fraud-based market manipulation without burdening legitimate business activity." [666] It recognized that players in the petroleum marketplace are "sophisticated and experienced commercial actors," who require markedly less protection than "individual retail securities investors."[667]

The significant deviations from Rule 10b-5 are threefold. First, the FTC rule includes a two-part conduct prohibition, separately addressing actual misrepresentations and omissions, as compared to Rule 10b-5, which has a single prohibition. Second, the FTC rule contains an explicit scienter requirement in contrast to the implied scienter requirement of Rule 10b-5. Third, the FTC rule prohibits only those omissions that distort or are likely to distort market conditions. Rule 10b-5 does not have such a pervasive causation requirement.

Section 317.3 of the Rule states:

> It shall be unlawful for any person, directly or indirectly, in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale, to:
>
> > (a)Knowingly engage in any act, practice, or course of business – including the making of any untrue statement of material fact – that operates or would operate as a fraud or deceit upon any person; or
> >
> > (b)Intentionally fail to state a material fact that under the circumstances renders a statement made by such person misleading, provided that such omission distorts or is likely to distort market conditions for any such product.[668]

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[665] Prohibitions on Market Manipulation, 74 Fed. Reg. 40,690 (Aug. 12, 2009) (to be codified at 16 C.F.R. pt. 317); see also Prohibitions on Market Manipulation in Subtitle B of Title VIII of the Energy Independence and Security Act of 2007, 74 Fed. Reg. 18,304, 18,308-10 (April 22, 2009).

[666] Prohibitions on Market Manipulation, 74 Fed. Reg. at 40,690 (Aug. 12, 2009) (to be codified at 16 C.F.R. pt. 317).

[667] *Id.*

[668] Prohibited Practices, 16 C.F.R. § 317.3 (2014).

Pursuant to the Rule:

- A "material fact" is one that a reasonable market participant would view as significantly altering the total mix of information available.
- Violations must be knowing or intentional – recklessness is not sufficient.[669]
- The FTC's compliance guide lists among the examples of prohibited conduct "fraudulent or deceptive transactions designed to disguise the actual liquidity or price of a particular asset or market for that asset."
- The guide also states the FTC's intent to broadly interpret its authority to regulate fraudulent and deceptive conduct "in connection with" wholesale transactions for covered products – that is, "whenever there is a sufficient nexus between the action and the purchase or sale of a covered product."

C. Enforcement

1. Civil Action

The FTC can bring suit in federal court under the EISA or the Anti-Manipulation Rule,[670] And the court can impose civil penalties of up to $1 million per day per violation.[671]

In assessing civil penalties, a court must consider factors including (1) the seriousness of the violation and (2) any efforts by the violator to remedy the harm.[672] The court can also impose other remedies such as injunctive relief to stop illegal conduct.[673]

Example Case: *Federal Trade Commission v. Ken Roberts Co.*, 273 F.3d 583 (D.C. Cir. 2001), *cert. denied*, 537 U.S. 820 (2002)

In the course of a coordinated investigation of deceptive day-trading practices in violation of 15 U.S.C. §§ 45 and 52 by the FTC, CFTC, and SEC, the FTC began to scrutinize Ken Roberts Company and various of its affiliated companies and individuals (collectively, "Ken Roberts").[674] In 1999, the FTC issued civil investigative demands ("CIDs") requiring Ken Roberts to produce documents and respond to interrogatories concerning the companies' online advertising of courses in commodities training.[675] When Ken Roberts resisted compliance with the CIDs, arguing that they were beyond the FTC's regulatory power, the FTC petitioned to the U.S. District Court for

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669 Definitions, 16 C.F.R. § 317.2(c) (2014).

670 42 U.S.C. § 17304(b) (2012).

671 *Id.* §§ 17304(a), (c)(1).

672 *Id.* §§ 17304(c)(2)(A)–(B).

673 *Id.* § 17304(a).

674 *FTC v. Ken Roberts Co*., 273 F.3d 583 (D.C. Cir. 2001).

675 *Id.*

the District of Columbia to enforce the CIDs. The district court granted the petition, and Ken Roberts appealed.

The D.C. Circuit affirmed, rejecting Ken Roberts' argument that the CEA and the Investment Advisors Act ("IAA") reserve to the CFTC and the SEC, respectively, the authority to regulate online advertising of courses in commodities trading. [676] The court explained that subpoena-enforcement proceedings are not the proper context in which to challenge an agency's regulatory authority, absent a showing that the agency "patently" lacks jurisdiction.[677] The court went on to hold that the CEA provision vesting the CFTC with exclusive jurisdiction over futures transactions does not plainly extend to encompass all possible transactions touching on the subject of futures trades—such as, in the instant case, courses that teach about futures transactions.[678] Nor does the IAA manifestly preclude all agencies but the SEC from regulating the activities of investment advisers in advertising courses concerning investment.[679] In short, "[b]ecause we live in an age of overlapping and concurring regulatory jurisdiction, a court must proceed with the utmost caution before concluding that one agency may not regulate merely because another may."[680]

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676 *Id.* at 584.

677 *Id.* at 585-87.

678 *Id.* at 590–92.

679 *Id.* at 592–93.

680 *Ken Roberts Co*., 273 F.3d at 593 (internal quotation marks omitted).

VI. UNITED KINGDOM JURISDICTION AND MARKET ENFORCEMENT REGIME

A. Governing Authority

The UK market-abuse regime, both civil and criminal, is overseen by the Financial Conduct Authority ("FCA"). Separate civil and criminal regimes apply. As discussed below, substantial structural changes have recently been made to the civil market abuse regime with effect from July 3, 2016, although the pre-existing law will apply to misconduct occurring prior to that date.[681]

The criminal market abuse regime is contained in § 397 of the Financial Services and Markets Act 2000 ("FSMA") (in respect of conduct occurring prior to April 1, 2013), §§ 89 and 90 of the Financial Services Act 2012 ("FSA 2012") (in respect of conduct occurring on or after April 1, 2013) and Part 5 of the Criminal Justice Act of 1993.

The civil market abuse regime was, until July 3, 2016, contained in Part 8 of FSMA. The EU Market Abuse Regulation (Regulation 596/2014) ("MAR") has applied since July 3, 2016 and covers conduct occurring on or after that date. Although it has now been repealed, details of the pre-July 3, 2016 law have been included in this chapter because many enforcement cases are likely to be concerned (at least in part) with conduct occurring prior to this date for some time to come.

Various rules made under other parts of FSMA governing the conduct of "authorized persons" and "approved persons" are also relevant as they are drafted sufficiently broadly to cover market-related misconduct, even if it does not fall within the ambits of the market abuse regimes. These are unchanged by amendments to the civil market abuse regime, although significant separate changes have been made to some of these provisions as they apply to individuals within banks with effect from March 7, 2016. Corresponding changes are due to be made to rules governing misconduct by individuals (including, but not limited to, market misconduct) in other types of financial institutions. Current estimates are that these changes will be in force by approximately summer 2018.

B. Changes to Market Abuse Regime

In 2014, the text of MAR and an accompanying directive on criminal sanctions for insider dealing and market manipulation was finalized. The UK government decided to exercise its discretion not to opt into the new directive (although the majority of other EU member states did opt in).

The majority of the provisions of MAR have been in force since July 3, 2016 (when the previous EU Market Abuse Directive, upon which Part 8 of FSMA was largely based, was repealed). Technical standards setting out details on the application of its provisions were released by the European Securities and Markets Authority ("ESMA") during the period between the text being finalized and the date on which provisions came into force. Technical standards in some areas

[681] The UK's current regime is based on the EU Market Abuse Regulation, which took direct effect without the need for English legislation. As such, depending on the mechanics of Brexit, the current regime may cease to exist following the UK's exit from the EU. At such time, the UK would likely revert to its earlier regime based on the EU Market Abuse Directive, which was enacted based on English legislation.

came into force to coincide with the coming into force of linked provisions of the MiFID II Directive (2014/65/EU) and the Markets in Financial Instruments Regulation (600/2014).

MAR has significantly extended the scope of the civil market-abuse regime in the UK. Instruments traded on multilateral trading facilities and organized trading facilities have been added to those covered by the regime. OTC instruments whose value or price has an effect on or depends on instruments traded on any such venue also now fall within its scope. Taken together with changes due to be introduced under the revision of the Markets in Financial Instruments Directive (2004/39/EC), this brings many commodity derivatives not currently covered by the market abuse regime within its ambit.

It has also changed the definition of "inside information" in several important respects. In addition to amending the definition as it applies to commodity derivatives and reflecting developments in several European cases, it will formally embed the "reasonable investor" test by specifying that information is likely to have a "significant effect" on price if it is information that a reasonable investor would use as part of the basis of his investment decisions.

C. The Previous Civil Market Abuse Regime: Part 8 of the FSMA

The UK civil market-abuse regime prohibits, *inter alia*, the manipulation of transactions in commodities markets.

The paragraphs below describe the relevant provisions of the UK civil market abuse regime both as in force previously under Part 8 of FSMA and the associated guidance contained in the Code of Market Conduct set out in the FCA's Handbook ("The Code") (in respect of conduct occurring prior to July 3, 2016) and as in force as at the time of writing under MAR (in respect of conduct occurring on or after July 3, 2016).

1. Statutory Standards.

To constitute market abuse under Part 8 of FSMA it is necessary for a "behavior" to have occurred "in relation to" a "qualifying investment" (or, in some cases, a "related investment") traded, or that is the subject of a request for admission to trading, on a "prescribed market."[682]

(a) Behavior

Pursuant to this standard "Behavior" can consist of action or inaction.[683] A failure to act constitutes a "behavior" either:

1. when it "involves failing to discharge a legal or regulatory obligation,";[684] or

[682] FSMA § 118(1)(a).

[683] *Id.* § 130A(3).

[684] The Code § 1.2.6E(1).

2. "if the person's representations have created a reasonable expectation of him acting in a particular manner, those representations are no longer correct and he has failed to inform people whom he is under an obligation to inform that the representations are no longer correct."[685]

Behaviors proscribed by the market-abuse regime were:

- Insider dealing;
- Improper disclosure;
- Misuse of information;
- Manipulating transactions;
- Manipulating devices;
- Dissemination of false or misleading information; and
- Misleading behavior or distortion.

(1) Insider Dealing

Insider dealing is defined as a transaction "where an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information in relation to the investment in question."[686]

Definitions of "inside information" under the civil market abuse as it applied in the UK prior to July 3, 2016 varied slightly depending upon the type of "qualifying investments" or "related investments" concerned.[687] However, in all cases, the information in question had to have been:

- "precise";[688]

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685 *Id.* § 1.2.6E(2).

686 FSMA § 118(2).

687 *See id.* § 118C.

688 Information is "precise" for these purposes where it "indicates circumstances that exist or may reasonably be expected to come into existence (or an event which has occurred or may reasonably be expected to occur," and "is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of the qualifying investments or related investments." FSMA § 118C(2)(a) & (5); *see also Markus Geltl v Daimler AG* (Case C-19/11, June 28, 2012). Further clarification has also been given in relation to the meaning of "precise" for these purposes in a judgment handed down by the Upper Tribunal in May 2014 in connection with action taken by the FSA/FCA against Ian Hannam and, more recently, in a judgment of the EU Court of Justice in March 2015 relating to action taken by the Autorité des Marchés Financiers in France. *See FCA v Hannam* [2014] UKUT 0233; *Lafonta v AMF* (Case C628/13, Mar. 11. 2015).

- not "generally available";[689] and
- information which, if generally available, would "be likely to have [had] a significant effect" on the price of the "qualifying investments" or "related investments" concerned.[690]

In addition, it was necessary for the "insider" to have acquired the "inside information" in one of five sets of prescribed circumstances based upon, *inter alia*, his professional, employment, or criminal activities or position as a shareholder.[691]

Dealing will only be considered to have amounted to insider dealing for these purposes if there was a sufficiently close connection between the insider's receipt of the information and his dealing.[692] This, in effect, places a burden on firms to demonstrate that they did not use "inside information" as part of a decision to deal, for example by proving that robust Chinese Walls are in place.

(2) Improper Disclosure

Improper disclosure of inside information is defined as an act "where an insider discloses inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties."[693]

Improper disclosure differed from insider dealing in that no dealing is required in order for market abuse to occur. The mere fact of "improper disclosure" sufficed.

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689 Information is not "generally available" when it cannot "be obtained by research conducted by, or on behalf of users of a market." FSMA § 118C(2)(b). The MAR provides further detail on factors affecting whether information is to be treated as "generally available," including whether information is available on the Internet and whether it has already been disclosed to a "prescribed market." *See* the Code at 1.2.12E.

690 Information is "likely to have a significant effect" if it is "information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions" (the so-called "reasonable-investor" test). In February 2011, the Financial Services and Markets Tribunal confirmed, in *Massey v. FSA*, that whether a matter is "likely to have a significant effect on price" must be read with the extended definition provided by the reasonable-investor test. In other words, if the information satisfies the reasonable-investor test, it is by definition price-sensitive. *See* FSMA § 118C(2)(c).

691 *See* FSMA § 118B.

692 Following clarification provided by the European Court of Justice in *Spector Photo Group NV v. Commissie voor het Bank-, Financie- en Assurantiewezen* [2011] BCC 827, it appears to be generally sufficient for a finding of market abuse if a person who has "inside information" knew or ought to have known that he or she had the "inside information" and acquired or disposed of "qualifying investments" or "related investments" to which that information related.

693 FSMA § 118(3).

The Code made clear that, in determining whether a disclosure is proper, regard is to be had to the purpose of the disclosure, the recipient of the information, and whether confidentiality obligations were imposed.[694]

(3) Misuse of Information

Misuse of information occurs where

> the behavior (a) is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would be, or would be likely to be, regarded by him as relevant when deciding the terms on which transactions in qualifying investments should be effected, and (b) is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the proper standard of behavior reasonably expected of a person in relation to his position in the market.[695]

The "relevant information not generally available" and "regular user" definitions were features of the UK legislation predating the introduction of the previously applicable EU Market Abuse Directive (2003/6) ("MAD"). They enabled the FCA to act in a theoretically broader set of circumstances than was possible under other provisions of the market-abuse regime (as it was not necessary to show that the information upon which the behavior was based was precise or price-sensitive).

However, the implementation of MAD, and specifically the rise of the "reasonable-investor" test that pervades it, left a much-reduced function for this "super equivalent" provision, which lapsed on December 31, 2014.

(4) Manipulating Transactions

Manipulating transactions occurs where

> the behavior consists of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which – (a) give, or are likely to give, a false or misleading impression as to the supply of, or demand for, or as to the price or value of qualifying investments, or (b) secure the price of one or more such investments at an abnormal or artificial level.[696]

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694 Financial Conduct Authority, MARKET CONDUCT § 1.4.5E(2) (hereinafter "The Code").

695 FSMA § 118(4).

696 *Id.* § 118(5).

The statutory definition of this behavior was supplemented by examples set out in the Code focusing on many well-recognized means of manipulation, such as "painting the tape," "wash trades," "marking the close," "advancing the bid," and "abusive squeezes."[697]

In particular, the Code contained factors that indicate whether the behavior is carried out for "legitimate reasons," a key aspect of which is the intention or motive behind the transaction.[698] The scope for acceptance by the FCA of market practices is limited given the associated procedural formalities. Indeed, the FSA has only done so on one occasion.

There was helpful guidance indicating that trading by market users at times and in sizes most beneficial to them is unlikely to amount to distortion for these purposes.[699] However, the focus of the regime on the effect of transactions means that it is more difficult to be confident that it is permissible to deal in large sizes where it is possible that such dealing could have a significant effect on price.

(5) Manipulating Devices

Manipulating devices occurs "where the behavior consists of effecting transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance."[700]

Again, the statutory definition of this behavior was accompanied by examples in the Code of colorfully named manipulative devices such as "pumping and dumping" and "trashing and cashing."

These focus on the execution of transactions or orders whilst simultaneously disseminating information that is false or misleading or that fails to disclose conflicts of interest.[701]

(6) Dissemination of False or Misleading Information

Dissemination of false or misleading information occurs where

> the behavior consists of the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew or could reasonably have been expected to have known that the information was false or misleading.[702]

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697 The Code § 1.6.2E.

698 *Id.* § 1.6.5E.

699 *Id.* § 1.6.7G.

700 FSMA § 118(6).

701 The Code § 1.7.2E.

702 FSMA § 118(7).

This provision covered both dissemination of information through the media (although FSMA recognized elsewhere that journalists are in a special position)[703] and undertaking a course of conduct in order to give a false or misleading impression.

The examples in the Code suggested that different standards may apply in determining whether a person has engaged in market abuse through dissemination, depending on the method of dissemination. Although a person may engage in market abuse by *recklessly* disseminating false or misleading information through a "regulatory information service," the Code stated that they may engage in market abuse only if they *knowingly* disseminate false or misleading information through an internet bulletin board or chat room.[704]

(7) Misleading Behavior or Distortion

Misleading behavior or distortion occurred where

> the behavior. . . (a) is likely to give a regular user of the market a false or misleading impression as to the supply of, demand for or price or value of, qualifying investments, or (b) would be, or would be likely to be, regarded by a regular user of the market as behavior that would distort, or would be likely to distort, the market in such an investment, and the behavior is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behavior reasonably expected of a person in his position in relation to the market.[705]

As has been the case for the other super-equivalent provisions, the importance of this behavior has been diminished by the implementation into the UK civil market-abuse regime of broadly stated MAD provisions.

However, there are some specific instances given within the Code that would be difficult to fit within any of the other behaviors. The examples given include the movement of empty cargo ships to give a false impression of demand or supply of a commodity or a failure to disseminate information required or expected of the person in question as a result of reasonable expectations created by him.

This provision lapsed on July 3, 2016.

(b) "In relation to"

Neither FSMA nor MAD expressly delineated the circumstances under which conduct will be deemed to be "in relation to" qualifying investments.

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703 *See* FSMA § 118A(4).

704 The Code § 1.8.6E(1).

705 FSMA § 118(8).

The Code, however – which was issued by the FCA to give guidance as to what it considers market abuse under the civil regime – sets out factors indicating that behavior can be "in connection with" a transaction even if it occurs before a request for admission to trading or before the admission to or commencement of trading.[706]

Moreover, the scope of the market-abuse regime applicable prior to July 3, 2016 was not limited to on-exchange activity; it also covered off-exchange trading in "qualifying investments" and went beyond trading practices to cover matters such as the dissemination of information about "qualifying investments" in, for example, company announcements or research.[707]

(c) "Qualifying investment"

The types of "qualifying investments" covered by the UK market-abuse regime were set out in a relatively wide-ranging list in MAD, which is incorporated into UK law by order of Her Majesty's Treasury.[708] This list included a wide range of securities, instruments, and commodities.

(d) "Related investment"

For some types of behavior – namely, insider dealing and improper disclosure of inside information – the market-abuse regime applied more widely to "related investments" in addition to "qualifying investments."

A "related investment" was "an investment whose price or value depends on the price of [a] qualifying investment."[709] This definition was broad and included, for example, over the counter ("OTC") and exchange-traded derivatives.

(e) " Prescribed markets"

The "prescribed markets" were set out in the PMQI Order and included commodities markets.

2. Knowledge, Intention, and Purpose

The Code made clear (by way of guidance) that the market-abuse regime "does not require the person engaging in the behavior in question to have intended to commit market abuse."[710]

This was confirmed by, for example, the Financial Services and Markets Tribunal's determination, in an enforcement action taken by the FSA against Winterflood Securities Limited and a number

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706 *See* The Code § 1.2.5E.

707 *See, e.g.*, FSA Final Notice, *Cattles Limited*, Mar. 28, 2012, (http://www.fsa.gov.uk/static/pubs/final/cattles-ltd.pdf); FSA Final Notice, *Welcome Financial Services Limited*, Mar. 28, 2012, (http://www.fsa.gov.uk/static/pubs/final/welcome-financial-service.pdf).

708 Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001 (SI 2001/996) ("PMQI Order").

709 FSMA § 130A(3).

710 The Code § 1.2.3G.

of associated individuals, that there is no need for a person to have an "actuating purpose" in order to commit market abuse.[711]

However, in practice – particularly for the purposes of the behaviors describing insider dealing and misuse of information – issues of intention, knowledge, and purpose are important to determining whether market abuse occurred under the regime applicable prior to July 3, 2016. Key concepts including "inside information," "insider," and the dissemination of "false or misleading" information all clearly contemplated knowledge on the part of the person concerned.

On the face of it, the definition of the manipulating transaction limb of market abuse (see below) was expressed in more objective terms. It suggested that a person engaged in market abuse if he effected a transaction or order to trade that gives a false or misleading impression or secured the price of investments at an abnormal or artificial level. This prohibition would appear to cover conduct regardless of whether the person concerned knew (or ought to have known) that his conduct would have the relevant effect. However, the FCA's descriptions of behaviors amounting to market abuse of this type are laced with references to the intention or purpose of the parties.[712]

In any event, for practical purposes, it is often necessary to understand the purpose behind the transaction in order to determine whether it gave a false or misleading impression or secured an abnormal or artificial price level. For example, the difference between an offensive "wash trade" and a legitimate sale and repurchase transaction lies in the purpose of the parties entering into the transaction.[713] Moreover, the wording of the definition excluded situations in which a transaction was entered into for legitimate reasons and in conformity with accepted market practices, which therefore explicitly required an understanding of the purpose of the transaction.

3. Territorial Application

Behavior was subject to the civil market abuse regime applicable prior to July 3, 2016 only if it occurred in the UK or in relation to "qualifying investments" traded, or for which a request has been made for admission to trading, on a "prescribed market" situated in or accessible from the UK.[714]

The FSA and the FCA have, however, demonstrated that the laws have extended far beyond the UK's shores. They have done so principally by taking enforcement actions against individuals not physically located in the UK but who have conducted trading (including in relation to the energy

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711 *Winterflood Securities Limited v. FSA*, [2009] UKFSM FSM066 (https://assets.publishing.service.gov.uk/media/5752c233e5274a6ed1000028/WinterfloodSecuritiesLimitedStephenSotiriouJasonRobins.pdf).

712 *See, e.g.*, § 1.6.2E of the Code.

713 *See id.* § 1.6.3G.

714 As explained above, the scope of the regime is wider for insider dealing and improper disclosure, which take account of behaviour in relation to "related investments."

markets) from and/or on markets located in, for example, the U.S.,[715] Japan,[716] Canada,[717] Switzerland,[718] Lithuania,[719] and Dubai[720] or who have subsequently located themselves in those jurisdictions.

In addition to the safe harbors identified in the Code in respect of particular types of behavior, the Code and FSMA provide for a number of exceptions, although these are of limited relevance to activity on the commodities markets.[721]

4. Defenses

The "defenses" under the civil market abuse regime applicable prior to July 3, 2016 are described below. Although commonly referred to as "defenses," this provision did not (and does not) relieve firms or individuals of liability for engaging in market abuse.

The FCA may decide not to impose a penalty on a person who has engaged in market abuse where it is satisfied that the person concerned reasonably believed that his behavior did not amount to engaging in market abuse or to encouraging or requiring another person to do so, or where he "took all reasonable precautions and exercised all due diligence" to avoid behaving in such a way.[722]

Thus, a firm that employs a "fat thumbs" trader who causes market disruption by making errors when entering orders onto an exchange's trading system may be able to avoid a penalty for market abuse by establishing that, through its policies and procedures, it has taken all reasonable precautions and exercised all due diligence to avoid market abuse.[723] The trader may be able to

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[715] *See* FCA Final Notice, *Michael Coscia*, July 3, 2013 (http://www.fca.org.uk/your-fca/documents/final-notices/2013/michael-coscia).

[716] *See* FSA Final Notice, *Philippe Jabre & GLG Partners LP*, Aug. 1, 2006 (http://www.fsa.gov.uk/static/pubs/final/jabre.pdf).

[717] *See 7722656 Canada Inc (formerly carrying on business as Swift Trade) v. FSA*, Upper Tribunal (Tax and Chancery Chamber), Jan. 23, 2013 (https://assets.publishing.service.gov.uk/media/5752dfdfed915d3c8c00001a/7722656_Canada_INC___formerly_Swift_Trade_and_Peter_Beck.pdf).

[718] *See Chaligne, Sejean, and Diallo v. FSA*, Upper Tribunal (Tax and Chancery Chamber), Apr. 15, 2012 (https://assets.publishing.service.gov.uk/media/5753d6e6e5274a6ed1000036/C_S_D_v_FSA.pdf).

[719] *See Michiel Visser and Oluwole Fagbulu v. FSA*, Upper Tribunal (Tax and Chancery Chamber), (FS/2010/0001 and FS/2010/0006), Aug. 9, 2011 (https://assets.publishing.service.gov.uk/media/5752b0b940f0b6432800001e/VisserandFagbulu_v_FSA.pdf).

[720] *See* FSA Final Notice, *Rameshkumar Goenka*, Oct. 17, 2011 (http://www.fsa.gov.uk/static/pubs/final/rameshkumar_goenka.pdf).

[721] *See* FSMA §§ 118(5)(a), 118A(5)(b), & 118A(5)(c); *see also* Commission Regulation (EC) No 2273/2003, Dec. 22, 2003, implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and the stabilization of financial instruments.

[722] FSMA § 123(2).

[723] *Id*.

avoid a penalty on the same basis, or if he establishes that he reasonably believed that he was not committing market abuse.

However, the threshold for the "defense" is very high. It is almost impossible for individuals in particular to show that they have taken "all reasonable precautions" and exercised "all due diligence."

D. The Current Civil Market Abuse Regime: MAR

1. Statutory Standards

The scope and structure of the currently applicable civil market abuse regime under MAR is different in some important respects to the previous regime. These changes and the essential elements of the current regime are described in detail below insofar as they are relevant to commodities trading.[724]

As noted above, guidance in relation to the application of the provisions of MAR is set out in relevant technical standards published by the European Securities and Markets Authority (as opposed to the Code, which has now been withdrawn). In some cases, interpretative guidance is also provided in the recitals to MAR.

The previous list of categories of behaviors amounting to market abuse has been condensed and consolidated. The list of prohibited behaviors is set out below.

(a) Engaging or attempting to engage in insider dealing (article 14(a), MAR)

The behavior is defined at Article 8(1) of MAR, which makes clear that insider dealing occurs for these purposes where a person "possesses[725] inside information and uses[726] that information by

[724] In addition to the changes in scope noted, the scope of MAR is wider than that of the predecessor civil market abuse regime in that it applies to conduct relating to benchmarks.

[725] A person "possesses" inside information for these purposes where they have it as a result of being a member of the administrative, management or supervisory bodies of an issuer or an emission allowance market participant, having a holding in the capital of an issuer or an emission market participant, having access to the information through the exercise of an employment, profession or duties, being involved in criminal activities or under circumstances other than those described above where the person knows or ought to know that the information is inside information (Article 8(4), MAR). Article 8(5) adds that where the person concerned is a legal person, those natural persons who participate in decisions to carry out the acquisition, disposal, cancellation or amendment of an order for the legal person concerned, may also be deemed to be in possession of inside information.

[726] Recital 24 to MAR states in relation to "use" that it should be implied that a person has used inside information where a person in possession of that information acquires or disposes of, or attempts to acquire or dispose of, for their own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates, but adds that this presumption is without prejudice to the rights of the person concerned to defend themselves against any such allegations.

acquiring or disposing of (for his own account or for that of a third party), directly or indirectly, financial instruments to which that information relates."[727]

Article 8(1) further makes clear that the "use of inside information by cancelling or amending an order concerning a financial instrument to which the information relates where the order was placed before the person concerned possessed the inside information" also amounts to insider dealing.[728]

"Inside information" is defined at Article 7 of MAR. As was the case under the previously applicable civil market abuse regime, definitions differ slightly according to the type of instruments concerned. However, in all cases, in order to fall within the definition of "inside information," it must be "precise,"[729] must not have been made public, must relate, directly or indirectly to one or more issuers or to one or more financial instruments (or derivative or related spot commodity contracts as applicable); and must be information which, if it were made public, would be likely to have a significant effect on the prices of the instruments or derivatives concerned or on the prices of certain related instruments or contracts.[730]

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[727] Recital 54 to MAR states that information relating to a market participant's own trading strategies should not be considered to be inside information, but that information relating to the trading strategies of a third party may amount to inside information.

[728] Recital 25 to MAR indicates that orders placed before a person possesses inside information should not be deemed to be insider dealing but that a rebuttable presumption arises that any changes to orders made after a person comes into possession of inside information amounts to insider dealing.

[729] As was the case under the previous civil market abuse regime, information is "precise" for these purposes if it indicates "a set of circumstances which exists or which may reasonably be expected to come into existence" or "an event which has occurred or which may reasonably be expected to occur" (article 7(1), MAR) "where the information is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the financial instruments or the related derivative financial instrument, the related spot commodity contracts or the auctioned products based on the emission allowances". Additional clarification in relation to the meaning of "precise" in relation to intermediate steps in protracted processes, drawing upon the judgment of the European Court of Justice in *Markus Geltl v. Daimler AG* (Case C-19/11, 28 June 2012) (*see* Article 7(3), MAR). Recital 16 of MAR states "where information concerns a protracted process occurring in stages that is intended to bring about, or that results in, particular circumstances or a particular event, each stage of the process as well as the overall process could constitute inside information. An intermediate step in a protracted process may in itself constitute a set of circumstances or an event which exists or where there is a realistic prospect that they will come into existence or occur, on the basis of an overall assessment of the factors existing at the relevant time. However, that notion should not be interpreted as meaning that the magnitude of the effect of that set of circumstances or that event on the prices of the financial instruments concerned must be taken into consideration. An intermediate step should be deemed to be inside information if it, by itself, meets the criteria laid down in [MAR] for inside information.". Recital17 provides further clarification, stating that such information could relate to, for example, the state of contract negotiations, terms provisionally agreed in contract negotiations, the possibility of the placement of financial instruments, conditions under which financial instruments will be marketed, provisional terms for the placement of financial instruments and the consideration of the inclusion of a financial instrument in a major index or consideration of deletion of a financial instrument from a major index.

[730] Article 7(4) of MAR states that "Information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments, derivative financial instruments, related spot commodity contracts, or auctioned products based on emission allowances shall mean information a reasonable investor would be likely to use as part of the basis of his or her investment decisions". This lends weight to the approach historically taken by the FSA/FCA in, for example, *Massey v FSA*, which is discussed above; *also see* MAR art. 7(1).

Different definitions are used for financial instruments, commodity derivatives, emission allowances (and auctioned products based on emission allowances) and cases concerning persons charged with the execution of orders concerning financial instruments.[731] In October 2016, ESMA published its final guidelines in relation to the meaning of "inside information" under MAR for the purposes of commodity derivatives.[732]

In cases involving commodity derivatives, there is an additional requirement that information, in order to be regarded as "inside information," must be of a type that is reasonably expected or required to be disclosed on the relevant commodity derivatives markets or spot markets in accordance with EU or national level legal or regulatory provisions, market rules, contract, practice, or custom.[733] Recital 20 to MAR sets out "notable examples" of such requirements, including the EU Regulation on Wholesale Energy Market Integrity and Transparency (Regulation 1227/2011) ("REMIT") for the energy market and the Joint Organizations Database Initiative for oil.

The scope of the definition of "inside information" under MAR as applied to commodity derivatives is wider than under the previously applicable civil market abuse regime based on MAD. The definition now covers price sensitive information relevant to related spot commodity contracts, in addition to that which is relevant to the derivative itself.

(b) Recommending that another person engage in insider dealing or inducing another person to engage in insider dealing (Article 14(b), MAR).

Further clarification in relation to the circumstances in which this conduct will be considered to have occurred is provided by Article 8. In particular, Article 8(3) states that the use of recommendations or inducements will amount to insider dealing where the recipient of the recommendation or inducement knows or ought to have known that it was based upon inside information.

(c) Unlawfully disclosing inside information (Article 14(c), MAR)

The behavior is defined at Article 10 of MAR, which states that it occurs when a person possesses inside information and discloses that information to any person otherwise than in the normal exercise of an employment, profession or duties.[734]

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[731] MAR art. 7(1)(a)–(d).

[732] These guidelines set out a non-exhaustive list of information which is reasonably expected or required to be disclosed in accordance with legal or regulatory provisions in EU or national law, market rules, contract, practice or custom on the relevant commodity derivatives markets or spot markets as referred to in Article 7(1)(b) of MAR (https://www.esma.europa.eu/sites/default/files/library/2016-1412_final_report_on_mar_guidelines_on_commodities.pdf).

[733] MAR art. 7(1)(b).

[734] See discussion of when disclosure will be deemed to be in the course of an employment, profession or duties in, for example, *FCA v Hannam* [2014] UKUT 0233; *also see* MAR art. 12(1)(a).

The most common scenario in which it may occur is that where market soundings (i.e. communications prior to the announcement of a transaction aimed at assessing levels of interest amongst potential investors) are being conducted. Under Article 11(4) of MAR, disclosure of inside information in the course of market soundings is deemed to fall within the normal exercise of a person's employment, profession, or duties provided that certain conditions are complied with. These are set out in detail in technical standards published by ESMA.

(d) Engaging or attempting to engage in market manipulation (article 15, MAR).

The behaviors which may amount to market manipulation are listed at Article 12 of MAR as:

1. "entering into a transaction, placing an order to trade or any other behavior which gives or is likely to give false or misleading signals as to the supply of, demand for or price of a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances, or [which] secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level" unless the person concerned does so for legitimate reasons and in conformity with an 'accepted market practice'";[735]

2. "entering into a transaction, placing an order to trade or any other activity or behavior which affects or is likely to affect the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances, which employs a fictitious device or any other form of deception or contrivance";[736]

3. "disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances or secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level, including the dissemination of rumors, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading";[737]

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[735] "Accepted market practices" are required to be established and listed by national competent authorities (Article 13, MAR). Whether particular practices are designated as such in respect of particular markets is governed by technical standards issued by ESMA. These assessments depend upon, *inter alia*, national competent authorities' view of the degree of transparency inherent in it, whether it adequately safeguards proper forces of supply and demand, whether it has a positive impact on liquidity and efficiency, its potential effect on the integrity of the market concerned and the specific trading mechanisms, structural characteristics and typical levels of sophistication of participants in that market. Under equivalent provisions in the Code, there were no "accepted market practices" for the purposes of the previously applicable civil market abuse regime.

[736] MAR art. 12(1)(b).

[737] *Id.* art. 12(1)(c).

4. "transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark where the person who made the transmission or provided the input knew or ought to have known that it was false or misleading, or any other behavior which manipulates the calculation of a benchmark";[738]

5. "conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument, related spot commodity contracts or auctioned products based on emission allowances which has, or is likely to have, the effect of fixing, directly or indirectly, purchase or sale prices or creates, or is likely to create, other unfair trading conditions";[739]

6. "the buying and selling of financial instruments, at the opening or closing of the market, which has or is likely to have the effect of misleading investors acting on the basis of the prices displayed, including the opening or closing prices";[740]

7. "the placing of orders to a trading venue, including any cancellation or modification, by any available means of trading, including by electronic means, such as algorithmic and high-frequency trading strategies, and which has one of the effects set out in articles 12(1)(a) or (b) by:

    a. disrupting or delaying the functioning of the trading system of the trading venue or being likely to do so;

    b. making it more difficult for other persons to identify genuine orders on the trading system of the trading venue or being likely to do so, including by entering orders which result in the overloading or destabilization of the order book; or

    c. creating or being likely to create a false or misleading signal about the supply of, or demand for, or price of, a financial instrument, in particular by entering orders to initiate or exacerbate a trend";[741]

8. "the taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument, related spot commodity contract or auctioned product based on emission allowances and profiting subsequently from the impact of the opinions voiced on the price of that instrument, related spot commodity contract or auctioned product based on emission allowances, without

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[738] Further detail in relation to the meaning of "calculation" for these purposes is provided at recital 44 to MAR, which states that it includes the receipt and evaluation of all data relating to the calculation of a benchmark and the methodology, whether algorithmic or judgement based.

[739] MAR art. 12(2)(a).

[740] *Id.* art. 12(2)(b).

[741] *Id.* art. 12(2)(c).

having simultaneously disclosed that conflict of interest to the public in a proper and efficient way";[742]

9. "the buying or selling on the secondary market of emission allowances or related derivatives prior to the auction held pursuant to the EU ETS Regulation, with the effect of fixing the auction clearing price for the auctioned products at an abnormal or artificial level or misleading bidders bidding in the auctions."[743]

Attempted market manipulation is a separate behavior. It applies in circumstances including where activities which would amount to manipulation as described above are commenced but not completed.[744]

2. Knowledge, Intention and Purpose

Notwithstanding that the Code is no longer in effect, the analysis above in relation to knowledge, intention and purpose applies equally to the civil market abuse regime under MAR.

3. Territorial Application

The territorial scope of MAR is wider than that of the predecessor civil market abuse regime. MAR covers behavior both within and outside the EU in relation to instruments admitted to trading on an EU trading venue. In some circumstances, this means that trading in securities listed outside the EU by parties based outside the EU will be covered.

4. Exceptions

Behavior which, provided certain conditions are complied with, will not amount to particular types of market abuse is described above.

In addition, there is a presumption that behavior does not amount to market abuse where it is shown to be "legitimate behavior." Examples may include where adequate internal procedures are in place within a legal person and those making decisions to deal are not in possession of inside information.[745]

5. Defenses

FSMA § 123(2), which has survived (in amended form) the transition from the pre-July 3, 2016 civil market abuse regime to the new regime based on MAR applicable from that date, allowed (and continues to allow) the FCA to opt not to impose a penalty for market abuse in certain circumstances. However, it no longer provides for the "defense" of taking all reasonable

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[742] *Id.* art. 12(2)(d).

[743] *Id.* art. 12(2)(e).

[744] Article 15 and recital 46, MAR.

[745] Article 9, MAR.

precautions and exercising all due diligence to avoid behaving in a matter amounting to market abuse.

E. The Criminal Market Abuse Regime

There are two agencies in the UK who may have authority to prosecute criminal market abuse cases – the FCA and the Serious Fraud Office ("SFO"). The SFO is a specialist criminal prosecutor primarily concerned with pursuing criminal proceedings in respect of fraud, bribery and corruption, while the FCA has more limited powers to prosecute criminal offences where the conduct amounting to the commission of the offence falls within the scope of specific criminal offences.[746]

1. Application to the Commodities Markets

Like its civil counterpart described above, the criminal market-abuse regime in the UK encompasses the commodities markets to some extent.[747] Of the offences set out under this regime, the most relevant for these purposes are those dealing with misleading statements and market manipulation. As set out below, these are now set out within Part 7 of the FSA 2012, and were until April 1, 2013, contained in FSMA § 397.

The principal differences brought by the enactment of Part 7 of FSA 2012 are:

1. The addition of a new specific offense in relation to benchmarks; and
2. The inclusion of misleading impressions made recklessly in addition to those made intentionally within the criminal market abuse regime.

2. Specific Criminal Offenses

(a) Misleading Statements It is a

criminal offence for a person to:

1. "make a statement that he/she knows to be false or misleading in a material respect"; or

[746] While the discussion below focuses on the FCA's market abuse authority, the FCA has broader powers and in recent years, defended its right to prosecute offences in other areas where action may equally be taken by other agencies. In particular, it has successfully defended (all the way to the Supreme Court) a challenge to its right to prosecute money laundering offences and has taken action for fraud and forgery offences where they have related to the way in which regulated activities have been carried on (or purported to have been carried on, but where firms or individuals have lacked the requisite authorization or approval). (See *R v Rollins* [2010] UKSC 39). At the time of writing, the FCA (and the FSA before it) have secured over 30 convictions in criminal market abuse cases. All of these have involved the prosecution of individuals for insider dealing offences.

[747] *I.e.*, to the extent that they fell within the old pre-MAR market abuse regime (as to which see section C above and, in particular, the definitions of Qualifying Investments, Related Investments and Prescribed Markets).

2. "make a statement which is false or misleading in a material respect, being reckless as to whether it is"; or

3. "dishonestly conceal any material facts whether in connection with a statement made by that person or otherwise."[748]

It is also a criminal offense "if the person makes the statement or conceals the facts with the intention of inducing, or is reckless as to whether making it or concealing them may induce another person (whether or not the person to whom the statement is made) to:

1. enter into or offer to enter into, or to refrain from entering into or offering to enter into, a relevant agreement;

2. exercise, or refrain from exercising, any rights conferred by a relevant investment."[749]

Trading in commodities falls within one or both of the definitions of "relevant agreement"[750] and/or "relevant investment,"[751] depending on the context.

(b) Misleading Impressions

It is a criminal offense for a person to "do any act or engage in any course of conduct which creates a false or misleading impression as to the market in or the value of any relevant investments"[752] if the person:

1. "intends to create the impression";[753] and

2. "intends, by creating the impression, to induce another person to acquire, dispose of, subscribe for or underwrite the investments or to refrain from doing so";[754] and/or

3. "knows that the impression is false or misleading or is reckless as to whether it is," and intends to cause a gain for himself or herself or another or to cause a loss for another person or expose another person to a loss.[755]

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[748] FSA 2012 § 89(1).

[749] *Id.* § 89(2).

[750] *Id.* § 93(3).

[751] *Id.* § 93(5).

[752] *Id.* § 90(1).

[753] FSA 2012 § 90(1)(a).

[754] *Id.* § 90(2).

[755] *Id.* §§ 90(3)-(4).

(c) Misleading Statements and Impressions in Relation to Benchmarks

In response to the Wheatley Review of LIBOR, whose findings were released in October 2012, FSA 2012 includes a separate offence covering false and misleading statements made in connection with the setting of benchmark rates.[756] The following benchmarks are currently covered by this offense: (i) LIBOR; (ii) ISDAFIX; (iii) Sterling Overnight Index Average ("SONIA"); (iv) Repurchase Overnight Index Average ("RONIA"); (v) WM/Reuters London 4 p.m. Closing Spot Rate; (vi) London Gold Fixing; (vii) LBMA Silver Price; (viii) ICE Brent Index.[757]

The authorization to prosecute individuals and corporations for misleading benchmark submissions was not retroactive in effect, and as a result, the SFO rather than the FCA has been deemed the more appropriate prosecutor for conduct related to alleged LIBOR manipulation that occurred prior to 2012. Prosecutions of individuals pursued to date in respect of benchmark manipulation have been under the general criminal law for conspiracy to defraud. The SFO also has greater experience with prosecuting these offences (and has received some dedicated additional funding and resources from the UK government to enable it to do so).[758]

3. Territorial Application

(a) Misleading Statements For

the misleading statements offense to apply:

1. the statement (or the facts contained therein) must be made in or from the UK, or the arrangements for the making of the statement or the concealment must be made in the UK;

2. the person on whom the inducement is intended to or may have effect must be in the UK; or

3. it must be the case that the "relevant agreement" is or would be entered into, or that the rights are or would be exercised, in the UK.[759]

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[756] *Id.* § 91.

[757] FSA 2012 (Misleading Statements and Impressions) Order 2013 (S.I. 2013/637) art. 3.

[758] The SFO has, at the time of writing, brought charges against 13 individuals in connection with the manipulation of LIBOR. One individual pleaded guilty in October 2014 to offences of conspiracy to defraud in connection with the manipulation of Yen LIBOR. He was sentenced to 14 years' imprisonment, although that sentence was subsequently reduced to 11 years. Six individuals were subsequently acquitted of all charges relating to alleged conspiracy with that individual to defraud in connection with LIBOR submissions. In June 2016, three former bank employees were convicted of conspiracy to defraud in connection with USD LIBOR submissions and sentenced to a total of 13 years' and three months' imprisonment. In these latter proceedings, the jury could not reach a verdict in respect of two other individuals and retrials are awaited at the time of writing.

[759] *Id.* § 89(4).

(b) Misleading Impressions

For the misleading impressions offense or the offense relating to misleading statements in connection with benchmarks to apply:

1. The act must be done, or the course of conduct engaged in, in the UK; or

2. the false or misleading impression must be created in the UK.[760]

4. Defenses

It is a defense to all three offenses for the person to show that he or she acted in conformity with particular control-of-information, stabilization, and buy back rules (which are not applicable to the commodities markets).[761]

It is also a defense to the misleading statements offense for a person to show that he or she reasonably believed that the conduct would not create a false or misleading impression as to the matter(s) in question.[762]

F. The Relationship Between the Market Abuse Regimes and Other Regulatory Obligations

The FCA enjoys considerable discretion as to how to deal with market-based misconduct involving authorized firms or approved persons. It can act against firms authorized and/or individuals approved by it for misconduct akin or relating to market abuse even where jurisdictional, evidentiary, and other hurdles prevent it from acting against them under the civil or criminal market abuse regimes.

Similarly, there is no bar to the FCA's acting for market abuse at the same time as action for breaches of others of its rules and standards.

1. Authorized Persons: The Principles for Businesses

The Principles are, in one sense, of narrower application than the market-abuse regimes, in that they apply only to "authorised persons . . . carrying on regulated activities" in the United Kingdom.[763]

In practice, however, they prohibit a much wider range of behavior. They are not limited to conduct relating to "qualifying investments," "related investments," or "prescribed markets," and apply to

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760 *Id.* § 90(10).

761 *Id.* §§ 89(3), 90(9)(b)-(d), & 91(3)-(4).

762 *Id.* § 90(9)(a).

763 FSMA § 19.

all conduct, whether or not it falls within one of the seven types of behavior proscribed under the market abuse regime.

The FCA can act against an authorized person for both market abuse and breaches of the Principles on the basis of the same conduct. It is not necessary for market abuse to have actually occurred in order for the FCA to act under the Principles.[764]

2. Rules and Standards Applicable to the Conduct of Individuals

The approved-persons regime, and specifically the Code of Practice and Statements of Principle for Approved Persons ("APER") under FSMA Part 5, provides a similarly useful alternative (or additional) means for the FCA to deal with market based misconduct by individuals who are approved to perform "controlled functions."[765]

The approved persons regime applied to individuals within "authorised persons" performing one or more of these functions prior to March 6, 2016. After that date, the Approved Persons Regime was replaced by the Senior Managers and Certification Regimes and Conduct Rules for individuals within "relevant authorized persons" (which, at the time of writing, means banks, although separate regimes apply to insurers and the scope of the new regimes mentioned above is expected to be widened to take in all UK financial services firms with effect from Summer 2018). Further, details in relation to these new regimes is included below.

Allegations of market abuse are not necessary, and the misconduct need not have been deliberate, for the FCA to be able to act under the approved-persons regime or the new individual accountability regimes which have replaced it. In addition to imposing financial penalties or public censures, the FCA may make prohibition orders and/or withdraw individuals' approval(s) if it considers that market abuse related (or any other) conduct demonstrates that they are not fit and proper.[766]

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[764] For example, in February 2016, the FCA imposed a financial penalty of £1.2 million and a restriction on carrying on regulated activities for a period of 72 days on W H Ireland Limited for breaches of Principle 3 (management and control) and rules contained in the Senior Management Arrangements, Systems and Controls section of the FCA's Handbook in connection with failures to maintain adequate systems and controls to prevent market abuse (https://www.fca.org.uk/publication/final-notices/wh-ireland.pdf).

[765] For example, in March 2012, the FSA imposed a financial penalty of £210,000 on Nicholas Kyprios for breaching Principles 2 (skill, care and diligence) and 3 (market conduct) in connection with the disclosure of confidential information. The information disclosed was not "inside information" as the instruments in question were not "qualifying investments". *See* FSA Final Notice, *Nicholas Kyprios*, March 13, 2012 (http://www.fsa.gov.uk/static/pubs/final/nicholas-kyprios.pdf); *also see* FSMA § 59.

[766] Fitness and propriety is assessed by reference to honesty and integrity, competence and capability and financial soundness. See the Fit and Proper Test for Approved Persons in the FCA's Handbook For example, in December 2013, the Court of Appeal upheld a decision of the Upper Tribunal that David Hobbs should be made the subject of a prohibition order as he lacked integrity based upon findings that he lied to the FCA during an investigation and subsequent enforcement proceedings. It decided that this was the appropriate course of action notwithstanding the fact that the Upper Tribunal did not accept submissions made by the FCA that Mr Hobbs had engaged in market manipulation contrary to the civil market abuse regime in connection with instructions to a broker to

3. Other Rules and Standards

Conduct amounting to market abuse in the UK may also constitute breaches of rules or standards contained in other parts of the FCA's Handbook or imposed by other regulators or standard-setters, both in the UK and in other jurisdictions. This may result in both the FCA and the other regulator(s) investigating and enforcing their own rules.[767]

4. The FX and Precious Metals Codes of Conduct

In June 2015, in the wake of the benchmark interest rate investigations discussed above, the Bank of England published the Fair and Effective Markets Review's final report, which was commissioned by the Chancellor of the Exchequer in order to reinforce confidence in the UK wholesale fixed-income, currency and commodity (FICC) markets and to influence the international debate on market practices. Following the report, both the FX and Precious Metals industries published new Codes of Conduct to govern market behavior. Both of these Codes are drafted as principal-based codes rather than a set of rules and is a voluntary code. However, the FCA has stated that it expects "firms, Senior Managers, certified individuals and other relevant persons to take responsibility for and be able to demonstrate their own adherence with standards of market conduct." In both cases, these codes set out best practice in ethics, governance, compliance and risk management, information sharing and business conduct.

G. FCA Investigations

1. The FCA's Investigative Process and Powers

The civil market abuse regime under FSMA Part 8, as applied to transactions in the commodities markets, overlaps significantly in a number of areas with the criminal offenses set out at FSA 2012 Part 7 (or, in respect of historic misconduct, FSMA § 397).[768]

Because conduct amounting to market abuse may also fall within the definition of these criminal offenses, the FCA has significant discretion as to which of its powers to use in each particular case. Indeed, investigations into suspected market abuse sometimes commence with FCA investigators (in conjunction with police officers) executing search warrants under FSMA § 176 and/or

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purchase coffee futures. *See Financial Conduct Authority v David John Hobbs* [2013] EWCA Civ 918 (http://www.bailii.org/ew/cases/EWCA/Civ/2013/918.html).

[767] For example, in July 2013 coordinated action by the FCA, the CFTC, the CME, and the ICE Futures Exchange against Michael Coscia and Panther Energy Trading LLC resulted in the imposition of more than $2.1 million in fines in connection with manipulation of markets through the use of algorithmic computer programmes. *See* FCA Final Notice, *Michael Coscia*, July 3, 2013 (http://www.fca.org.uk/your-fca/documents/final-notices/2013/michael-coscia). It should be noted that the FCA does have powers to direct recognized investment exchanges and recognized clearing houses to terminate, suspend, or limit the scope of investigations that they may be carrying out in order to allow the FCA to take over the investigation itself. *See* FSMA § 128.

[768] Beginning as of April 1, 2013, the offenses set out at FSA 2012 Part 7 replaced those previously contained in FSMA § 397 concerning misleading statements to the market.

conducting interviews using their criminal investigation powers under, *inter alia*, the Police and Criminal Evidence Act 1984.

In the majority of market abuse investigations, however, investigators use their wide-ranging powers under FSMA Part 11, which enable them to require the production of documents and to compel individuals to attend interviews and answer questions. In order to avoid infringing the privilege against self-incrimination under the European Convention on Human Rights ("ECHR"), FSMA provides that statements given under compulsion may not be used against the maker of the statements in a market abuse case.[769]

The FCA's stated policy is to elect to either pursue regulatory action for breaches of FSMA Part 8 or to prosecute criminal offenses, rather than to pursue individuals or entities using both sets of powers.[770]

The FCA (and the FSA before it) has, to date, adhered to this policy in market abuse cases. However, in several cases illustrating the wide range of tools available to it and the flexible way in which it seeks to use them (see below), the FSA has followed up criminal prosecutions for insider dealing against approved persons by taking regulatory action to ban them from the financial services industry[771] or to require the disgorgement of profits.[772]

2. Regulatory Enforcement Action

If, after investigating a matter, the FCA decides that it is appropriate to take regulatory enforcement action, unless the matter is settled under the FCA's executive settlement procedures, [773] the investigators will make a recommendation to the Regulatory Decisions Committee ("RDC"), an independent sub-committee of the FCA's board. Having heard representations from the FCA investigating team and the subject(s) of the action, the RDC will decide whether any breaches have occurred and, if so, which penalties should be imposed. If it decides to impose a sanction, the RDC will issue a Decision Notice setting out the breaches and the penalty.[774]

If the subject of the action disagrees with the RDC's findings and/or the penalty imposed, he or she may refer the matter to the Upper Tribunal (Tax and Chancery Chamber) (the "Tribunal"), which will hear the matter *de novo* and make its own determination as to whether any breaches have occurred and what, if any, penalty is appropriate.

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769 FSMA § 174(2).

770 Enforcement Guide, Chapt. 12.

771 *See, e.g.*, FSA Final Notice, *Christian Littlewood* (May 31, 2012), http://www.fsa.gov.uk/static/pubs/final/christian-littlewood.pdf.

772 *See, e.g.*, FSA Final Notice, *Anjam Ahmad* (June 22, 2010), http://www.fsa.gov.uk/pubs/final/ahmad.pdf).

773 Decision Procedure and Penalties Manual ("DEPP") Chapter 5.1.

774 FSMA § 126.

At the end of this process, either the subject of the action or the FCA may appeal the Tribunal's determination on a point of law to the Court of Appeal.

Proceedings before the RDC are not subject to any rules of evidence. The RDC must simply be "satisfied" that market abuse has taken place in order to make a finding against and impose a penalty on a person.[775] The onus is on the FCA investigators to satisfy the RDC on this point.

Proceedings before the Tribunal, although less formal than civil or criminal litigation before the courts, are more rigidly governed by procedural rules[776] than those before the RDC. These rules provide for the calling of witnesses by and the exchange of evidence between the FCA and the subject of the action.

The appropriate standard of proof is the civil standard of the balance of probabilities.

H. Examples of Enforcement Proceedings

1. Manipulation: Marking the Close

Although there are no concluded cases relating to this type of manipulation in the commodities markets, the FSA has taken action for "marking the close" in relation to other types of "qualifying investments."

In September 2012, the Tribunal imposed a financial penalty of £900,000 on Stefan Chaligné and ordered him to disgorge €362,950 in profits in connection with market abuse accomplished by manipulating transactions. The Tribunal found that Chaligné engaged in a scheme to "window dress the close" on certain key portfolio valuation dates in 2007 and 2008. It rejected his defense that he did so in order to "defend his positions" against others who, he argued, were seeking to depress the price of the "qualifying investments" in question.[777]

This followed the Tribunal's imposition in July 2011 of a financial penalty of £2 million on Michiel Visser for similarly engaging in manipulating transactions aimed at marking the close in respect of several illiquid securities in 2007.[778]

2. Manipulation: Corners and Squeezes

In June 2010, the FSA imposed a financial penalty of £100,000 and a prohibition order on Andrew Kerr in relation to his role in manipulating the market in LIFFE traded coffee futures and options in 2007. The FSA acted under § 118(5) of FSMA in connection with his actions, on the instructions

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775 *Id.* § 123(1).

776 Reg. 26B and Schedule 3, Tribunal Procedure (Upper Tribunal) Rules 2008 (SI 2008/2698).

777 *Chaligne, Sejean and Diallo v. FSA*, Upper Tribunal (Tax and Chancery Chamber), Apr. 15, 2012 (https://assets.publishing.service.gov.uk/media/5753d6e6e5274a6ed1000036/C_S_D_v_FSA.pdf).

778 *Michiel Visser and Oluwole Fagbulu v. FSA*, Upper Tribunal (Tax and Chancery Chamber), (FS/2010/0001 and FS/2010/0006), Aug. 9, 2011 (https://assets.publishing.service.gov.uk/media/5752b0b940f0b6432800001e/VisserandFagbulu_v_FSA.pdf).

of a client, to place large numbers of orders with a view to raising the price of coffee futures to a particular level.[779]

In August 2011, the Tribunal imposed a financial penalty of £25,000 on Jason Geddis for bringing about an abusive squeeze through trading in lead futures on the London Metals Exchange in 2008. The Tribunal decided that the conduct amounted to market abuse notwithstanding that it arose from extreme carelessness rather than any attempt to engage in a premeditated abusive strategy.[780]

In March 2014, the FCA imposed a financial penalty of £662,700 and a prohibition order on Mark Stevenson in relation to attempts to inflate the price of UK government gilts during the second round of quantitative easing by the Bank of England.[781]

3. Layering

In July 2013, the FCA imposed a financial penalty of USD $903,176 on Michael Coscia for market manipulation through layering using an algorithmic trading program to trade in oil futures on the ICE Futures Europe exchange. The FCA action against Coscia and his firm, Panther Energy Trading LLC, was coordinated with the CFTC and CME, leading to the imposition of total fines of more than USD $2.1 million.[782]

In December 2013, the Upper Tribunal imposed a financial penalty of £8 million on Swift Trade Inc. for market manipulation through layering in relation to shares traded on the London Stock Exchange between January 2007 and January 2008.[783]

In August 2015, the FCA applied for and obtained a permanent injunction restraining market abuse by Da Vinci Invest Limited and associated companies and individuals and orders imposing financial penalties on various associated individuals in connection with market manipulation through layering. The conduct involved the placing of large orders to purchase contracts for difference, which were subsequently cancelled, aimed at giving the impression of shifts in supply and demand in the market.[784]

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[779] FSA Final Notice, *Andrew Charles Kerr*, June 2, 2010 (http://www.fsa.gov.uk/pubs/final/andrew_kerr.pdf).

[780] *Geddis v. FSA*, [2011] UKUT 344 (TCC) (https://assets.publishing.service.gov.uk/media/5752b5feed915d3c89000014/JasonGeddis_v_FSA.pdf).

[781] FCA Final Notice, *Mark Stevenson* (Mar. 20, 2014), https://www.fca.org.uk/publication/final-notices/mark-stevenson.pdf.

[782] FCA Final Notice, *Michael Coscia* (July 3, 2013), http://www.fca.org.uk/your-fca/documents/final-notices/2013/michael-coscia.

[783] *See 7722656 Canada Inc (formerly carrying on business as Swift Trade) v. FSA*, Upper Tribunal (Tax and Chancery Chamber), (Jan. 23, 2013), https://assets.publishing.service.gov.uk/media/5752dfdfed915d3c8c00001a/7722656_Canada_INC_formerly_Swift_Trade_and_Peter_Beck.pdf.

[784] The FCA sought and obtained freezing injunctions under section 381 of FSMA. This provision allows it to apply to the Court, and for the Court to grant relief where it is satisfied that there is a reasonable likelihood that any person will engage in market abuse or where any person is engaging or had engaged in market abuse and there is a reasonable likelihood that the market abuse will continue or be repeated. The FCA applied to the Court to seek

Case Study: Paul Axel Walter FCA Final Notice (November 22, 2017)

In November 2017, the FCA found that Paul Walter had engaged in market abuse through his trading in Dutch State Loans ("DSL"s) and was fined £60,000. According to the FCA Final Notice, Walter, a London-based bond trader was a customer-facing market maker for DSLs and also traded DSLs on the inter-dealer market through the BrokerTec trading platform. According to the FCA, in July and August of 2014, Walter engaged in twelve instances of a distinctive trading pattern. On eleven occasions, Walter entered bids above the highest bid price for 2,000,000 DSLs, the minimum size allowed in BrokerTec, and became the Best Bid. Other firms using automated systems to track the Best Bid raised their bid prices, and Walter would then, in quick succession, sell to another firm at these raised prices and then cancel his Best Bid. In one other instance, Walter used the same trading pattern on the opposite transaction side, becoming the Best Offer at the lowest price for the minimum 2,000,000 DSLs and then buying DSLs at a lower price from other firms. In two instances Walter's Best Bid or Offer was accepted. At the same time, Walter's offers to buy or sell on the opposite side of his Best Bid or Offer were larger in size than his Best Bid or Offer in all but one occasion.

The FCA found that Walter's conduct violated Section 118(5) of the Financial Services and Markets Act of 2000, which prohibits acts that create a false or misleading impression about supply and demand or price. The FCA found that Walter had made a representation to the market that he wanted to buy by placing the Best Bid when he in fact wanted to sell at an artificial and advantageously higher price and had conversely represented that he wanted to sell by placing the Best Offer when he in fact wanted to buy at an artificial and advantageously lower price. And although the FCA noted that no mental state is needed to make a case of market abuse, it found that Walter had intentionally given these false or misleading representations to the market and was negligent in not knowing that this would constitute market abuse under Section 118(5). Notably, the FCA found this violation despite Walter's actions not affecting the overall liquidity of the market available to investors because the misrepresentations about his own desires as a buyer or seller affected supply and demand and the price monetarily.

Interestingly, the FCA also made a distinction between Walter's trading actions, here, and what it would otherwise consider to be spoofing and layering. Walter argued that his bids were high quality and available for multiple seconds, a long time given the speed of the market. Thus, he claimed his actions were not spoofing or layering in that there was a likelihood that his Best Bids or Offers would be accepted. The FCA acknowledged that Walter did risk a transaction occurring but explained that the FCA was not alleging that Walter had engaged in either spoofing or layering. Instead, the FCA noted that Walter's Best Bids and Offers constituted market manipulation because they were not "genuine" in that he did not intend to engage in trades with them and also mitigated his downside risk by using the minimum trade amount.

The FCA Final Notice highlights a distinction between U.S. and UK manipulation cases since Walter's actions would be considered spoofing under U.S. law. However, UK case law has defined

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the imposition of a financial penalty under section 129 of FSMA, which enables the Court to make an order requiring any person to pay to the FCA a penalty of such amount as it thinks appropriate. *FCA v Da Vinci Invest Limited* [2015] EWHC 2401 (Ch).

spoofing as the placing of a large order at prices that are unlikely to be filled, distinguishing it from Walter's actions here.

I. The Regime Covering Market Manipulation and Insider Dealing Distorting Wholesale Energy Prices

In December 2011, EU Regulation 1227/2011 on wholesale energy market integrity and transparency ("REMIT") came into force in EU member states. It has since been implemented in the UK with effect from 29 June 2013.[785]

REMIT is aimed at preventing increases in retail prices due to the distortion of wholesale energy prices through market manipulation and insider dealing. Specifically, it:

1. prohibits the use of "inside information" when buying or selling in the wholesale energy markets;[786]

2. requires the disclosure of "inside information" before trades can take place;[787]

3. prohibits "market manipulation" or the dissemination of incorrect information giving false or misleading signals in relation to supply, demand or prices;[788] and

4. imposes transaction reporting obligations on energy traders.[789]

REMIT's definitions of "inside information" and "market manipulation" are materially identical to those used for the purposes of the UK civil market abuse regime.

Responsibility for monitoring the gas and electricity markets and some other areas lies with the Agency for Co-operation of Energy Regulators ("ACER"), a supranational body based in Ljubljana, Slovenia. However, responsibility for enforcement of provisions relating to insider dealing and market manipulation lies with national regulatory authorities. In the UK, the national regulatory authority is the Gas and Electricity Markets Authority ("GEMA"), which acts mainly through the Office of Gas and Electricity Markets ("OFGEM").

OFGEM has not yet concluded any action under REMIT but has powers to investigate breaches, compel the provision of information, and impose penalties. In June 2015, it published procedural

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785 *See* Electricity & Gas (Market Integrity and Transparency) (Enforcement etc.) Regulations 2013.

786 REMIT arts. 3(1) & 3(5).

787 *Id.* arts. 4(1)–4(3).

788 *Id.* art. 5.

789 *Id.* art. 15.

guidelines[790] setting out the process for enforcement, a penalties statement[791] setting out how it will decide whether to impose a penalty or take other action, when action will be taken, and the process for determining the appropriate level of penalties, and a prosecution policy statement[792] stipulating the circumstances in which it will prosecute insider dealing or market manipulation offences.

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[790] Office of Gas and Electricity Markets, *Consultation Decision – REMIT Procedural Guidelines and Penalties Statement Consultation* (Jun. 23, 2015), https://www.ofgem.gov.uk/publications-and-updates/consultation-decision-remit-procedural-guidelines-and-penalties-statement-consultation.

[791] Office of Gas and Electricity Markets, *REMIT Penalties Statement* (Jun. 23, 2015), https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/remit_penalties_statement_23_june_2015_1.pdf.

[792] OFGEM is required by regulation 9 of the Electricity and Gas (Market Integrity and Transparency) (Criminal Sanctions) Regulations 2015 to issue a prosecution policy statement in relation to the circumstance sin which it will prosecute particular offences in relation to insider dealing under the Gas Act 1986 and the Electricity Act 1989. Office of Gas and Electricity Markets, *Criminal Prosecution Policy Statement* (Feb. 29, 2016), https://www.ofgem.gov.uk/system/files/docs/2016/02/criminal_prosecution_policy_statement_29_februar y_2016_0.pdf.

VII. RESPONDING TO A U.S. GOVERNMENT INVESTIGATION

A. Introduction

Unlike the prospect of responding to a civil lawsuit, investigations tend to be iterative processes. When the prospect of an investigation involving U.S. authorities presents itself, stakeholders should set forth an efficient plan for identifying and comprehensively understanding pertinent issues and responding effectively. It is important to begin an investigation with potential endpoints in mind. Meanwhile, however, any investigative plan should be flexible enough to incorporate and respond to suggested modifications, including from government regulators. At the outset of a U.S. investigation, a company should comprehensively consider, among other things: potential and desired outcomes, expectations of relevant agencies, and the structuring of investigative processes to minimize risky and constraining decisions.

Recent high-profile investigations have seen collaboration among U.S. enforcement agencies, including the U.S. Department of Justice, the U.S. Commodity Futures Trading Commission, the Federal Energy Regulatory Commission, as well as the New York State Department of Financial Services and states' attorneys general and district attorneys' offices. Criminal prosecutors are also working in tandem with civil enforcement attorneys, rather than waiting for referrals. This collaboration also extends across borders and among a multitude of non-U.S. regulators. The key enforcement authorities not only include U.S. civil and criminal authorities but also states' attorneys general. And fines and penalties levied against corporate defendants have reached astronomical highs, with unclear mathematical correlation to specified violations or actual harm.

B. Stages of an Investigation

Broadly, an investigation can be considered to have three overarching phases: (1) commencement, (2) information gathering, and (3) resolution.

During the commencement phase of an investigation, corporations should strive to understand the potential sources and triggers of an investigation, including internal reporting, external requests, or market awareness. Additionally, at the onset of an investigation, corporations should identify which government agencies might ultimately be involved and consider the respective agencies' expectations.

Next, during the information gathering phase, the target of investigation should determine an optimal outcome and structure an investigation plan with that outcome in mind. Special consideration should be given to identifying potential sources of information, the scope of the inquiry, and issues concerning confidentiality and privileged communication.

Finally, in the resolution phase, corporations should carefully manage the outflow of information and ensure that all actions taken are directed at the desired outcome. The resolution strategy should be tailored to the specific agency or agencies involved and also reflect cognizance of any potential collateral consequences.

C. Legal Framework: Reach of U.S. Law and Process

1. Jurisdiction

(a) Generally

In order to hear a claim against a foreign person or entity in either the civil or criminal context, a court must first assert jurisdiction over the person and the conduct. Jurisdiction refers to a court's ability to exert its power and legal authority over the parties and matter at hand. Where conduct occurs outside the U.S., courts must separately find that the relevant U.S. law or laws to be applied are able to reach beyond U.S. territory. As a general matter, U.S. regulators and prosecutors take an expansive view of their territorial reach and are asserting increasingly aggressive jurisdictional claims in U.S. courts.

(b) Personal Jurisdiction

Personal jurisdiction refers to the authority of a court to exercise its power over a particular person or entity. There are two types of personal jurisdiction – general and specific – but only one must be present.

General jurisdiction grants courts the ability to hear any and all claims against a party, and specific jurisdiction grants courts the power to hear claims relating to specific conduct of the parties. In the criminal context, courts exercising personal jurisdiction must do so in a manner consistent with federal due process.[793] Courts have expounded upon this rather nebulous standard and explained that, to prosecute a foreign individual or entity, there must be "a sufficient nexus between the defendant and the United States, so that such application would not be arbitrary or fundamentally unfair."[794]

(1) General Jurisdiction

General jurisdiction exists where a party has "continuous and systematic" contacts with the forum, regardless of whether those contacts relate to the lawsuit. The central inquiry in determining whether a court has general jurisdiction is not the conduct of the parties involved, but rather the geographical connection that an entity maintains with the forum. The U.S. Supreme Court recently clarified that courts may assert general jurisdiction over a nonresident corporation only when its affiliations with the forum are "so continuous and systemic as to render [it] essentially at home in the forum State."[795] Under this formulation, absent "exceptional" circumstances, a corporation is only subject to general jurisdiction in the district or state where it is incorporated or where it has its principal place of business.[796]

Notably, courts obtain personal jurisdiction over individuals when they are physically present in the forum, even if only transiently.

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[793] *See* U.S. CONST. amend. V.

[794] *United States v. Yousef*, 327 F.3d 56, 58 (2d Cir. 2003).

[795] *Daimler AG v. Bauman*, 134 S. Ct. 746, 754 (2014).

[796] *Id*. at 761 n.19; *see also Gucci Am., Inc. v. Li*, 768 F.3d 122 (2d Cir. 2014).

(2) Specific Jurisdiction

Specific jurisdiction requires that a party purposefully direct its activities toward the forum and that the lawsuit itself relate to that party's contacts with the forum. Typically, specific jurisdiction involves a fact-intensive inquiry into "Who did what? And where?"

Example Case: *Gucci America, Inc. v. Weixing Li*, 768 F.3d 122 (2d Cir. 2014)

In *Gucci Am., Inc. v. Weixing Li*, the Second Circuit held that the district court could not exercise general jurisdiction over a Chinese bank that had branch offices within the U.S., but conducted the vast majority of its business abroad.[797]

The question of whether the bank is subject to specific jurisdiction was remanded to the lower court.

2. Extraterritoriality Principles

As is discussed extensively in §§ II(B)(2) and III(c) above, there are significant limits on the U.S. government's ability to prosecute individuals and entities for conduct outside of the U.S.

The U.S. Supreme Court has consistently reaffirmed this presumption against extraterritoriality by holding that, unless a statute clearly indicates Congress intended an extraterritorial application, it has none. The Supreme Court's treatment of the Exchange Act provides a key example of an application of the presumptions against extraterritoriality.

There are, however, certain circumstances where U.S. law unambiguously anticipates extraterritorial application. For example, the broad reach of the U.S. wire fraud statute criminalizes any scheme to defraud that affects "interstate or foreign commerce" and may be prosecuted in the United States where an electronic communication, such as a telephone call or email, in furtherance of the alleged scheme travels through the United States.[798] In enforcing crimes that invoke this statute, the DOJ has the ability to bring criminal charges for violations of U.S. law despite the fact that the conduct at issue occurred almost entirely overseas.

Moreover, as discussed above, recent cases covering a wide range of sectors demonstrate that foreign nationals, even when operating outside the U.S., may fall within the ambit of U.S. criminal prosecution.[799]

D. Commencement Phase: Anticipating How a U.S. Investigation Can Begin

1. Sources and Triggers for Investigations

A variety of events may warrant conducting an internal inquiry. Investigations may be commenced through the direct intervention of a government agency, whether of its own volition or as a result

[797] *Gucci*, 768 F.3d at 135.

[798] 18 U.S.C. § 1343.

[799] *See supra* at II(B).

of information supplied to it. Investigations can be triggered by third party allegations (for example, in the press or in the context of ongoing regulatory investigations) or staff concerns (in exit interviews, disciplinary procedures, or by internal whistleblowing). Internal investigation may also be the prudent response to known regulatory enforcement in a discrete area which indicates broader risk issues.

2. Internal Identification of Potential Issues

(a) Discovery of Misconduct

Discovery of possible misconduct can occur while undertaking routine corporate inquiries such as internal audits and due diligence. In addition, employees and others connected with the company may be aware of or suspect a violation and make a report internally or to a governmental agency. Companies should be sensitive to increasing whistleblower activity.

(b) Internal Reports

Internal reports of potential misconduct, whether to in-house counsel, human resources personnel, or employee supervisors, will require an assessment of whether the issue presents a violation of law, regulations, or company policy. Not all reports of misconduct within a company will necessitate an internal investigation conducted by outside counsel or the creation of a special investigative board committee. If the alleged misconduct involves an individual employee and does not implicate potential violations of law, in-house counsel, with support from appropriate business functions such as the internal audit department, can investigate the allegations and recommend appropriate remedial and personnel actions to management. Conversely, where the potential misconduct is widespread, may involve officers or directors, potentially violate law, affect corporate governance, or subject the company to government investigation and enforcement actions, the company should utilize external counsel to lead the investigation.

(c) Investigations

During an investigation, a company may uncover evidence of a different but related category of misconduct. In these situations, the company should consider the potential scope of the issue as well as whether leniency may be available for the conduct.

(d) Whistleblowers

Due to the increases in protections, an investigation is now more likely to be triggered by internal whistleblowers. Section 23 of the CEA provides for whistleblower protections – including a private right of action for retaliation that allows for reinstatement, back pay with interest, and compensation for special damages – and employers cannot discriminate against a whistleblower in retaliation for reporting misconduct to, or assisting in investigations of, the CFTC.[800] The CFTC has recently increased its commitments to anti-retaliation by amending its rules. Also, in determining retaliatory conduct, courts have refused to create a bright-line standard for what constitutes adverse employment action, meaning retaliation cases are likely to be difficult to

[800] 15 U.S.C. § 78u–6(h)(1)(A).

dismiss and to defeat at the motion for summary judgment stage, especially given that the burden on the whistleblowers are not onerous. These reasons give whistleblowers more of an incentive to report violations to the CFTC and other agencies.

3. Awareness of Investigations of Other Market Participants and Risk Assessments

Often, government agencies and prosecutors will conduct industry-wide investigations of entities that undertake similar business activities or offer similar products where a violation is suspected at a peer company, especially where the violation may involve collusive conduct. Counsel should monitor developments and trends in agencies' enforcement priorities and conduct appropriate due diligence where an investigation of a peer company involves a product or business function that the company shares. Often, similar structural characteristics or incentives exist in companies in a given industry that independently lead employees to undertake similar actions. An initial risk assessment is therefore highly advisable where a peer company is under investigation for conduct that could plausibly occur at the company. The necessity of conducting a risk assessment is particularly acute where the investigated conduct could involve external coordination or communications, because investigators could come into possession of materials involving the company through investigation of others. A risk assessment should be guided by counsel that is familiar with potentially applicable U.S. law.

E. Commencement Phase: Analyzing U.S. Agencies' Priorities

1. Cooperation Expectations of U.S. Authorities

After a company learns that a governmental authority has begun an investigation into it, the company must decide how cooperative it will be with the authority. That decision is laden with numerous considerations, and a decision either way involves many potential benefits and drawbacks

(a) DOJ

The standards that guide the U.S. Department of Justice's criminal prosecution of companies are set out in the USAM's "Principles of Federal Prosecution of Business Organizations." That section of the USAM lists ten factors – often called the "Filip Factors," so-named after former Deputy Attorney General ("DAG") Mark Filip – which DOJ attorneys consider in determining whether to charge a company. These factors include the company's "willingness to cooperate in the investigation of its agents" and its "efforts . . . to cooperate with the relevant government agencies."[801] In other words, whether and the extent to which a company cooperates with the DOJ directly affects the DOJ's likely treatment of it.

The potential benefits of cooperation are significant. The USAM explains that "[c]ooperation is a mitigating factor, by which a corporation . . . can gain credit in a case that otherwise is appropriate

[801] U.S. Attorney's Manual, *supra* note 427, at § 9-28.300; Filip, *supra* note 581.

for indictment and prosecution."[802] Such credit can lead to reduced charges and penalties, or avoidance of charges altogether.

Although the USAM does not formally define "cooperation," it identifies how a company can be eligible for cooperation credit. Of utmost importance, "the company must identify all individuals involved in or responsible for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all facts relating to that misconduct."[803] These relevant facts include: "[H]ow and when did the alleged misconduct occur? Who promoted or approved it? Who was responsible for committing it?"[804]

Pursuant to DOJ policy, "any company seeking cooperation credit in criminal cases must identify every individual who was substantially involved in or responsible for the criminal conduct."[805] Pursuant to this policy, companies must "identify all wrongdoing by senior officials" to earn any cooperation credit in a civil case, with maximum credit available after the company "identif[ies] every individual person who was substantially involved in or responsible for the misconduct."[806]

Cooperation can take many forms, including: producing relevant documents, making employees available for interviews, proffering findings from internal investigations, and assisting in the analysis and synthesis of potentially voluminous evidence. Further, to achieve cooperation under current DOJ policy, corporations must also attempt to identify all culpable individuals, timely produce all relevant information, and agree to continued cooperation even after resolving any charges against the company. The amount of credit earned will depend on the proactive nature of the cooperation and the diligence, thoroughness, and speed of any internal investigation. But the USAM also clarifies that waiver of attorney-client privilege or work-product protection is not required for credit so long as the relevant facts concerning misconduct are disclosed.[807]

Notwithstanding the increased responsibility on the part of companies to make "extensive efforts" in their internal investigations, counsel should be aware that the DOJ has, in the past, often conducted its own parallel investigation "to pressure test" a company's efforts, and if the DOJ concludes through its own investigation that the internal investigation's efforts "spread corporate talking points rather than secure facts related to individual culpability," companies will "pay a price when they ask for cooperation credit."[808] Thus, any attempt to cooperate and seek credit should be taken on diligently and with the full commitment of all involved.

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802 U.S. Attorney's Manual, *supra* note 427, at § 9-28.700.

803 *Id*.

804 *Id*. at § 9-28.720.

805 Rosenstein, *supra* note 1. The Justice Manual has been updated to reflect these priorities at §§ 9-28.210, 9-28.300, 9-28.700. U.S. Dep't of Justice, Justice Manual §§ 9-28.210, 9-28.300, 9-28.70 (2018), https://www.justice.gov/jm/jm-9-28000-principles-federal-prosecution-business-organizations?utm_medium=email&utm_source=govdelivery#9-28.700.

806 *Id*.

807 U.S. Attorney's Manual, *supra* note 427, at § 9-28.710.

808 Miller, *supra* note 552.

(1) DOJ Antitrust Division Leniency Program

A company engaged in cartel conduct that is the first to self-report and fully cooperate with the DOJ's investigation will receive full leniency.[809] The company and its cooperating employees will not be criminally prosecuted. Although leniency applicants can still incur liability for civil damages, such liability is limited to actual damages, rather than the usual treble damages provided for by U.S. antitrust laws. A "second in the door" company can still obtain favorable treatment from the DOJ, if it cooperates and provides information valuable to the DOJ's investigation.

The Antitrust Division first developed its Corporate Leniency Program in 1978, but made significant changes to the program in 1993. Under the revised Corporate Leniency Program, the first company to contact the Antitrust Division and report its involvement in a criminal antitrust violation will receive full amnesty from criminal liability for itself and its cooperating employees, as long as the company meets the criteria outlined in the Leniency Program.

A company is eligible for "Type A" leniency if it self-reports an antitrust violation before the DOJ has opened an investigation and: (1) the Antitrust Division has not yet received information about the misconduct from any other source at the time the company comes forward; (2) the company took "prompt and effective" action to terminate its involvement in the illegal activity upon discovering it; (3) the company reports the misconduct with "candor and completeness" and provides "full, continuing, and complete cooperation" throughout the Antitrust Division's investigation; (4) the company admits to a criminal antitrust violation as a "truly corporate act," rather than "isolated confessions of individuals executives or officials"; (5) the company makes restitution to injured parties "where possible"; and (6) the company did not "coerce" another party to participate in the anticompetitive conspiracy and clearly was not the "leader" or "originator" of the misconduct.

A company who does not satisfy the requirements for "Type A" leniency may still qualify for "Type B" leniency. If a company contacts the Antitrust Division *after* it has opened an investigation, the company may still receive leniency if it is the first company to contact the Division and self-report its involvement in the anticompetitive conspiracy. However, the company will only receive leniency if at the time it self-reports the misconduct, the Antitrust Division does not yet have evidence against the company that is "likely to result in a sustainable conviction." Like Type A applicants, Type B applicants must also take "prompt and effective action" to terminate their involvement in the misconduct, provide "full, continuing, and complete cooperation" with the Division's investigation, confess to a criminal antitrust violation as a truly "corporate act," and make restitution to injured parties where possible.

If these criteria are met, the Division will grant the Type B applicant amnesty from prosecution if it also determines that doing so would not be "unfair to others" based on factors such as: (1) when the company came forward and self-reported the misconduct; (2) how much information and evidence the Division possessed at the time the company self-reported; (3) the company's role in the misconduct; and (4) whether the company "coerced" another party to participate in the misconduct or was the "leader" or "originator" of the conduct.

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[809] U.S. Dep't of Justice, *Corporate Leniency Policy* (1993), https://www.justice.gov/atr/corporate-leniency-policy.

The Corporate Leniency Program creates a strong incentive for companies to report potential antitrust violations to the Division as soon as possible. The Division grants leniency to only one participant in a given anticompetitive conspiracy. Companies are therefore in a "race" against their co-conspirators, and possibly even their own employees, who may also apply to the Division for leniency individually. The Division has noted that in many cases, the second company to seek leniency has been beaten to the Division's door by only a matter of hours.

The Antitrust Division has established a marker system that permits companies to report a possible violation prior to completing a full investigation of the conduct. A marker secures the company's position as the first to come forward and report a violation, while the company gathers more information. To obtain a marker, counsel for the company must contact the Division and: (1) report that the company has discovered information indicating that it engaged in a criminal antitrust violation; (2) disclose the general nature of the conduct; (3) identify the industry, product, or service involved with enough specificity to allow the Division to determine whether a marker is available; and (4) identify the company.

Division guidance makes clear that because companies are encouraged to seek leniency at the first indication of wrongdoing, the evidentiary standard for securing a marker is relatively low.

The Antitrust Division will not prosecute an applicant who meets the requirements of the leniency program for the antitrust violation that it reports or for "acts or offenses integral to that violation."[810] However, a conditional leniency letter only binds the Antitrust Division, not other agencies or sections of the DOJ. It does not protect applicants from prosecution by other agencies for non-antitrust crimes.

(b) CFTC

In January and September 2017, the CFTC issued updated guidance on its cooperation and self-reporting programs. In January 2017, CFTC released a pair of "Enforcement Advisories" detailing the factors the Enforcement Division will consider in rewarding cooperation credit to companies and individuals. In September 2017, CFTC issued another "Enforcement Advisory," this time addressing changes to the agency's self-reporting program. The Advisory clarifies the "concrete benefits" a company will receive in return for self-reporting, cooperation, and remediation.

The CFTC has recognized the cost-benefit analysis companies go through when they discover misconduct and consider whether to voluntarily report it and explained that the updated policies are intended to "shift this analysis in favor of self-reporting."[811]

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[810] U.S. Dep't of Justice, *Frequently Asked Questions about the Antitrust Division's Leniency Program and Model Leniency Letters* 7 (2017), https://www.justice.gov/atr/page/file/926521/download (Appendix H).

[811] James McDonald, Director of the Division of Enforcement, U.S. Commodity Futures Trading Comm'n, *Speech Regarding Perspectives on Enforcement: Self-Reporting and Cooperation at the CFTC* (Sept. 25, 2017), http://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald092517; *see also* U.S. Commodity Futures Trading Comm'n, *Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Companies* (Jan. 19, 2017), http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/ enfadvisorycompanies011917.pdf (Appendix A); U.S. Commodity Futures Trading Comm'n, *Enforcement*

Significantly, the CFTC has also stated that it wants its self-reporting program to "line up with other self-reporting programs, most notably at the Department of Justice."[812] One objective of this effort is to limit the extent to which companies subject to oversight by more than one regulator have to deal with "multiple, sometimes conflicting, self-reporting and cooperation programs."[813] Consistent with this approach, the updated self-reporting guidance aims to provide "greater transparency" regarding what the Enforcement Division requires of companies seeking mitigation credit for voluntarily self-reporting misconduct, and the benefits of doing so.[814]

The updated CFTC self-reporting program stops short of the DOJ Antitrust Division Leniency Program's promise of full amnesty for the first company to self-report misconduct. Instead, the CFTC's new guidance promises that if a company or individual self-reports, fully cooperates, and remediates, the Enforcement Division will recommend that the Commission consider a "substantial reduction" from the otherwise applicable civil penalties.

The new guidance does indicate that in certain cases, the Enforcement Division *may* recommend that the Commission decline to prosecute a company that has self-reported misconduct. However, the guidance indicates the Division will only do so in "extraordinary circumstances" such as when "misconduct is pervasive across an industry and the company or individual is the first to self-report."

To obtain credit, a company must report to the CFTC's Enforcement Division "prior to an imminent threat of exposure of the misconduct" and "within a reasonably prompt time after the company or individual becomes aware of the misconduct." A self-reporting company must disclose "all relevant facts" known to it at the time, including relevant facts about individuals involved in the misconduct. To encourage early disclosure of misconduct, the updated guidance states that the Division will still recommend full self-reporting credit where the company used "best efforts" to: (1) ascertain relevant facts at the time of disclosure; (2) fully disclose the facts known to it at the time; (3) continue to investigate the conduct; and (4) disclose additional relevant facts as they came to light.

The January 2017 Enforcement Advisories provided a detailed overview of factors the Enforcement Division considers in granting cooperation credit. The September 2017 Advisory on self-reporting states that to receive self-reporting credit, a company must also adhere to the terms of the January 2017 cooperation guidance. CFTC considers three broad factors of cooperation:

Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Individuals (Jan. 19, 2017), http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisoryindividuals 011917.pdf (Appendix B); U.S. Commodity Futures Trading Comm'n, *Enforcement Advisory: Updated Advisory on Self Reporting and Full Cooperation* (Sept. 25, 2017), http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/ legalpleading/enfadvisoryselfreporting0917.pdf (Appendix C).

[812] *Id.*

[813] *Id.*

[814] *Id.*

First, the value of the company's cooperation to the Commission's investigation or enforcement action. In this regard, the CFTC will consider: (1) the materiality of the company's assistance; (2) the timeliness of the company's cooperation; (3) the nature of the company's cooperation, such as whether the company independently investigated the misconduct and provided information that was "truthful, specific, complete, and reliable"; and (4) the quality of the cooperation, based on the extent to which the company investigated the misconduct and the completeness of the information reported.

Second, the value of the company's cooperation to the Commission's broader law enforcement interests. In this regard, the CFTC will consider: (1) whether granting cooperation credit would encourage cooperation by other entities; (2) the significance of the matter under investigation; (3) the extent to which the company's cooperation conserved the Enforcement Division's time and resources; and (4) the extent to which granting cooperation credit would otherwise enhance the Commission's ability to detect and pursue violations of the CEA.

Third, the level of the company's culpability and history of past misconduct, balanced against the company's acceptance of responsibility, mitigation, and remediation. In this regard, the CFTC will consider: (1) the circumstances of the misconduct, including its pervasiveness and the level of involvement by management or officers at the company; (2) prior misconduct by the company; and (3) steps taken by the company to mitigate harm, remediate and prevent future misconduct, and accept responsibility for the misconduct.

As for remediation, to obtain the greatest available cooperation credit, the CFTC requires "timely and appropriate remediation of flaws in compliance and control programs." Formal guidance on this issue indicates that the nature and extent of this obligation will be "fact and circumstance dependent." However, in all cases, a company or individual will be required to disgorge all profits resulting from violations and pay restitution to injured parties "where applicable."

2. Anticipating Referral and Charging Decisions

(a) Referral to the DOJ

Although civil regulators such as the CFTC do not themselves bring criminal charges against entities or individuals, they can refer criminal violations of U.S. securities and commodities laws to the DOJ for prosecution.

In a January 2012 memorandum, the DOJ provided that "[T]here may be matters that come to the attention of the Department's civil attorneys or attorneys of other agencies in the first instance that would be appropriate for the Department's prosecutors to investigate and pursue to ensure culpable individuals and entities are held criminally accountable. Early and effective communication and coordination will help avoid many problems and enhance the overall result for the United States."[815]

As discussed at § II(F)(3), in November 2017, Deputy Attorney General Rod Rosenstein gave remarks in which he indicated that DOJ is seeking further coordination with both domestic

[815] Parallel Proceedings, *supra* note 576.

regulators as well as foreign law enforcement agencies. [816] Rosenstein stated that the DOJ is mindful of respondents' concerns with regard to multiple overlapping penalties when the DOJ pursues parallel enforcement actions with domestic enforcement agencies, and the DOJ "is considering proposals to improve coordination in those situations and to help avoid unwarranted payments."[817]

Following on these remarks, on May 9, 2018, Deputy Attorney General Rod Rosenstein announced a new non-binding DOJ policy regarding "Piling On" – the simultaneous imposition of multiple penalties for the same underlying misconduct by different regulatory or criminal authorities. Rosenstein explained, "our new policy discourages 'piling on' by instructing Department components to appropriately coordinate with one another and with other enforcement agencies in imposing multiple penalties on a company in relation to investigations of the same misconduct.[818] He further noted:[819]

> In highly regulated industries, a company may be accountable to multiple regulatory bodies. That creates a risk of repeated punishments that may exceed what is necessary to rectify the harm and deter future violations.
>
> Sometimes government authorities coordinate well. They are force multipliers in their respective efforts to punish and deter fraud. They achieve efficiencies and limit unnecessary regulatory burdens.
>
> Other times, joint or parallel investigations by multiple agencies sound less like singing in harmony, and more like competing attempts to sing a solo.

Of particular importance for multi-national corporations is the directive that DOJ attorneys should "coordinate with other federal, state, local, and foreign enforcement authorities seeking to resolve a case with a company for the same misconduct."[820] The DOJ will consider a number of factors when applying the policy, including the "egregiousness of the wrongdoing; statutory mandates regarding penalties; the risk of delay in finalizing a resolution; and the adequacy and timeliness of a company's disclosures and cooperation with the Department."[821] While the actual impact of the new policy has yet to be seen, members of the defense bar have already voiced their skepticism over whether the policy will result in a notable reduction in DOJ penalties. Where the policy may have the most significant impact is in cases where foreign entities are subject to enforcement actions in their home or other non-U.S. jurisdictions.

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[816] Yates Memo, *supra* note 558.

[817] *Id*.

[818] Rosenstein, *supra* note 426.

[819] *Id*.

[820] *Id*.

[821] *Id*.

(b) DOJ Charging Decisions

Potential resolutions can range from a decision not to charge a corporation to a guilty plea to felony charges. In a Non-Prosecution Agreement ("NPA"), in exchange for cooperation, the DOJ will agree not to prosecute the corporation. In a Deferred-Prosecution Agreement ("DPA"), criminal charges are filed along with an agreement to dismiss the charges within a specific time period if the defendant fulfills the DPA requirements. The DOJ generally requires an admission of wrongdoing to resolve an investigation of a corporation.

The U.S. Attorney's Manual directs prosecutors to consider a number of factors (the previously mentioned Filip Factors) in determining whether to bring charges, negotiate a plea agreement, or enter into some other form of settlement agreement, with cooperation being emphasized above the rest.

Under the Yates Memo, prosecutors cannot enter into a settlement agreement with a corporation without first preparing a written plan to investigate and prosecute individuals. Prosecutors must alternatively prepare a written memorandum justifying a decision not to charge an individual and must obtain approval from a senior Department official.[822]

F. Information Gathering Phase: Conducting the Investigation

1. Planning the Endgame

Every internal investigation should begin with an end game – the ultimate objective – and a plan to get there along the most efficient path. Identifying a desired outcome facilitates the process of anticipating potential issues. Corporations facing investigation must develop a single strategy that works across the various government agencies and jurisdictions at issue, since taking a materially different position in one jurisdiction can come back to be used against you by another authority.

2. Scope and Depth of the Investigatory Request

Corporate counsel should analyze the operative request (whether subpoena, document request, or informal request) to determine which entities, employees, and records may be relevant.

In the rush to get to the bottom of what has happened, it is all too easy for those conducting investigations to become beholden to a pre-determined process and to lose sight of what they set out to achieve. Setting and communicating clear objectives, as well as defining and continuously reviewing the scope and terms of the inquiry, are critical first steps towards achieving an appropriate and proportionate outcome.

A company can likely negotiate with the relevant authority regarding the scope of documents covered by the request and the production date in order to ensure the company and its advisors can undertake a proportionate and reasonable response.

[822] Yates Memo, *supra* note 558.

A request with a long look-back period, or even without any time limit, could involve a time and resource intensive review and production exercise.

3. Governing Structure

Another initial point of consideration is who will be responsible for leading the investigation: the board, management, or outside counsel.

In establishing a governance structure and reporting lines for the investigation, a company should consider:

1. Expectations of the relevant authority, who may take a skeptical view of management-led inquiries, rather than an investigation by outside counsel;

2. Who is known to be involved or potentially involved in the subject matter of the investigation and establishing reporting lines accordingly;

3. Attorney-client and work-product issues – the governance structure and reporting lines should be established so as to ensure maximum protection of potentially privileged materials.

4. Establishing an Investigation Plan

Unlike the prospect of responding to a civil lawsuit, investigations tend to be iterative processes. When the prospect of an U.S. investigation presents itself, stakeholders should set forth an efficient plan for bottoming out pertinent issues and responding effectively. While important to begin with an endpoint in mind, any investigative plan should be flexible enough to incorporate and respond to suggested modifications, including from government regulators.

Internal reports of potential misconduct, whether to in-house counsel, human resources personnel, or employee supervisors, will require an assessment of whether the issue presents a violation of law, regulations, or company policy. Not all reports of misconduct within a company will necessitate an internal investigation conducted by outside counsel or the creation of a special investigative board committee. If the alleged misconduct involves an individual employee and does not implicate potential violations of law, in-house counsel, with support from appropriate business functions such as the internal audit department, can investigate the allegations and recommend appropriate remedial and personnel actions to management. Conversely, where the potential misconduct is widespread, may involve officers or directors, potentially violates law, affects corporate governance, or subjects the company to government investigation and enforcement actions, the company should utilize external counsel to lead the investigation.

At the outset of a U.S. investigation, a company should comprehensively consider, among other things: (1) potential and desired outcomes, (2) expectations of relevant agencies, and (3) structuring investigative processes to minimize risky and constraining decisions. It is critical for the company to develop and memorialize an action plan at the outset of the investigation that defines the parameters of the investigation. Broadly, the plan should aim to define:

1. The relevant time period to be investigated;

2. The geographic scope of the investigation;

3. Which entities of the company (e.g., subsidiaries, affiliates, or departments) will be covered, as well as an explanation of why particular entities are not included; and

4. The subject matter of the investigation.

Broadly, an investigation can be considered to have three overarching phases: (1) commencement, (2) information gathering, and (3) disposal.

During the commencement phase of an investigation, corporations should strive to understand the potential sources and triggers of an investigation, including internal reporting, external requests, or market awareness. Additionally, at the onset of an investigation, corporations should identify which government agencies might be involved and consider the respective agencies' expectations.

Next, during the information gathering phase, the target of investigation should determine an optimal outcome and structure an investigation plan with that outcome in mind. Special consideration should be given to identifying potential sources of information, the scope of the inquiry, and issues concerning confidentiality and privileged communication.

Finally, in the disposal phase, corporations should carefully manage the outflow of information and ensure that all actions taken are directed at their desired outcome. The disposal strategy should be tailored to the specific agency involved and also reflect cognizance of any potential collateral consequences.

Because the relevant authority may be interested in how the company has set the parameters of an internal investigation, the investigation plan should be drafted with the possibility of disclosure in mind.

When constructing the investigation plan, key considerations for information gathering include:

1. Documents – The investigation plan should set out what documents will be collected, how they will be processed, and who will be responsible for collection and processing them.

2. Any concerns or considerations related to data privacy should also be addressed in the investigation plan.

3. Interviews – The investigation plan should list individuals that have been interviewed as part of a preliminary investigation or will be interviewed as part of a full investigation.

4. The plan should also provide a rationale for why it has been decided that certain individuals will not be interviewed.

5. Witness interviews may have various purposes, including: scoping the investigation, understanding the facts and issues at play, and assessing the accountability of individuals as well as possible defenses for the company and its employees.

6. Third Parties – The plan should describe whether the investigation will require consultation with or assistance from third parties such as forensic accountants, foreign counsel, or industry experts, as well as the scope of any such anticipated consultation.

7. Reporting – The plan should describe generally how the company intends to report its investigation findings and whether it will be necessary to issue an interim report.

8. Anticipated time frame for completion of the investigation.

9. Anticipated costs of the investigation.

10. Anticipated potential remediation.

During an investigation, a company may uncover evidence of a different but related category of misconduct. In these situations, the company should consider the potential scope of the issue as well as whether leniency may be available for the conduct.

Critically, once an investigation is ongoing, whether initiated by a government authority or an exchange, a respondent must ensure that all responses to information requests are complete and accurate. On September 22, 2017, Merrill, Lynch, Pierce, Fenner & Smith Incorporated entered into a $2.5 million settlement with the CFTC to resolve allegations that it violated the CEA by failing to supervise its employees and keep adequate records.[823] From 2009 to 2010, the CME investigated whether Merrill Lynch traders executed U.S. Treasury Futures transactions on the CME before entering into block trades with these counterparties. [824] In November 2010, the CME interviewed certain traders about the suspected conduct. The traders allegedly provided "misleading answers" to the CME by suggesting that the trades were unrelated to the block trades or that the trades actually occurred after the block trades and that the reported execution times for the block trades were inaccurate.[825] The traders also claimed that it would have been impossible for them to trade ahead of a counterparty's block trade because the time between receiving the customer's block trade inquiry and executing the block trade was very brief. [826] However, according to the CFTC's Order of Settlement, the traders "did in fact trade futures contracts" in this way and engaged in other questionable conduct such as eavesdropping on calls between counterparties and salespersons about block futures trades without announcing their presence and then using the information learned to hedge expected risk from those block futures trades.[827]

The CFTC alleged that Merrill Lynch violated CFTC Regulation 166.3, which requires entities registered with the CFTC to "diligently supervise the handling by its partners, officers, employees and agents" of "all commodity interest accounts . . . relating to its business as a Commission registrant."[828] Typically, the CFTC brings Regulation 166.3 claims against firms who failed to

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[823] *In re Merrill, Lynch, Pierce, Fenner & Smith Inc*., CFTC No. 17-25 (Sept. 22, 2017).

[824] *Id.* at 2.

[825] *Id.* at 2-3.

[826] *Id.*

[827] *Id.*

[828] *Id.* at 6 (quoting 17 C.F.R. § 166.3 (1983)).

prevent their employees from committing misconduct (such as manipulative trading practices). However, here the CFTC took an expansive and unprecedented approach in applying this provision to find Merrill Lynch liable for its inadequate response to the CME investigation.

According to the CFTC, Merrill Lynch failed to adequately supervise its employees and agents entrusted with investigating the CME's claims of trading ahead on block trades. Although Merrill Lynch's compliance and legal departments were primarily responsible for responding to the inquiry, they relied on the Bank's operations support group to gather information for Merrill Lynch's response and provided only "minimal oversight." This was problematic because the operations support group primarily handled operational and technical issues.

The CFTC also alleged that Merrill Lynch's operations support group was authorized to speak with the traders but never provided the results of these discussions for legal and compliance functions.[829] Additionally, when collecting and analyzing electronic futures trading activity data, the operations support group provided only an "abridged version" to the legal and compliance departments that failed to disclose "a number of occasions" where certain traders traded futures contracts in the five minutes before the execution time of block trades. Rather, in responding to the CME's inquiries, the business unit generated an internal spreadsheet identifying several potential instances of "pre-hedging" but did not share it with legal and compliance personnel. Overall, the CME found that Merrill Lynch's "failure to stay adequately informed" regarding the activities of the operations support group contributed to its failure to detect the improper trading activity before the traders misled the CME during the interviews.[830]

5. Information Preservation, Retrieval, and Review

(a) Information Preservation

As soon as it becomes apparent that an investigation will be necessary, the company should distribute a litigation hold to prevent the intentional or accidental destruction of relevant documents and information. Failure to do so could be eventually viewed as an obstruction of justice.

Necessary steps to issuing a litigation hold include:

1. Determining the scope of documents that will be subject to the hold;

2. Determining who should receive the hold notices, which may include both individual employees and the IT or records department of a particular entity;

3. Collaborating with IT/records departments to suspend normal document destruction practices, identify the location of stored data/information, and implement proactive data-capturing measures such as forensic imaging of employee computers and other electronic devices;

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[829] *Id.* at 4.

[830] *Id.*

4. Considering the need for translations of the hold; and

5. Considering whether data privacy laws/restrictions are implicated.

(b) Information Collection/Retrieval

With document preservation measures in place, the investigation should work to collect documents within the scope of the investigation plan.

Investigators should anticipate whether there will be barriers to document collection, which may include:

1. Local employment laws;

2. Company policies or codes of conduct;

3. The need to collect documents in the possession of third parties;

4. Data privacy laws (particularly in cases involving documents located outside the United States)

(c) Collection of Electronic Data

Collection will ordinarily require making forensic copies of files identified as containing potentially relevant data and maintaining backups. In addition to electronic files, it is also important to preserve and collect the underlying metadata contained in those files. Often, the process of collecting, processing, and hosting electronic materials is performed by a third-party data vendor. Even when such steps are performed by a vendor, the document collection process should be documented by the investigation team.

(d) Document Review

When the collection stage results in a large volume of documents for review, it is important to adopt methods of efficiently identifying relevant documents.

(1) Search Terms

Search terms should be applied in a way that is sufficiently broad enough to capture responsive documents, but narrow enough to eliminate documents that do not require examination by the review team.

(2) Predictive Coding

Predictive coding is a developing review tool that can significantly reduce the number of documents that need to be manually reviewed. The company should consider the view of the relevant agency on whether and when the use of predictive coding is acceptable.

(3) Manual Review

After potentially reducing the universe of relevant documents through search terms and predictive coding, it is usually necessary to have a human review team tag and code the potentially responsive documents.

A tagging or coding system should be developed that allows for efficient organization and identification of documents.

The review team should be provided with a detailed review protocol explaining the purpose of the review, how to identify responsive documents, and how to appropriately apply tags and codes.

As the review stage proceeds, information learned may lead to an expansion of the investigation's scope, either with respect to subject matter or the individuals involved.

6. Protecting Privilege During the Investigation

(a) Types of privilege

(1) Attorney-client privilege

Under U.S. law, the attorney-client privilege is a common law right that protects the confidentiality of certain types of communications made between an attorney and client. It protects a confidential communication made between an attorney (or agent) and a client for the purpose of seeking, obtaining, or providing legal assistance to the client. Courts tend to construe the privilege narrowly because the privilege exists in derogation of the principle that the public has a right to access evidence that supports or refutes a claim pending in a public legal proceeding.[831] The attorney-client privilege applies if: (1) a person asserting the privilege is or sought to become a client; (2) a person to whom communication was made is an attorney (or certain agents of an attorney) acting in his or her legal capacity; (3) the statement was made in confidence, outside presence of any third party, for the purpose of securing legal advice, legal services, or assistance in some legal proceeding; and (4) the privilege has been claimed and not waived by the client.[832]

(2) Attorney work product

A corollary to the attorney-client privilege, the "attorney work-product" doctrine protects from discovery materials prepared by lawyers in anticipation of litigation. The attorney work-product doctrine protects the mental processes of the attorney through which an attorney can recognize and prepare a client's case.[833] Recognizing that such preparation may require the assistance of non-lawyers, the work-product doctrine also shields any materials prepared by agents of the attorney,

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[831] *See In re Grand Jury Proceedings*, 219 F.3d 175, 182 (2d Cir. 2000).

[832] *See Wultz v. Bank of China*, 979 F. Supp. 2d 479 (S.D.N.Y. 2013) (citing *Colton v. United States*, 306 F.2d 633, 637 (2d Cir. 1962)).

[833] *See United States v. Nobles*, 422 U.S. 225, 238 (1975).

if prepared at the direction of counsel. [834] Thus, the attorney work-product doctrine protects interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and other tangible and intangible information gathered in anticipation of litigation. [835] Any memoranda or work prepared by the attorney or at the direction of counsel should be labeled as attorney work product. The labeling alone, however, will not be a decisive factor in determining whether the privilege applies, especially if the advice is business rather than legal in nature. The purpose of the attorney work-product privilege, similar to that of the related attorney-client privilege, is to ensure proper functioning of the justice system.[836] It reflects a public policy that prosecution and defense of legal claims deserves the protection of privacy without the interference from discovery.[837]

(3) Common Interest/Joint Defense

While disclosure of privileged information to a third party would typically result in a waiver of the privilege, the common interest doctrine allows for sharing of privileged information under certain circumstances. Independent entities engaged in a joint defense effort can share confidential information if the communications were made in the course of the joint defense effort, were designed to further the effort, and the privilege was not otherwise waived.

(b) Maintaining privilege

(1) Corporate Setting

Corporations are entitled to the protections of the attorney-client privilege.[838] As a practical matter, however, a corporation can speak only through its employees. Several criteria apply to determine when a statement made by one of these employees will be entitled to the corporation's protection. In general, the corporate privilege applies only if: (1) the person making the communication is an employee, (2) the communication is made at the direction of a corporate superior for the purposes of seeking legal advice, and (3) the communication is within the scope of the employee's duties.[839]

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[834] *See id.* at 239-40.

[835] *See Hickman v. Taylor*, 329 U.S. 495, 514-15 (1947) (Jackson, J., concurring).

[836] *See id.* at 238.

[837] *See id.*; *see also Hickman*, 329 U.S. at 514-15 (1947) (Jackson, J., concurring) ("Historically, a lawyer is an officer of the court and is bound to work for the advancement of justice while faithfully protecting the rightful interests of his clients. In performing his various duties, however, it is essential that a lawyer work with a certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel. Proper preparation of a client's case demands that he assemble information, sift what he considers to be the relevant from the irrelevant facts, prepare his legal theories and plan his strategy without undue and needless interference. That is the historical and the necessary way in which lawyers act within the framework of our system of jurisprudence to promote justice and to protect their clients' interests.")

[838] *See Upjohn Co. v. United States*, 449 U.S. 383, 390 (1981) (citing *United States v. Louisville & Nashville R. Co.*, 236 U.S. 318, 336 (1915)).

[839] *See id.* at 394.

This does not mean, however, that there is a blanket privilege for communications with in-house or even external counsel, even where the communication falls within the scope of the employee's duties. Privilege law recognizes that attorneys, particularly in smaller organizations, may serve business functions. As a result, a communication will not be considered privileged simply because one of the recipients (or senders) is a lawyer. Merely copying a lawyer on a communication will not protect the communication from disclosure.

Rather, courts will carefully consider whether the communication with the corporation's in-house or outside counsel was made for the purpose of securing legal advice.[840] Where communications from in-house counsel contain both business and legal advice, courts will generally make an inquiry into the "primary purpose" of the document in order to determine if the privilege applies.[841] The court will deem the communication protected by the attorney-client privilege upon a finding that the "primary purpose" of the communication is legal; in other words, that the purpose of the communication is "to discern the legal ramifications of a potential course of action."[842]

(2) Employee Interviews

Interviews are typically conducted by an attorney, with another attorney taking written notes of the interview, including their thoughts and mental impressions. This method, rather than a "purely factual" verbatim transcript, makes the record of the meeting more likely to be protected under the attorney work product doctrine. Interviews may still be privileged if conducted by non-lawyers at the direction of an attorney.

Counsel will need to consider use of *Upjohn* warnings. Under the U.S. Supreme Court case of *Upjohn Co. v. United States*, the attorney-client privilege covers communications between company counsel and employees under certain circumstances. At the beginning of an interview, employees should be given an "*Upjohn* warning," explaining that the communications between employees and legal counsel are privileged and confidential, but that the privilege belongs to the company, which may choose to waive the privilege in the future. The *Upjohn* warning should clarify that the lawyer represents the company and not the employee. It is paramount for counsel to advise employees at the start of the interview that they represent the company and that the privilege and the right to waive it belong to the company alone. Otherwise, successful claim to the privilege by an employee can lead to suppression of information, hampering the company's efforts to cooperate with the government during an investigation.

Communications with employees will be privileged if (1) the communications were made by the employees at the direction of management for the purpose of obtaining legal advice; (2) the information sought from the employee was necessary to providing legal advice and was not

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[840] *See id.*

[841] *See Phillips v. C.R. Bard, Inc.*, 290 F.R.D. 615, 628 (D. Nev. 2013).

[842] *See id.* (quoting *Henderson Apartment Venture, LLC v. Miller*, No. 2:09-cv-01849-HDM-PAL, 2011 WL 1300143, at *9 (D. Nev. Mar. 31, 2011); *Premier Digital Access, Inc., v. Central Telephone Co.*, 360 F. Supp. 2d 1168 (D. Nev. 2005)).

otherwise available to the management "control group" (i.e., the holders of the privilege); (3) the matters communicated were within the scope of the employee's corporate duties; (4) the employee knows the communications are for the purpose of obtaining legal advice; and (5) the communications are kept confidential.[843]

Interviews of former employees may also be privileged, but the subject matter of the interview should be limited to the period of the former employee's tenure at the company. The investigation team should also consider whether the former employee can be relied upon to cooperate or maintain the confidentiality of the interview.

(3) Legal Advice

The company should meticulously document the nature of the investigation as being for the purpose of obtaining legal advice, rather than for some business purpose.

Communications with the company should be labeled "attorney-client privilege" and the content of such communications should in fact relate to legal advice, rather than business advice.

(c) Waiving privilege

Disclosure of privileged communications or information to a third party may constitute a waiver of the privilege. In addition to the particular communication, the disclosure may waive the privilege with respect to other communications relating to the same subject matter.[844]

For the purposes of obtaining cooperation credit, it may not be necessary to waive the attorney-client privilege, if the company can disclose all relevant facts without doing so.

A disclosure of privileged information could potentially avoid being deemed a waiver of the privilege if:

1. The disclosure was inadvertent;
2. The holder of the privilege took reasonable steps to prevent disclosure; and
3. The holder promptly took reasonable steps to rectify the error.[845]

In-house counsel should be careful to involve only third parties who are essential to the communication in order to avoid the risk of being deemed to have waived the privilege. For example, in *Allied Irish Banks, P.L.C. v. Bank of America*, the court found that no privilege applied to communications where in-house counsel had included non-lawyer third parties who had no "need to know" about the content of the communications.[846] The same court also found the

843 *See Upjohn*, 449 U.S. at 383.

844 Fed. R. Evid. 502(a).

845 Fed. R. Evid. 502(b).

846 *See Allied Ir. Banks, P.L.C. v. Bank of Am., N.A.*, 252 F.R.D. 163, 170 (S.D.N.Y. 2008).

privilege applied to one communication where the company showed that the recipients had a reason to participate and were acting for the company.[847]

A similar result was also reached in *In re Weatherford Int'l Sec. Litig*., where defendant Weatherford International Ltd. was forced to turn over two internal investigation reports and the materials underlying them, after producing the reports and presentations to the SEC.[848] Following precedent in the Southern District of New York, the court found that the "rule . . . that information is discoverable if it has been actually disclosed or referenced in such detail that it has been 'effectively produced' to an investigatory government agency – has been satisfied."[849] Notably, even the interview summaries written by Weatherford's counsel, redacted only for "explicit mental impressions, conclusions, opinions or legal theories," were ordered produced.

There are ways of limiting disclosure risk; in *In re Gen. Motors LLC Ignition Switch Litig*., a case that actually distinguishes itself from *Allied Irish Banks*, the attorney-client privilege and attorney work product privileges were upheld in spite of the fact that a report of an internal investigation was widely and publicly distributed.[850] There, because the investigation and report were prepared by external counsel specifically retained to provide legal advice, the court upheld the privilege in connection with key interview materials "reflecting communications between current and former [client] employees and agents and outside counsel."[851]

And, even more recently, *In re Kellogg Brown & Root, Inc.* is instructive on steps counsel should take to protect internal investigative efforts.[852] There, Kellogg, Brown & Root (KBR) sought mandamus twice after the district court overseeing the case found the defense contractor had waived its privilege. In the first mandamus action, KBR challenged the district court's decision that it had waived attorney-client privilege concerning certain documents; the DC Circuit "granted the writ and vacated the District Court's order to produce a key document" but allowed the district court to consider other arguments for disclosure.[853] The second mandamus action challenged these subsequent determinations by the district court, which again ordered disclosure. After seeking mandamus, a second time, the DC Circuit again granted the writ and vacated the orders. A single writ of mandamus is unusual, but two is very rare – evidencing the importance placed on the privilege within the DC Circuit.

At issue in KBR was whether an internal investigation, and its materials, would have to be disclosed. In the first mandamus action, the district court incorrectly applied the primary purpose test, requiring a "but for" analysis of the materials generated in the litigation (i.e., but for the legal

[847] *Id.*

[848] *In re Weatherford Int'l Sec. Litig*., No. 11 Civ. 1646, 2014 WL 6628964 (S.D.N.Y. Dec. 16, 2013) ("Interview materials need not be produced unless those specific materials are explicitly identified, cited, or quoted in information disclosed to the SEC.").

[849] *Id.* at *3.

[850] *In re Gen. Motors LLC Ignition Switch Litig*., 80 F.Supp.3d 521, 530-531 (S.D.N.Y. 2015).

[851] *Id.* at 531.

[852] *In re Kellogg Brown & Root, Inc*., 796 F.3d 137 (D.C. Cir. 2015), *cert. denied*, 136 S.Ct. 823 (2016).

[853] *Id.* at 140.

advice sought, the investigation would not have been undertaken). In the second application for the writ, the district court's findings that (1) documents needed to be produced pursuant to Fed. R. Evid. 612 and (2) had been put "at issue" and therefore waived were also rejected by the Circuit. The DC Circuit noted, "If all it took to defeat the privilege and protection attaching to an internal investigation was to notice a deposition regarding the investigations (and the privilege and protection attaching them), we would expect to see such attempts to end-run these barriers to discovery in every lawsuit in which a prior internal investigation was conducted relating to the claims."[854]

7. Investigation of Individual Employees

(a) Employee cooperation

Employees in the U.S. are obligated to cooperate with their employer and its counsel.

(b) When to Obtain Separate Counsel for an Employee

Employees in the U.S. are free to obtain independent legal advice in the face of a potential interview with the company's counsel.

Depending on the situation, companies may provide legal representation for employees to ensure they have fully considered their legal exposure and are well-prepared for interviews.

A company may be required to advance legal fees and expenses to certain of its employees depending on the laws in a company's state of incorporation and its own by-laws or internal policies.

(c) Disciplinary Considerations

(1) Disciplinary Hearings

A disciplinary procedure and any disciplinary decision must be procedurally and substantively fair. Any contractually-mandated procedure should be followed unless the parties agree to modifications.

Employees have the right to be accompanied by counsel, the right to be notified of maximum sanctions, and the right to appeal.

(2) Reassigning, Suspending, or Terminating an Individual

If a fair disciplinary process is followed and the employer reasonably decides that the employee is guilty of misconduct it will need to apply a sanction. Sanctions may include: termination, demotion, remuneration decisions, warning, and/or compliance training.

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[854] *Id.* at 151.

If termination does not occur, the employer should actively monitor the employee to ensure no further wrongdoing occurs and to safeguard the employer from retaliation actions.

Where employees are terminated for cause resulting from an unfair, incomplete or inaccurate investigation, they may be able to bring wrongful dismissal claims in court.

G. Managing Stakeholders

Companies should be proactive in evaluating their crisis management infrastructure to ensure that they are prepared to move quickly at the first sign of trouble. This includes establishing reporting lines and procedures that can be implemented when a crisis arises.

1. Developing a Global Corporate Communications Strategy

Even before the facts are fully developed, the company will face pressure to disclose information regarding the crisis to senior management, regulators/prosecutors, the media, and/or investors. The company must develop a clear communications strategy for such internal and external communications so that it conveys a consistent message to its various constituencies. It is important that management (or anyone speaking on behalf of the company) resists the impulse to issue premature denials or apologies before the facts are fully developed and be sensitive to the risk that any inartful comments about the conduct at issue may be used by regulators in the investigative proceedings. Most large corporations have sophisticated in-house communications professionals to handle these issues.

2. The Role of Outside Counsel

Outside counsel is likely to be more familiar with the full array of facts developing in the various spokes of the investigation and thus to be more sensitive to risk areas. Further, outside counsel is likely to be more attuned to public comments that may provoke a negative reaction from regulators. In certain circumstances, counsel will work with regulators to preview public statements.

3. Managing Stakeholders Within the Company: Senior Management

The board should be updated periodically and should be sufficiently conversant in the facts so that it can assess the progress of the investigation and management's response to it.

Senior management should be informed of whatever facts are needed to run the company. Senior management will be helpful in developing strategy, marshalling resources, and ultimately deciding what the company should do with the results of the investigation. In the event the investigation involves members of senior management, counsel should revise its communications so as to preserve the integrity of the investigation.

4. Managing Stakeholders Within the Company: Employees

Rumors of an investigation can cause significant problems that complicate the investigation.

Facts about the investigation must be narrowly disseminated only to employees who have a need to know. Natural curiosity about an investigation can cause otherwise irrelevant witnesses to

become part of the investigation and lead to examination and scrutiny from regulators. Further, counsel should be careful in conducting interviews with fact witnesses to protect the confidentiality of the investigation and to avoid contaminating witnesses. For example, interviewees should not be shown communications that they were not party to or otherwise previously saw in the normal course of business.

Unsupervised communications among employees can lead to a waiver of attorney-client privilege. All employees who know of the investigation should be instructed to treat it as confidential and not to discuss it with anyone other than counsel (or at counsel's direction). Thereafter, it is important to remind employees to preserve the confidentiality of regulatory investigations and to avoid gossip.

H. Resolution Phase: Disclosure and Information-Sharing with Agency Investigators

From the beginning of the investigation, or even earlier, it is almost always desirable to maintain a continuous dialogue with officials. Proactive communication will often lead to a better working environment once the investigation reaches the resolution phase.

A good working relationship with agencies will involve clear communication. It should be made clear when a statement is being made on behalf of the company, and communications should always be made in clear, complete, and accurate language.

The company's point of contact, whether it is the investigating board committee, an in-house lawyer, or external counsel, should communicate with the government about the scope of the investigation and schedule a regular dialogue to keep the government apprised of the investigation's progress.

1. Managing Communications with Government Authorities

Any response to a governmental inquiry, whether voluntary or by subpoena, must be complete, accurate, and as timely as possible. Unless warranted by a deliberate strategy, counsel should foster a reasonable working relationship with their counterpart at the regulator.

The company must also be careful to take a consistent approach to communications with all of the government actors involved in the investigation. The company should generally assume that separate government entities are communicating with each other and sharing information. However, the company must be careful to share information equally among investigators or risk impairing its relationship with those left out. In so doing, however, the company must also be sensitive to any confidentiality requests from individual officials.

The company must assume that regulators and prosecutors are reviewing all of its public statements. Regulators will also be sensitive to any public comments from the company seeming to minimize the importance of the investigation or being unduly optimistic.

2. Reporting

Ultimately, the results of an internal investigation should be compiled into some form of report that can be presented to the company's leadership, and ultimately, U.S. agency officials.

Beyond the raw factual information uncovered by the investigation, there are a number of components that may be included in an investigation report, including:

1. Background information on the circumstances leading up to the investigation;
2. A description of the investigation's scope and the steps taken to collect relevant information;
3. Conclusions and analysis based on the facts discovered.

Even though the findings of an internal investigation may reveal misconduct or other unfavorable facts, a written report is an opportunity to contextualize the conduct and present the underlying facts in a manner more favorable to the company.

I. Resolution Phase: Outcomes

1. Identifying the Desired Achievable Outcome

It is important to re-evaluate the investigation's optimal achievable outcome throughout the investigation as facts develop.

Most investigations are resolved through a negotiated settlement with a U.S. authority. Nevertheless, a company can itself adjudicate the issues being investigated where circumstances call for it.

Trial is rare, but companies can refuse to cooperate with a government investigation and instead try to contest the charges on the merits.

2. CFTC and DOJ Resolution Tools

(a) CFTC

The CFTC can administer civil penalties in settlement orders. Although the CFTC does not itself bring criminal charges against entities or individuals, it can refer criminal violations of the Commodity Exchange Act to the DOJ for prosecution. Civil penalties can include disgorgement of ill-gotten gains and restitution to victims. The CFTC can also require special supervision, suspend business registrations, and even bar an entity or individual from working in an industry altogether.

(b) DOJ

Most DOJ enforcement actions are settled before trial, either in NPAs or DPAs. In recent years, the DOJ has intensified its enforcement endeavors, many times requiring corporations to plead guilty before agreeing to settle their claims. Given this new, increasingly hostile environment, the level of cooperation with the government remains a key factor to the ultimate settlementoutcome.

3. Considering Collateral Consequences

While consequences such as the loss of the ability to conduct certain business can apply in many types of inquiries, the risks are greater when facing a criminal investigation.

If a guilty plea would have significant adverse consequences for innocent third parties, the DOJ is more likely to consider an NPA or DPA than a felony guilty plea. However, the existence of potential collateral consequences will not necessarily lead the DOJ away from demanding a guilty plea for the conduct under investigation.

Regardless, an admission of wrongdoing through any settlement mechanism can have substantial negative consequences for a business's future activities. The nature of those consequences can depend on determinations made by other regulators in a given industry. In a negotiated settlement, authorities may waive such consequences or agree to reinstate the applicable memberships and authorizations.

Settlement agreements may contain admissions that can be used in follow-on civil litigation or in future criminal enforcement actions.

J. Ethical Issues in Internal Investigations and the Attorney-Client Privilege

Multinational corporations continue to be subjects of large-scale, high-profile, cross-border investigations. With increasing cooperation among local and international regulators, growth in real-time media coverage, and advances in technology, this trend is unlikely to abate any time soon.[855] Counsel representing corporations in these investigations must consider how cross-border considerations impact already complex ethical and tactical issues relating to the attorney-client privilege and discovery, and as discussed further below, be prepared to persistently defend the privileges at home and abroad. Evaluating and protecting the privilege, at every stage of an investigation, is now a practical reality for attorneys involved in these types of multifaceted investigations.

The Attorney-Client Privilege and Work-Product Protections

The attorney-client privilege and the related attorney work-product doctrine are long-standing hallmarks of the U.S. legal system. Maintaining and protecting legal privilege in cross-border investigations, however, can be particularly challenging, in part because many jurisdictions offer far less privilege protection than in the United States or do not recognize privilege at all. The privilege also may be jeopardized during the course of a government or internal investigation, especially in the context of voluntary disclosures. Voluntary disclosures to the government,

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[855] *See e.g.*, Press Release, *Odebrecht and Braskem Plead Guilty and Agree to Pay at Least $3.5 Billion in Global Penalties to Resolve Largest Foreign Bribery Case in History*, Dec. 21, 2016, *available at*: https://www.justice.gov/opa/pr/odebrecht-and-braskem-plead-guilty-and-agree-pay-least-35-billion-global-penalties-resolve. The U.S., Brazil, and Switzerland jointly settled the case, which involved "a massive and unparalleled bribery and bid rigging scheme," for $3.5 billion in penalties, illustrating the increasingly global nature of many internal investigations and potential ramifications of the same.

incentivized by the offer of cooperation credit for disclosure of misconduct, directly implicate the issues of privilege and waiver.

Under U.S. law, the attorney-client privilege is a common law right that protects the confidentiality of certain types of communications made between an attorney and client. It protects a confidential communication made between an attorney (or agent) and a client for the purpose of seeking, obtaining, or providing legal assistance to the client. Courts tend to construe the privilege narrowly because the privilege exists in derogation of the principle that the public has a right to access evidence that supports or refutes a claim pending in a public legal proceeding.[856] The attorney-client privilege applies if:

(1) a person asserting the privilege is or sought to become a client;

(2)a person to whom communication was made is an attorney (or certain agents of an attorney) acting in his or her legal capacity;

(3)the statement was made in confidence, outside presence of any third party, for the purpose of securing legal advice, legal services, or assistance in some legal proceeding; and

(4) the privilege has been claimed and not waived by the client.[857]

The purpose of the privilege is to foster open communications between a client and his or her attorney so as to promote compliance with the law.[858] In addition, the "privilege recognizes that sound legal advice or advocacy serves public ends" and the administration of justice and "that such advice or advocacy depends upon the lawyer's being fully informed by the client."[859]

The privilege will not apply when the communication is made in the presence of a third party. The privilege is considered waived when shared with a third party at the time of the communication, or at a later stage. The law recognizes, however, that attorneys often seek the help of non-lawyers (e.g., forensic accountants) in preparing legal advice. [860] Thus, communications made in the presence of a non-client who is acting as an attorney's agent in helping the attorney provide legal advice are protected by the attorney-client privilege.

An additional consideration relevant to defendants in the age of social media is the extent to which information shared with public relations firms or specialists is protected by the privilege. Increasingly, courts appear unwillingly to extend the privilege to such individuals or entities, finding that "a media campaign is not a litigation strategy."[861] In the limited circumstances where

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[856] *See In re Grand Jury Proceedings*, 219 F. 3d 175, 182 (2d Cir. 2000).

[857] *See Wultz v. Bank of China*, 979 F. Supp.2d 479 (S.D.N.Y. 2013) (citing *Colton v. United States*, 306 F.2d 633, 637 (2d Cir. 1962)).

[858] *See Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

[859] *Id.*

[860] *United States v. Kovel*, 296 F.2d 918, 920-922 (2d Cir. 1961).

[861] *See Chevron Corp. v. Donziger*, No. 11 Civ. 0691, 2013 WL 3805140 (S.D.N.Y. Jul. 19, 2013), *quoting Haugh v. Schroeder Inv. Mgmt. N. Am. Inc.*, No. 02 Civ. 7955, 2003 WL 21998674, at * 3 (S.D.N.Y. Aug. 25, 2003); *see*

the privilege is upheld in connection with public relations efforts, it is construed narrowly. To be protected, the communications must be "(1) confidential communications (2) between lawyers and public relations consultants (3) hired by the lawyers to assist them in dealing with the media … (4) that are made for the purpose of giving or receiving advice (5) directed at handling the client's legal problems…." [862] Accordingly, before retaining and communicating with public relations personnel, clients should consult with their legal counsel to determine what information to share and how to utilize the consultants within the scope of the privilege.

Another exception to the general rule on waiver of privilege is the inadvertent production doctrine that applies where reasonable precautions were taken to protect the privilege, but information was nonetheless produced. Finally, as discussed below, the privilege may be preserved as to other parties where disclosures are made to government regulators pursuant to a negotiated confidentiality agreement.

A corollary to the attorney-client privilege, the "attorney work-product" doctrine protects from discovery materials prepared by lawyers in anticipation of litigation. The attorney work-product doctrine protects the mental processes of the attorney with which an attorney can recognize and prepare a client's case.[863] Recognizing that such preparation may require the assistance of non-lawyers, the work-product doctrine also shields any materials prepared by agents of the attorney, if prepared at the direction of counsel. [864] Thus, the attorney work-product doctrine protects interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and other tangible and intangible information gathered in anticipation of litigation.[865]

Any memoranda or work prepared by the attorney or at the direction of counsel should be labeled as attorney work product. The labeling alone, however, will not be a decisive factor in determining whether the privilege applies, especially if the advice is business rather than legal in nature. The purpose of the attorney work-product privilege, as the related attorney-client privilege, is to ensure proper functioning of the justice system.[866] It reflects a public policy that prosecution and defense of legal claims deserves the protection of privacy without the interference from discovery.[867]

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also Waters v. Drake, No. 2:14-cv-1704, 2015 WL 8281858 (S.D. Ohio Dec. 8, 2015) (In employment discrimination matter involving the discharge of the Ohio State University's marching band director, the court found that the privilege did not attach to documents shared with a public relations firm. The documents were ultimately not produced, however, because they were found not relevant.).

[862] *In re Grand Jury Subpoenas Dated March 24, 2003 Directed to (A) Grand Jury Witness Firm and (B) Grand Jury Witness*, 265 F.Supp.2d 321, 331 (S.D.N.Y. 2003) (public relations consultant and firm employed by target of the grand jury to influence prosecutors' perceptions sought to shield communications from disclosure based upon the privilege).

[863] *See United States v. Nobles*, 422 U.S. 225, 238 (1975).

[864] *See id.* at 239-40.

[865] *See Hickman v. Taylor*, 329 U.S. 495, 514-15 (1947) (Jackson, J., concurring).

[866] *See id.* at 238.

[867] *See id.*; *see also Hickman*, 329 U.S. at 514-15 (1947) (Jackson, J., concurring) ("Historically, a lawyer is an officer of the court and is bound to work for the advancement of justice while faithfully protecting the rightful interests of his clients. In performing his various duties, however, it is essential that a lawyer work with a certain degree of

1. Privilege in the Corporate Setting

Corporations are entitled to the protections of the attorney-client privilege.[868] As a practical matter, however, a corporation can speak only through its employees. Several criteria apply to determine when a statement made by one of these employees will be entitled to the corporation's protection. In general, the corporate privilege applies only if: (1) the person making the communication is an employee, (2) the communication is made at the direction of a corporate superior for the purposes of seeking legal advice, and (3) the communication is within the scope of the employee's duties.[869]

This does not mean, however, that there is a blanket privilege for communications with in-house or even external counsel, even where the communication falls within the scope of the employee's duties. Privilege law recognizes that attorneys, particularly in smaller organizations, may serve business functions. As a result, a communication will not be considered privileged simply because one of the recipients (or senders) is a lawyer. Merely copying a lawyer on a communication will not protect the communication from disclosure.

Rather, courts will carefully consider whether the communication with the corporation's in-house or outside counsel was made for the purpose of securing legal advice.[870] Where communications from in-house counsel contain both business and legal advice, courts will generally make an inquiry into the "primary purpose" of the document in order to determine if the privilege applies.[871] The court will deem the communication protected by the attorney-client privilege upon a finding that the "primary purpose" of the communication is legal, in other words, that the purpose of the communication is "to discern the legal ramifications of a potential course of action."[872]

The Evolution of Upjohn Warnings

Ethical issues arise where counsel represents the company but engages, as counsel must, with company employees in the course of the investigation. As a general proposition, the privilege belongs to the corporation, not the individual employee communicating with the attorney. This means that the company holds the right to decide whether or not to waive the privilege and, relatedly, to disclose information received from that employee to regulators. The company ultimately may decide to share that information with the government, leading to criminal

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privacy, free from unnecessary intrusion by opposing parties and their counsel. Proper preparation of a client's case demands that he assemble information, sift what he considers to be the relevant from the irrelevant facts, prepare his legal theories and plan his strategy without undue and needless interference. That is the historical and the necessary way in which lawyers act within the framework of our system of jurisprudence to promote justice and to protect their clients' interests.")

[868] *See Upjohn Co. v. United States*, 449 U.S. 383, 390 (1981) (citing *United States v. Louisville & Nashville R. Co.*, 236 U.S. 318, 336 (1915)).

[869] *See id.* at 394.

[870] *See id.*

[871] *See Phillips v. C.R. Bard, Inc.*, 290 F.R.D. 615, 628 (D. Nev. 2013).

[872] *See id.* (quoting *Henderson Apartment Venture, LLC v. Miller*, No. 2:09-cv-01849-HDM-PAL, 2011 WL 1300143, at *9 (D. Nev. Mar. 31, 2011); *Premiere Digital Access, Inc. v. Central Telephone Co.*, 360 F. Supp. 2d 1168 (D. Nev. 2005)).

incrimination or civil penalties for the employee – a risk that may not be clear to the interviewee who does not appreciate that counsel's role is not to protect the employee's interests.

As a result, company counsel must provide employees with so-called "*Upjohn* warnings" when conducting investigatory interviews. These warnings are derived from the seminal Supreme Court opinion in *Upjohn Co. v. United States*, which held that communications between corporate counsel and corporate employees are protected by the attorney-client privilege[873] *Upjohn* warnings notify employee witnesses that the company holds the attorney-client privilege and maintains the option to claim it or waive it, at its discretion, in case of disclosure to regulators. As part of these warnings, company counsel must make it clear to the employee that the company may, in fact, disclose the information obtained to regulators. Relatedly, counsel should also explain to the employee that the employee may be subject to obstruction of justice charges if he or she makes misleading statements in the interview that are relayed to the government.

Failure to adequately explain these points to employees may jeopardize the company's ability to disclose this information down the road, and may also disqualify counsel. In some instances, courts have recognized a personal privilege with respect to conversations between employees and corporate counsel, despite the fact that the privilege belongs to the company. [874] Although the employee bears a high burden in showing that an attorney-client relationship existed between the employee and counsel and that it concerned "personal matters,"[875] companies should still be aware that employees may prevail on such claims.

Courts have suppressed information where they recognize such a dual privilege. For example, in *United States v. Nicholas*, the court suppressed statements made by the company's chief financial officer (CFO) to outside counsel because counsel had failed to make it clear that he did not represent the CFO personally. [876] The CFO was jointly represented by company counsel in an *unrelated* civil matter and the CFO claimed that he had a continuing attorney-client relationship with counsel. The notes taken at the time the statements at issue were made also did not reflect that the *Upjohn* warnings were given and the CFO did not recall hearing them. The court found that if any warnings were given, those warnings were inadequate and that outside counsel had a "clear conflict" because of the joint representation of the CFO and the company in another matter. The court ordered suppression of any disclosed information, holding that the CFO held the privilege and the disclosure by company counsel violated the duty owed to him.[877] The court also referred the counsel to the State Bar for appropriate discipline.[878]

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[873] 449 U.S. 383 (1981).

[874] *See United States v. Int'l Brotherhood of Teamsters*, 119 F.3d 210, 215 (2d. Cir. 1997).

[875] *See id.* at 214-216.

[876] 606 F. Supp. 2d 1109 (C.D. Cal. 2009).

[877] *See id.* at 1120.

[878] *Id.* at 1121. The suppression of evidence in Nicholas was reversed on appeal. The Ninth Circuit held that the lower court applied the state law standard for determining whether there was a privileged relationship between the company counsel and the CFO where it should have applied federal common law. Under federal common law, the CFO failed to meet the burden of showing an attorney-client relationship existed. However, the Ninth Circuit did not reverse the lower court's ruling that the counsel violated state ethical rules by jointly representing the CFO

U.S. counsel should also be aware that foreign counsel may be unfamiliar with *Upjohn* warnings. Therefore, it is important to ensure that *Upjohn* warnings are given, even if the employee interviews are not conducted in the United States. Counsel must also avoid any inclination to soften or water down the warning because of concerns that such warnings will have a chilling effect on interviewees. Note that issuing *Upjohn* warnings and memorializing them in interview notes may not be sufficient to preserve privilege in cross-border investigations. In order to preserve U.S. privilege, it may therefore be necessary for the company to demonstrate the efforts it has taken to protect privilege. In any event, in addition to giving *Upjohn* warnings, companies should engage local counsel in the foreign jurisdiction to advise and ensure that proper protocols are followed to protect privilege.

Upjohn warnings protect the company in the event that employees may become targets of the investigation. Company counsel must be sensitive to the fact that an employee's status as a witness or a target may shift as the facts are developed in the course of the investigation, giving rise to a conflict between counsel's corporate client and the individual. This presents a potential conflict of interest as employees who are targets or subjects of an investigation likely have interests that are adverse to that of the company. *Upjohn* warnings are intended to address a potential conflict between the company and the employee, namely, that company counsel represents the company and not the individual employee. Such warnings are essential to maintaining the separation of representation between the company and employees; they also help prevent employees from trying to usurp the company's privilege by putting employees on notice that it is the company, and not the employee, that holds the privilege.

In *United States v. Wells Fargo Bank, N.A.*, a former vice president of Wells Fargo sought to assert an advice of counsel defense in connection with a civil action that alleged "Wells Fargo [and the defendant]…engaged in misconduct with respect to residential mortgage loans insured by the Government."[879] The advice on which the defendant sought to rely, however, was that of Wells Fargo's counsel. At issue was whether the attorney client privilege, held by Wells Fargo, could be relied upon by the employee-defendant and effectively waived by him in the course of his defense. Ultimately, the court ruled that "[h]olding that [the employee] — who, indisputably, lacks authority to waive the privilege on behalf of Wells Fargo — can force disclosure of the Bank's privileged information, even if only for the purpose of using it to defend against the Government's claims, would essentially transform a corporate entity's attorney-client privilege into a qualified privilege."

In short, it is paramount for counsel to advise employees at the start of the interview that they represent the company and that the privilege and the right to waive it belong to the company alone. Otherwise, successful claim to the privilege by an employee can lead to suppression of information, hampering the company's efforts to cooperate with the government during an investigation.

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and the company without obtaining a waiver. *See United States v. Ruehle*, 583 F.3d 600, 613 (9th Cir. 2009). Thus, where there is a potential conflict of interest with interviewed employees, company counsel should advise the employee to retain separate counsel, or, at a minimum, obtain a written conflict waiver.

[879] *United States v. Wells Fargo*, 132 F. Supp. 3d 558, 559 (S.D.N.Y. 2015).

2. Protecting the Privilege During and After Internal Investigations

Companies develop and deploy internal investigations to strengthen both business operations and legal compliance efforts. Yet, despite the tremendous value-add offered by such investigations, the collection of sensitive data, interviews, and analyses presents its own unique set of challenges. Often the material assessed and incorporated in investigations is at the core of contentious litigation (or expected litigation), delicate publications relations, or other highly sensitive company considerations. Accordingly, legal departments and executives alike frequently (and correctly) fear the dissemination of investigative reports and their underlying materials. The disclosure of internal investigation materials is increasingly being litigated, and as recent precedent demonstrates, efforts to preserve the privilege should begin as soon as a company is put on notice of circumstances warranting further inquiry.

In-house counsel should be careful to involve only third parties who are essential to the communication in order to avoid the risk of being deemed to have waived the privilege. For example, in *Allied Irish Banks, P.L.C. v. Bank of America*, the court found that no privilege applied to communications where in-house counsel had included non-lawyer third parties who had no "need to know" about the content of the communications. [880] The same court also found the privilege applied to one communication where the company showed that the recipients had a reason to participate and were acting for the company.[881]

A similar result was also reached in *In re Weatherford Int'l Sec. Litig*., where defendant Weatherford International Ltd. was forced to turn over two internal investigation reports, and the materials underlying them, after producing the reports and presentations to the SEC.[882] Following precedent in the Southern District of New York, the court found that the "rule…that information is discoverable if it has been actually disclosed or referenced in such detail that it has been 'effectively produced' to an investigatory government agency – has been satisfied."[883] Notably, even the interview summaries written by Weatherford's counsel, redacted only for "explicit mental impressions, conclusions, opinions or legal theories," were ordered produced.

There are ways of limiting disclosures risk; in *In re Gen. Motors LLC Ignition Switch Litig*., a case that actually distinguishes itself from *Allied Irish Banks*, the attorney client privilege and attorney work product privileges were upheld in spite of the fact that a report of an internal investigation was widely and publicly distributed.[884] There, because the investigation and report were prepared by external counsel specifically retained to provide legal advice, the court upheld the privilege in

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[880] *See Allied Ir. Banks, P.L.C. v. Bank of Am., N.A.*, 252 F.R.D. 163, 170 (S.D.N.Y. 2008).

[881] *Id.*

[882] *In re Weatherford Int'l Sec. Litig.*, No. 11 Civ. 1646, 2014 WL 6628964 (S.D.N.Y. Dec. 16, 2013) ("Interview materials need not be produced unless those specific materials are explicitly identified, cited, or quoted in information disclosed to the SEC.").

[883] *Id.* at *3.

[884] *In re Gen. Motors LLC Ignition Switch Litig.*, 80 F.Supp.3d 521, 530-531 (S.D.N.Y. 2015).

connection with key interview materials "reflecting communications between current and former [client] employees and agents and outside counsel."[885]

And, even more recently, *In re Kellogg Brown & Root, Inc.*, is instructive on steps counsel should take to protect internal investigative efforts. [886] There, Kellogg, Brown & Root (KBR) sought mandamus twice after the district court overseeing the case found the defense contractor had waived its privilege. In the first mandamus action, KBR challenged the district court's decision that it had waived certain documents protected by the attorney-client privilege; the DC Circuit "granted the writ and vacated the District Court's order to produce a key document," but allowed the district court to consider other arguments for disclosure. [887] The second mandamus action challenged these subsequent determinations by the district court, which again ordered disclosure. After seeking mandamus a second time, the DC Circuit again granted the writ and vacated the orders. A single writ of mandamus is unusual, but two is very rare – evidencing the importance placed on the privilege within the DC Circuit.

At issue in KBR was whether an internal investigation, and its materials, would have to be disclosed. In the first mandamus action, the district court incorrectly applied the primary purpose test, requiring a "but for" analysis of the materials generated in the litigation (i.e., but for the legal advice sought, the investigation would not have been undertaken). In the second application for the writ, the district court's finding that (1) documents needed to be produced pursuant to Fed. R. Evid. 612, and (2) had been put "at issue" (discussed below) and therefore waived, was also rejected by the Circuit. The DC Circuit noted, "If all it took to defeat the privilege and protection attaching to an internal investigation was to notice a deposition regarding the investigations (and the privilege and protection attaching them), we would expect to see such attempts to end-run these barriers to discovery in every lawsuit in which a prior internal investigation was conducted relating to the claims."[888]

For better or worse, the intersection of privilege jurisprudence and internal investigations has already begun to alter the way in which investigations are conducted. This evolution was the subject of litigation in *United States v. Baroni*, a case involving the so-called "Bridgegate Scandal" that occurred when parts of the "George Washington Bridge were closed without public warning," seemingly as an act of political retribution.[889] A law firm conducted an intense review of the matter, ultimately conducting "70 interviews and review[ing] more than 250,000 documents" in only two months. After its investigation, the law firm issued a public report detailing its findings. *Baroni* arose when two individuals indicted in the misconduct sought access to the "handwritten notes" and related materials underlying the publicly released documents. The law firm, however, had intentionally deviated from its usual recordkeeping practices (contemporaneous notes and follow-up memoranda) and instead prepared memoranda in the same documents in which they had taken

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[885] *Id.* at 531.

[886] *In re Kellogg Brown & Root, Inc.*, 796 F.3d 137 (D.C. Cir. 2015), *cert. denied*, 136 S.Ct. 823 (2016).

[887] *Id.* at 140.

[888] *Id.* at 151.

[889] *United v. Baroni*, No. 2:15-cr-00193, 2015 WL 9049528 (D. NJ 2015).

contemporaneous notes – which had already been produced. Though finding the change of practice distasteful and frustrating, the court had no choice but to quash the subpoenas:

> Although [the law firm] did not delete or shred documents, the process of overwriting their interview notes and drafts of the summaries had the same effect. This was a clever tactic, but when public investigations are involved, straightforward lawyering is superior to calculated strategy. The taxpayers of the State of New Jersey paid [the law firm] millions of dollars to conduct a transparent and thorough investigation. What they got instead was opacity and gamesmanship. They deserve better.[890]

Yet despite "deserving better," no notes were produced.

In sum, strategies for protecting and preserving the privilege in internal investigations need to be rigorously considered and implemented before the first interview, document dump, or report is issued. As the cases illustrate, courts are increasingly forcing litigants to turn over investigative materials where only ad hoc or retrospective approaches to privilege are deployed.

3. Strategic Reasons to Waive the Attorney-Client Privilege

(a) Traditional View

In some jurisdictions, regulators or prosecutors may require legal privilege to be waived before crediting cooperation. Generally, the privilege will not apply if the communication is made in the presence of a third party. The privilege also is waived if shared with other third parties.

In Department of Justice ("DOJ") investigations, until recently, cooperation credit was dependent on waiver of privilege. That is no longer the case. The DOJ has recognized that the attorney-client privilege and attorney work-product doctrine are "essential and long-recognized components of the American legal system."[891] Today, both DOJ and Securities and Exchange Commission ("SEC") staff are directed not to ask parties to waive the attorney-client privilege or work-product protections during the course of investigations.[892] Company counsel should be mindful, therefore, that waiver is voluntary.

(1) Voluntary Waiver

There are many reasons a company might consider a voluntary waiver of its attorney client or attorney work product privileges. Among the reasons is that companies in the U.S. are eligible for "cooperation credit" from the government where they are willing to disclose information about

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890 *Id.* at *4.

891 U.S. Attorneys' Manual 9-28.710, http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm.

892 *See* SEC Enforcement Manual 4.3, http://www.sec.gov/divisions/enforce/enforcementmanual.pdf; U.S. Attorneys' Manual 9-28.700, http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm.

their potential misconduct.[893] Cooperation can lead to lower financial and regulatory penalties, faster resolution of the government's investigation, and even non-prosecution or deferred prosecution agreements.

If and when a company chooses to waive the privilege voluntarily to the government, the company should seek a confidentiality agreement with the regulator to protect the privilege. Note that courts may not find that a confidentiality agreement provides adequate protections against third parties seeking access to privileged materials that have been disclosed to the government. Under the doctrine of selective waiver, in certain limited circumstances, a voluntary disclosure of privileged documents to the government will not waive privilege as to all other parties and proceedings.[894] However, U.S. appellate courts have largely ***rejected*** the doctrine of selective waiver.[895]

The Second Circuit, however, refused to adopt "a *per se* rule that all voluntary disclosures to the government waive work-product protection."[896] In 2011, a district court within the Second Circuit limited the application of the selective waiver doctrine. In *Gruss v. Zwirn*, the court did not allow a hedge fund to invoke the selective waiver doctrine in a defamation action brought by its former CFO.[897] Instead, the court found that witness interviews made during the course of an internal investigation and subsequently disclosed to the SEC were discoverable, reasoning that a company cannot produce privileged material to its adversary, but maintain its privilege as to others.[898] The shifting landscape in U.S. courts as to whether a party effectively may assert selective waiver principles and take comfort in the enforceability of confidentiality agreements with the government counsels on careful consideration of the degree to which and the manner in which parties choose to disclose privileged material to the government in a cooperation setting. For example, oral presentations to the government highlighting key findings rather than wholesale disclosure of full investigative reports complete with citations to interview memoranda and other attorney work product will more likely protect privileged materials from third party access in subsequent proceedings.

In addition to confidentiality agreements with government regulators, there are also other instances where communications with third parties will not result in waiver of the privilege. For example,

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[893] *See e.g.*, Filip, *supra* note 581; Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation of Agency Enforcement Decisions," released as Securities Exchange Act of 1934 Release No. 44969, Accounting and Auditing Enforcement Release No. 1470 (Oct. 23, 2001) (the "Seaboard Factors").

[894] *See Diversified Indus. v. Meredith*, 572 F.2d 596 (8th Cir. 1977).

[895] *See*, *e.g.*, *In re Qwest Commc'ns Int'l,* 450 F.3d 1179, 1197 (10th Cir. 2006); *Burden-Meeks v. Welch*, 319 F.3d 897, 899 (7th Cir. 2003); *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 295 (6th Cir. 2002); *United States v. Mass. Inst. of Tech.*, 129 F.3d 681, 686 (1st Cir. 1997); *Genentech*, *Inc. v. U.S. Int'l Trade Comm'n*, 122 F.3d 1409, 1416-18 (Fed. Cir. 1997); *Westinghouse Elec. Corp. v. Rep. of Philippines*, 951 F.2d 1414, 1425 (3d Cir. 1991); *In re Martin Marietta Corp.*, 656 F.2d 619, 623-24 (4th Cir. 1988); *Permian Corp. v. United States*, 665 F.2d 1214, 1221 (D.C. Cir. 1981); *In re Pacific Pictures Corp.*, 679 F.3d 1121 (9th Cir. 2012).

[896] *In re Steinhardt*, 9 F.3d 230 (2d Cir. 1993).

[897] *Gruss v. Zwirn*, 276 F.R.D. 115, 122 (S.D.N.Y. 2011).

[898] *Id.*

communication made in the presence of a non-client who is necessary to facilitate attorney client communication (e.g. an accounting expert) to help the attorney give legal advice will not waive the attorney-client privilege. The privilege also will not be waived during inadvertent document production in litigation if reasonable precautions were taken. [899] However, absent such special circumstances, the general rule in most U.S. jurisdictions remains that if there is a waiver as to one person, the privilege is waived as to everyone.

On September 9, 2015, U.S. Deputy Attorney General Yates issued a memorandum titled Individual Accountability for Corporate Wrongdoing (the "Yates Memo"). The Yates Memo sets out the DOJ's new policy focusing on individual wrongdoers in corporate cases. According to the Yates Memo, "to be eligible for any cooperation credit" a company must (i) "Identify all individuals involved in or responsible for the misconduct at issue, regardless of their position, status or seniority"; and (ii) "Provide to the [DOJ] all facts relating to that misconduct."[900] The effect of the Yates Memo is to shift the role of corporate counsel from corporate-defender to quasi-employee-prosecutor. In order to seek cooperation credit, full disclosure of wrongdoing – including wrongdoing uncovered through exercise of the attorney client privilege – has now become mandatory.

(2) Specific Federal Cooperation Programs

The cooperation credit described above, including the relevant sections of United States Attorneys' Manual and the Yates Memo, applies to all criminal matters for which the U.S. Sentencing Guidelines may be at issue.[901] A number of specific government programs also exist, however, which further incentivize voluntary self-disclosure. Among the most prominent of these are the (i) Foreign Corrupt Practices Act ("FCPA") Pilot Program, and (ii) DOJ Antitrust Leniency Program. [902] Under the FCPA Pilot Program, [903] parties that self-disclose misconduct, cooperate fully with the government's investigation, and remediate appropriately, may be entitled to "a 50% reduction off the bottom of the Sentencing Guideline fine range" and avoid the imposition of a corporate monitor. Additionally, voluntary self-disclosure under the FCPA Pilot Program may also help a party avoid prosecution altogether – as of September 2016, the DOJ has issued five declinations to participants in the program.[904]

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899 *See Reckley v. City of Springfield*, No. 3:05-cv-249, 2008 WL 5234356 (S.D. Ohio Dec. 12, 2008) ("attorney client privileged" label and prompt action after learning of production indicated necessary precaution).

900 Yates, *supra* note 558.

901 Additional information on the U.S. Sentencing Guidelines is accessible at: http://www.ussc.gov/guidelines/2016-guidelines-manual.

902 Many other DOJ divisions and government agencies accept voluntary self-disclosures, including the Office of Foreign Asset Controls and the DOJ's National Security Division ("NSD") regarding export control and sanctions-related violation. For additional information on the NSD's policy, *see* https://www.justice.gov/nsd/file/902491.

903 U.S. Dep't of Justice, Criminal Division, Fraud Section, *Foreign Corrupt Practices Act Enforcement Plan and Guidance* (April 5, 2016), https://www.justice.gov/criminal-fraud/file/838416.

904 For specific declinations, please *see*: https://www.justice.gov/criminal-fraud/pilot-program/declinations.

Similar to the FCPA Pilot Program, the DOJ's Antitrust Division offers a Leniency Program to parties that report misconduct.[905] As explained by the Antitrust Division, "the first corporate or individual conspirator to confess participation in an antitrust crime, fully cooperate with the Division, and meet all other conditions that the Corporate Leniency Policy or the Leniency Policy for Individuals specifies receives leniency for the reported antitrust crime." In short, the first party to report misconduct and complete the program's requirements avoids criminal prosecution, financial penalties, and imprisonment. The program provides tremendous incentives for a party that is "first in" to disclose the contents of its internal investigations into possible misconduct, potentially implicating privilege issues, in order to avail itself of the benefits of leniency.

In short, with the development and success of these programs, the DOJ and other agencies are likely to implement similar self-disclosure programs in other areas of the law – both criminal and civil. Such programs will further implicate privilege-waiver issues, and therefore practitioners should consider whether possible voluntary self-disclosure might be necessary at the start of every investigation.

(b) Other Considerations

Treatment of waiver may differ in other jurisdictions. The UK, for example, may recognize selective waiver under certain circumstances.[906]

Overall, there is some uncertainty as to the effectiveness of confidentiality agreements, but it nevertheless is still prudent to have one in place. Companies considering whether to waive privilege will need to weigh the likelihood that a U.S. court will refuse to recognize a selective waiver of privilege against the need to disclose such information.

4. Impact of Foreign Law on Privilege Protections

Another consideration in cross-border investigations is that the attorney-client privilege and attorney work-product doctrine may not have a U.S. equivalent in other jurisdictions. It is important for companies to be aware of these differences, where they do exist. The consequences may be dire: in jurisdictions where privilege is not recognized, authorities have been known to conduct searches or dawn raids of external counsel's offices. Other jurisdictions do not consider communications with the company's in-house counsel to be privileged.[907] This can pose problems

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[905] *See Frequently Asked Questions about the Antitrust Division's Leniency Program and Model Leniency Letters*, (Jan. 26, 2017), https://www.justice.gov/atr/page/file/926521.

[906] *See* Financial Conduct Authority, The Enforcement Guide, Section 3.28, ("[F]irms may seek to restrict the use to which a report can be put, or assert that any legal privilege is waived only on a limited basis and that the firm retains its right to assert legal privilege as the basis for non - disclosure in civil proceedings against a private litigant."); *see also Berezovsky v. Hine*, (2011) EWCA Civ 1089 (C.A. Civ) (recognizing limited waiver); *Property Alliance Group Limited v. The Royal Bank of Scotland plc,* (2015) EWHC 1557 (Ch) (recognizing limited waiver and the validity of non-waiver agreements, even where they include carve-outs permitting onward disclosure, and citing Irish and Hong Kong decisions to similar effect).

[907] Certain jurisdictions do not recognize the attorney-client privilege congruent to U.S. privilege, particularly with respect to in-house counsel. *See*, *e.g.*, Case C-550/07, *Akzo Nobel Chem. Ltd. v. Comm'n*, 2010 E.C.R. I-08301

in the United States, where courts may refuse to recognize privilege in communications involving a company's foreign in-house counsel where the local law does not recognize it. [908] In such instances, a company should mitigate this risk by conducting the investigation through external counsel.

Southern District of New York Magistrate Judge Gabriel Gorenstein's January 2015 decision in *Wultz v. Bank of China Limited* illustrates the risk foreign companies face when seeking to assert attorney-client privilege and attorney work-product privilege over communications with foreign in-house legal counsel.[909] In *Wultz*, the family of a victim of a terrorist attack issued a demand letter to the Bank of China. In the demand letter, the family alleged that the bank was liable for its role in holding and transferring the funds the senior terrorist operative used in perpetrating the attack. The demand letter also indicated that the family intended to file suit against the bank in federal court. Subsequently, the bank initiated an internal investigation using mainly Chinese employees in the bank's compliance and legal departments, [910] consistent with the bank's anti-money laundering policies. The bank did not use any U.S.-qualified attorneys in its internal investigation. After filing suit in the Southern District of New York, the family sought discovery over the documents the bank created during its internal investigation.[911] The Bank of China argued that the documents prepared in connection with the internal investigation were protected under the attorney-client privilege because the documents were prepared to submit to U.S. counsel for review.[912] Judge Gorenstein disagreed, finding that the attorney-client privilege does not attach to documents foreign employees prepare for U.S. counsel to review.[913]

Practitioners must also be aware of how foreign courts will treat materials prepared at the behest of U.S. counsel when that material is taken or prepared outside of the U.S. In a recent landmark

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(finding that legal professional privilege requires an exchange emanating from independent lawyers, which excludes lawyers bound to the client by a relationship of employment).

908 *See*, *e.g.*, *Wultz v. Bank of China Ltd*., 979 F.Supp.2d 479, 495 (S.D.N.Y. Oct. 25, 2013) (quotations omitted) (holding that the attorney-client privilege did not apply to communications with in-house counsel in China because it does not apply to "communications from, to and among members of legal or other departments who are not licensed attorneys" and ordering the production of such documents).

909 *See Wultz v. Bank of China Ltd.*, 304 F.R.D. 384 (S.D.N.Y. 2015) (hereinafter the "Bank of China Opinion and Order").

910 In a prior discovery ruling in the same litigation, U.S. District Judge Shira Scheindlin found that in-house counsel in China as a general rule do not need to be admitted to the practice of law, and therefore, held that the employees in the Bank of China's compliance department could not invoke the attorney-client privilege despite the Bank of China's argument that the compliance employees were "the functional equivalent" of attorneys. *See Wultz v. Bank of China Ltd.*, 979 F. Supp.2d at 493-95.

911 *See* Bank of China Opinion and Order, at 304 F.R.D. at 386-390.

912 *See id.* at 391-392.

913 *See id.* The court also found that the attorney work-product doctrine did not apply to the documents prepared in connection with the internal investigation. Although Rule 26(b)(3) of the Federal Rules of Civil Procedure states that an attorney does not need to be the author of the document for the work-product doctrine to apply, the Bank of China failed to meets its burden of demonstrating that the documents produced in response to demand letter would not have been produced if the threat of litigation did not exist. *See id.* at 393-397.

U.K. case, *The RBS Rights Issue Litigation*,[914] a U.K. court found that the privilege did not shield interview notes, prepared in response to a SEC subpoena, from discovery in subsequent UK civil litigation. In short, the court held that materials compiled for fact gathering purposes, such as employee interview notes, are not covered by the U.K.'s legal advice privilege. Thus, although it is likely that attorney-prepared interview notes containing some legal analysis or assessment would be covered by both the attorney-client and work product privileges in the U.S., because the notes were subject to production in the U.K., U.K. privilege rules applied. When planning interviews or preparing to take other investigative steps, it is crucial that counsel consider the privilege rules of not only their own jurisdiction, but also the jurisdiction where the interview will take place.

In cross-border matters, the fact that a company is compelled to disclose privileged material in a foreign jurisdiction may not necessarily result in a waiver in subsequent U.S. proceedings. Some U.S. courts have held that involuntary or compelled disclosure of privileged documents does not automatically result in a waiver of attorney-client privilege.[915] Likewise, under the work-product doctrine, the result is the same.[916] However, even when the disclosure of protected documents is involuntary, the disclosure may still result in a waiver if the party asserting privilege cannot establish that it took steps "reasonably designed to protect and preserve the privilege."[917] Therefore, making every effort to preserve U.S. privilege every step of the way (and keeping records of those efforts) is crucial to preventing disclosure.

(a) Considerations for U.S. Discovery in Foreign Jurisdictions

In cross-border investigations, the information gathering process is further complicated because the relevant documents, witnesses, and information may be located at the company's foreign offices. Counsel representing multi-national corporations in these investigations thus need to be sensitive to important differences in information gathering expectations and laws overseas.

Preliminarily, counsel should be sensitive to the fact that management and employees in these foreign offices may not be as familiar with the breadth and scope of U.S.-style discovery. Counsel must take care to ensure that these officers preserve potentially relevant documents and information. This means putting a document hold into effect via a notice to employees likely to have relevant documents and suspending any routine document destruction policies.

Counsel must also consider any laws, bar rules, and privilege customs related to data privacy and bank secrecy of the local jurisdiction in which the investigation is being conducted that may affect

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914 [2016] EWHC 3161 (Ch).

915 *See, e.g., In re Parmalat Sec. Litig.*, No. 04-MD-1653, 2006 WL 3592936, at *4 (S.D.N.Y. Dec. 1, 2006) (seizure of privileged documents by Italian *authorities* did not on its own constitute a waiver of privilege over those documents in subsequent U.S. class action litigation because the disclosure to Italian authorities was involuntary); *see also Pension Comm. of U. of Montreal Pension Plan v. Banc of Am. Secs. LLC*, No. 05-9016, 2009 WL 2921302, at *1 (S.D.N.Y. Sept. 8, 2009) (disclosure of communications with counsel did not amount to a waiver of privilege because disclosures were made pursuant to a court order).

916 *Shields v. Sturm, Ruger & Co.*, 864 F.2d 379, 382 (5th Cir. 1989) ("When a party is compelled to disclose privileged work product and does so only after objecting and taking other reasonable steps to protect the privilege, one court's disregard of the privileged character of the material does not waive the privilege before another court.").

917 *In re Parmalat*, 2006 WL 3592936, at *4 (internal quotation omitted).

data collection and preservation efforts. Data privacy and bank secrecy regimes present significant challenges to disclosure of cross-border information by companies to the U.S. regulators and their counterparts in other jurisdictions. Non-U.S. organizations are often subject to additional duties of confidence and professional secrecy owed to their clients and may be placed in a difficult position when faced with a request for information from the U.S. authorities.

(1) Data Privacy

In countries with strict data privacy rules, companies should be aware that the laws may apply differently for data stored in the U.S. and data stored locally. Local laws may limit access to documents and ability to move them from one jurisdiction to another. This is particularly true in Europe, where data privacy laws place restrictions on how data can be collected and transmitted. In some instances, a company may need to enter agreements with the concerned individual. Certain jurisdictions also differentiate between data in emails and data in financial documents.

Personal data has a high standard of protection under the laws of EU countries. The European Union's Directive on Data Protection regulates data processing of personal information, and most EU countries have adopted national laws to implement the Directive with some variations. "Processing" is defined as "any operation or set of operations which performed upon personal data… such as collection, recording, organization, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination or otherwise making available, alignment or combination, blocking, erasure or destruction"[918] of personal data. Restrictions on processing of data, thus, directly impact companies conducting cross-border investigations in EU countries and considering disclosure to regulators or counsel. Under some national laws, companies may be required to enter into agreements with concerned individuals before they share data with regulators.

The Directive also imposes an "adequacy standard" for transfer of protected data to other jurisdictions. It prohibits transfer of personal data to non-EU countries that failed to meet the same "adequacy" standard for privacy protection. Until October 2015, the "adequacy" standard could be met either by participation in "safe harbor" arrangements between the European Commission and the U.S. Department of Commerce or by a formal finding of adequacy by the European Commission. On October 6, 2015, however, the U.S. Safe-Harbor was invalidated by the Court of Justice for the European Union.[919] For nearly four months the exchange of data was in flux between the EU and U.S., until February 2, 2016, when a new "EU-US Privacy Shield" was agreed to by the European Commission's College of Commissions. [920] Under this new regime, data protection obligations have increased and the Federal Trade Commission will have enforcement authority over certain data protection issues. Additionally, U.S. companies seeking to obtain data

[918] Directive 95/46/EC of the European Parliament and Council (available at http://ec.europa.eu/justice/policies/privacy/docs/95-46-ce/dir1995-46_part1_en.pdf); the directive will be replaced in 2018 when the newly passed General Data Protection Regulation comes into force.

[919] Press Release, Court of Justice of the European Union, The Court of Justice declares that the Commission's US Safe Harbor Decision is Invalid, No. 117/15 (Oct. 6, 2015), https://curia.europa.eu/jcms/upload/docs/application/pdf/2015-10/cp150117en.pdf.

[920] Fact Sheet, EU-US Privacy Shield (Feb. 2, 2016), https://www.commerce.gov/news/fact-sheets/2016/02/eu-us-privacy-shield.

from Europe will now be expected to comply with decisions from the European Data Protection Authorities and will be required to respond more rapidly to complaints from EU citizens.

There are a set of circumstances when sharing personal data with U.S. regulators is permitted, such as with an individual's consent. Companies should consult local counsel to ensure that any disclosure to U.S. regulators would not subject the company to the risk of sanctions by EU countries that may include compensation to concerned individuals, regulatory orders preventing disclosure, fines and, in rare instances, imprisonment. It should also be noted that the EU directive does not apply to non-member European countries, such as Switzerland.

(2) Bank Secrecy

Financial institutions are subject to bank privacy laws of foreign jurisdictions in which they operate. The English common law, which is followed in the UK offshore islands, the Cayman Islands and many other jurisdictions, recognizes a duty of confidentiality that banks owe to their customers. Such a duty can extend to instances where banks may be prevented from disclosing confidential customer information, including to domestic and foreign regulatory authorities, except in limited circumstances. Generally, data may not be shared without consent, necessity to protect a bank's interest, by virtue of a domestic court order (not foreign), and in rare instances where there is duty to disclose to the public.

Other jurisdictions treat any bank-customer relationship as an implied contract, such as Germany, and prohibit disclosure of customer-related information without consent. An exception is often made for domestic court orders, but not foreign. Violation of these duties by disclosure may lead to sanctions of civil penalties as well as injunctions against disclosure.

Finally, companies should be aware of the statutory bank secrecy obligations, such as those in Luxembourg and Switzerland, which may prohibit disclosure of confidential information even in instances of consent.

(3) Blocking Statutes

In addition to data privacy and data protection regimes in non-U.S. jurisdictions, certain jurisdictions also have the so-called "blocking statutes" that may directly place limitations on discovery in the United States. Such statutes may prohibit transfer of documents sought for the purpose of constituting evidence for a potential foreign judicial or administrative proceeding or in connection with it. However, notable exceptions in such statutes are made to discovery of documents through "treaties or international agreements." Where such statutes do exist, companies should be aware that the evidence may still be within the reach of U.S. regulations.

(b) Cooperation Agreements

U.S. regulatory authorities may be able to overcome restrictions on data transfer by operation of cooperation known as "mutual legal assistance." Many countries, including the U.S., are party to treatises, conventions, protocols, and Framework Decisions, designed to facilitate cooperation in transnational sharing of information among legal authorities. The Mutual Legal Assistance Treaties ("MLAT"), for example, can assist U.S. regulators to request information from non-U.S. companies through assistance of local authorities. The use of MLATs in criminal and civil

proceedings, thus, overcomes the restrictions that non-U.S. companies may face under domestic law to share the information directly with U.S. regulators. MLAT requests do impose a number of requirements, such as establishing "dual criminality" under both countries' laws.

Appendix A: Commodity Futures Trading Commission, Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Companies

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Division of
Enforcement

ENFORCEMENT ADVISORY

Cooperation Factors in Enforcement Division Sanction Recommendations for Companies

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The U.S. Commodity Futures Trading Commission ("CFTC" or "Commission") has long given credit to companies who cooperate in the Commission's investigations and enforcement actions.[1] Cooperation by companies[2] can contribute significantly to the agency's mission by enhancing the Commission's ability to detect and pursue violations of the Commodity Exchange Act ("Act") or Commission Regulations. More specifically, it can increase the effectiveness and efficiency of the Commission's investigations and provide the Commission with important evidence in its enforcement actions. To assist companies who want to cooperate with the Commission, the Division of Enforcement ("Division") sets forth here factors that the Division considers in assessing cooperation by companies which may be or have been charged by the Commission with violating the Act or its Regulations.[3] The purpose of this Advisory is to assist them and their counsel in assessing possible settlement positions and litigation risks.

The Division looks for more than ordinary cooperation or mere compliance with the requirements of law. In particular, the Division looks to what a company voluntarily does, beyond what it is required to do. Recognition for cooperation is most likely to be given to a company for conduct that is sincere, robustly cooperative, and indicative of a willingness to accept responsibility for the misconduct, where appropriate. The Division considers three broad policy issues in its assessment of whether cooperation was provided and the quality of that cooperation: (1) the value of the company's cooperation to the Division's investigation(s) and enforcement actions; (2) the value of the company's cooperation to the Commission's broader law enforcement interests; and (3) the balancing of the level of the company's culpability and history of prior misconduct with the acceptance of responsibility, mitigation and remediation. The rewards for cooperation by companies can range from the Division recommending no

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[1] *See* CFTC Policy Statement Relating to the Commission's Authority to Impose Civil Money Penalties, [1994 Transfer Binder] Comm. Fut. L .Rep. (CCH) ¶26,265 (November 1, 1994).

[2] "Company" as used herein means any type of business entity except for a sole proprietorship.

[3] In August 2004, the Division issued an Enforcement Advisory, which outlined factors considered in evaluating cooperation by a company. In March 2007, DOE issued an amended Enforcement Advisory, which added clarification regarding the attorney-client and work product privileges. This Enforcement Advisory is intended to update and replace the 2007 Advisory.

enforcement action to recommending reduced charges or sanctions in connection with enforcement actions.

The following are factors that the Division may consider, on a discretionary basis, when determining whether a company has cooperated, the quality of that cooperation and what credit, if any, should be awarded to the company for such cooperation with such factors being considered in the context of the unique facts and circumstances of each case.

I. The Value of the Company's Cooperation to the Commission's Investigation(s) or Enforcement Action(s)

The Division may assess the value of the company's cooperation and assistance to the Commission's investigation(s) or enforcement action(s) by considering, among other things—

A. **Material Assistance**. Whether the company's cooperation resulted in material assistance to the Commission's investigation(s) and enforcement action(s) and the success thereof.

B. **Timeliness.** The timeliness of the company's initial cooperation, such as whether-

1. the company quickly made appropriate disclosure of the misconduct and notified the Division;
2. the company was first to report the misconduct to the Commission or to offer its cooperation in the investigation(s) and enforcement action(s);
3. the cooperation was provided before the company had any knowledge of a pending investigation or enforcement action; and
4. the investigation(s) and enforcement action(s) were initiated based on information or other cooperation provided by the company.

C. **Nature.** The nature of the company's cooperation, including—

1. whether the cooperation was truthful, specific, complete, and reliable;
2. the means by which the company uncovered the misconduct;
3. whether the company independently investigated the misconduct before and/or during any Division investigation;
4. whether the cooperation was voluntary or required by the terms of an agreement with another law enforcement or regulatory organization;
5. whether the company encouraged high-quality cooperation of all its directors, officers and employees, including their provision of complete and truthful sworn statements and testimony during the investigation or in any related enforcement litigation or proceeding to which the Commission is a party; and

6. the various types of assistance provided.

D. **Quality.** The quality of the company's cooperation, including whether the company provided ongoing, extensive, timely, and meaningful cooperation and assistance. For example, whether—

1. the company promptly met with Division staff to review and explain the known facts about the misconduct, including all relevant facts relating to individuals responsible for the misconduct;

2. the company willingly used all available means to:

   a. preserve relevant information under the company's appropriate control, including documents and electronically stored information ("ESI") as kept in the normal course of business;

   b. make employee testimony or other relevant corporate documents, ESI, and data available in a timely manner (and in compliance with the Commission's Data Delivery Standards whenever possible);

   c. explain transactions and interpret key information;

   d. provide a financial analysis of its gain from the unlawful activities; and

   e. enable it to respond quickly to requests and subpoenas for information, including, to the extent necessary, hire or designate adequate staff and resources.

3. to the extent that the company independently investigated the misconduct, the investigation was conducted meaningfully, in good faith, and in a manner designed to uncover all relevant facts, such as, for example, by:

   a. using an independent entity where appropriate to investigate and report on the misconduct;

   b. identifying, securing, and reviewing potentially relevant documents and data; and

   c. seeking to identify all responsible individuals.

4. the company outlined findings and relevant evidence regarding the misconduct, and produced full and complete reports of any internal investigations to the Division, including full disclosure of the:

   a. scope of the wrongdoing;

   b. identities of individual wrongdoers within the organization, including culpable senior executives, where applicable;

   c. identities of known or suspected wrongdoers outside of the

organization, where applicable;

d. all relevant facts about individual wrongdoers, including:

i. relevant communications involving officers, directors, and employees; and

ii. documents and data evidencing the misconduct;

e. steps taken upon learning of the misconduct;

f. processes followed to ferret out necessary information; and

g. measures taken to address and ameliorate the misconduct.

II. The Value of the Company's Cooperation to the Commission's Broader Law Enforcement Interests

The Division may assess the value of the company's cooperation in the investigation(s) and action(s) to the Commission's broader programmatic interest in enforcing the Commodity Exchange Act and Regulations, by considering, among other things—

A. **Encouragement.** The degree to which appropriate cooperation credit in the company's particular instance encourages high-quality cooperation from other entities.

B. **Importance of the Investigation(s) and Action(s).** The nature of the investigation(s) and action(s), including-

1. whether the subject matters of the investigation(s) and action(s) are a Commission priority;

2. whether the reported misconduct involves regulated entities or fiduciaries;

3. whether the company exposed an industry-wide practice;

4. the type, age, duration and egregiousness of the misconduct; and

5. the harm or potential harm caused by the particular type of misconduct, including danger to others.

C. **Resources Conserved.** The time and resources conserved as a result of the company's cooperation in the investigation(s) and enforcement action(s).

D. **Enhancement.** The extent to which cooperation credit otherwise enhances the Commission's ability to detect and pursue violations of the Act and Regulations.

III. The Company's Culpability, Culture, and Other Relevant Factors

In assessing the appropriate level of cooperation credit for a company, the Division may

take into account the company's relative culpability in connection with the misconduct being investigated or charged, the company's culture, and other company-specific factors including, among other things—

A. **Circumstances of the Misconduct.** The Division may assess the circumstances of the misconduct, by considering, for example—

1. the number of instances of misconduct, the duration of misconduct, and the isolated, repetitive, or ongoing nature of the misconduct;

2. the levels of the organization at which the misconduct occurred, particularly whether the misconduct arose at or involved senior and/or supervisory levels of the company;

3. how long the misconduct lasted after supervisors learned of it;

4. how the misconduct was addressed (or not) under compliance policies in place at the time of the misconduct;

5. to what extent the company or the directors, officers or employees benefitted, financially or otherwise, from the misconduct;

6. the egregiousness of any misconduct; and

7. the level of intent, for example, whether the misconduct was inadvertent, negligent, reckless, intentional, or willful.

B. **Prior Misconduct.** Including prior violations of the Act and Regulations or similar conduct charged as violations of other federal or state statutes.

C. **Mitigation.** Whether the company took available actions to mitigate any losses caused by the misconduct.

D. **Remediation.** Whether the company engaged in meaningful remedial efforts to prevent future wrongdoing. For example, whether the company—

1. took immediate steps to address the misconduct and implement an effective response to it;

2. provided sufficient, credible assurances to the Division that the conduct is unlikely to recur;

3. implemented additional internal controls, procedures, and oversight, or took other reasonable steps targeted and specific to the misconduct at issue, in order to reduce the likelihood of recurrence of the misconduct;

4. provided an explanation of how such additional measures would have addressed the specific misconduct at issue, had they been in place at the

time of the misconduct;

5. implemented measures intended to anticipate and avoid similar, even if not identical, misconduct in the future (e.g., in different divisions, specialties, product lines, or groups across the organization);

6. adequately addressed the employment of the persons responsible for the misconduct, to the extent they were employed by the company when the conduct was discovered, including supervisors overseeing areas in which misconduct occurred.

E. **Acceptance of Responsibility.** Whether the company has admitted or otherwise demonstrated an acceptance of responsibility for its past misconduct.

IV. Uncooperative Conduct

Even when a company can demonstrate that other factors identified herein warrant credit for cooperation, certain actions by the company or its counsel may limit or offset the credit a company might otherwise receive. For example, if a company, while purporting to cooperate or taking certain cooperative steps, engages in conduct that actually impedes the Division's investigation or inappropriately consumes government resources, the Division may conclude that the company's cooperation does not warrant credit. [4] Uncooperative conduct includes, among others, such things as:

A. failing to respond to requests and subpoenas for documentary information and testimony in a complete and timely manner;

B. misrepresenting or minimizing the nature or extent of the company's misconduct;

C. claiming that information is not available when it is;

D. failing to preserve relevant information under the company's appropriate control, including documents and ESI as kept in the normal course of business, and/or to produce such information;

E. directing company counsel or others to limit Division staff access to employees;

F. inappropriately advising or directing employees or their counsel not to cooperate fully or openly with the investigation;

G. engaging in evasive, misleading or obstructive conduct during investigative testimony, interviews, or otherwise interfering in any other part of the investigation(s) or action(s);

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[4] Additionally, uncooperative conduct may subject the entity to criminal penalties for providing false information (18 U.S.C. § 1001), providing false information to the Commission in violation of Section 6(c)(2) of the Commodity Exchange Act (7 U.SC. § 9), contempt (18 U.S.C. §§ 401-402), perjury (18 U.S.C. § 1621), making false statements or declarations in court proceedings (18 U.S.C. § 1623) and/or obstructing justice (18 U.S.C. § 1503 et seq.).

H. providing specious explanations for instances of misconduct that are uncovered;

I. issuing questionnaires to employees or conducting interviews that offer suggestive responses;

J. providing employees or former employees access to corporate documents or data beyond what those individuals would have been privy to in the course of their employment;

K. failing to search computer hard drives properly for documents, data, and electronic images; and

L. failing to comply with CFTC Data Delivery Standards.

A company's conduct in response to a Commission investigation can also be deemed uncooperative even in the absence of any unnecessary expenditure of government resources. For example, if a company turned a blind eye to warnings or indications that its employees had acted in violation of the law and failed to report such warnings to the Commission, the conduct can reduce the credit the Division would be willing to recommend. Similarly, if a company has seen or received indications of wrongdoing, but waited for a governmental inquiry to take action to uncover ongoing misconduct, such inaction may suggest to the Division that the company has little interest in recognizing and taking responsibility for its misconduct.

V. Attorney-Client Privilege and Work Product Protections

With these cooperation factors in mind, the Division recognizes that the attorney-client privilege and the work product doctrine are fundamental to the American legal system and the administration of justice. These rights are no less important for an organizational entity than for an individual. The Division further recognizes that these protections can promote a client's communications with counsel and thereby serve to promote the client's compliance with the law. These rights are not intended to be eroded or heightened by this advisory. Moreover, actions by an entity recognizing the legal rights of its employees are not inconsistent with these factors.

* * *

The Division's assessment of cooperation in any matter is a discretionary function of the Division's Director and staff and requires a case-by-case analysis of the specific facts and circumstances of each matter. Nothing in this Advisory should be deemed to oblige the Division or the Commission to consider one or more cooperation factors, or to give certain factors more weight than others. The Advisory also should not be read as requiring the Division staff to recommend, or the Commission to impose or authorize, a reduction of sanctions based on the presence or absence of particular cooperation factors. Further, nothing in the Advisory is intended to waive any pre-decisional or other privileges that may apply to the Commission's or Division's deliberations or decision-making regarding cooperation or otherwise.

Appendix B: Commodity Futures Trading Commission, Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Individuals

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Division of
Enforcement

ENFORCEMENT ADVISORY

Cooperation Factors in Enforcement Division Sanction Recommendations for Individuals

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The U.S. Commodity Futures Trading Commission ("CFTC" or "Commission") has long given credit to individuals who cooperate in the Commission's investigations and enforcement actions.[1] Cooperation by individuals can contribute significantly to the agency's mission by enhancing the Commission's ability to detect and pursue violations of the Commodity Exchange Act ("Act") or Commission Regulations. More specifically, it can increase the effectiveness and efficiency of the Commission's investigations and provide the Commission with important evidence in its enforcement actions. To assist individuals who want to cooperate with the Commission, the Division of Enforcement ("Division") sets forth here factors that the Division considers in assessing cooperation by individuals who may be or have been charged by the Commission with violating the Act or its Regulations.[2] The purpose of this Advisory is to assist them and their counsel in assessing possible settlement positions and litigation risks.

The Division looks for more than ordinary cooperation or mere compliance with the requirements of law. In particular, the Division looks to what an individual voluntarily does, beyond what he or she is required to do. Recognition for cooperation is most likely to be given to an individual for conduct that is sincere, robustly cooperative, and indicative of a willingness to accept responsibility for the misconduct, where appropriate. The Division considers three broad policy issues in its assessment of whether cooperation was provided and the quality of that cooperation: (1) the value of the individual's cooperation to the Division's investigation(s) and enforcement actions; (2) the value of the individual's cooperation to the Commission's broader law enforcement interests; and (3) the balancing of the level of the individual's culpability and history of prior misconduct with the acceptance of responsibility and mitigation. The rewards for cooperation by individuals can range from the Division recommending no enforcement action to recommending reduced charges or sanctions in connection with enforcement actions.

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[1] *See* CFTC Policy Statement Relating to the Commission's Authority to Impose Civil Money Penalties., [1994 Transfer Binder] Comm. Fut. L .Rep. (CCH) ¶26,265 (November 1, 1994); CFTC Division of Enforcement Advisory Relating to Cooperation Factors in Enforcement Division Sanction Recommendations (2007).

[2] These factors are intended to apply equally to cooperation by all individuals regardless of whether the individual also qualifies as a Whistleblower, as defined by Commission Regulation 165.2(p), and who may have potential liability for any misconduct. Nothing in this Enforcement Advisory should be construed to modify, supplant, or characterize in any manner whatsoever the Commission's Whistleblower Rules at 17 C.F.R. Part 165.

The following are factors that the Division may consider, on a discretionary basis, when determining whether an individual has cooperated, the quality of that cooperation and what credit, if any, should be awarded to the individual for such cooperation with such factors being considered in the context of the unique facts and circumstances of each case.

I. The Value of the Individual's Cooperation to the Commission's Investigation(s) or Enforcement Action(s)

The Division may assess the value of the individual's cooperation and assistance in the Commission's investigation(s) or enforcement action(s) by considering, among other things—

A. **Material Assistance**. Whether the individual's cooperation resulted in material assistance to the Commission's investigation(s) and related enforcement action(s) and the success thereof.

B. **Timeliness.** The timeliness of the individual's initial cooperation, such as whether-

1. the individual was first to report the misconduct to the Commission or to offer his or her cooperation in the investigation(s) and related enforcement action(s);

2. the cooperation was provided before he or she had any knowledge of a pending investigation or related action; and

3. the investigation(s) and related enforcement action(s) were initiated based on information or other cooperation provided by the individual.

C. **Nature.** The nature of the individual's cooperation, including—

1. whether the cooperation was truthful, specific, complete, and reliable;

2. whether the cooperation was voluntary or required by the terms of an agreement with another law enforcement or regulatory organization;

3. any unique hardships resulting from, or unique circumstances of, the individual's cooperation; and

4. the various types of assistance provided.

D. **Quality.** The quality of the individual's cooperation, including whether the individual provided ongoing, extensive, and timely cooperation and assistance by, for example—

1. preserving relevant information under the individual's appropriate control, including documents and electronically stored information ("ESI") as kept in the normal course of business, and producing such information (in compliance with the Commission's Data Delivery Standards whenever possible);

2. providing key non-privileged information, particularly if the information was not requested and otherwise might not have been discovered;

3. explaining transactions, interpreting key information or identifying new and productive lines of inquiry; and

4. providing complete and truthful sworn statements and testimony during the investigation or in any related enforcement litigation or proceeding to which the Commission is a party.

II. The Value of the Individual's Cooperation to the Commission's Broader Law Enforcement Interests

The Division may assess the value of the individual's cooperation in the investigation(s) and action(s) to the Commission's broader programmatic interest in enforcing the Act and Regulations, by considering, among other things—

A. Importance of the Investigation(s) and Action(s). The nature of the investigation(s) and action(s), including-

1. whether the subject matters of the investigation(s) and action(s) are a Commission priority;
2. whether the reported misconduct involves regulated entities or fiduciaries;
3. whether the individual exposes an industry-wide practice;
4. the type, age, duration and egregiousness of the misconduct; and
5. the harm or potential harm caused by the particular type of misconduct, including danger to others.

B. Resources Conserved. The time and resources conserved as a result of the individual's cooperation in the investigation(s) and related enforcement action(s).

C. Enhancement. The extent to which cooperation credit otherwise enhances the Commission's ability to detect and pursue violations of the Act and Regulations.

III. The Individual's Culpability and Other Relevant Factors

The Division may assess the cooperating individual's culpability in connection with the misconduct being investigated or charged, as well as other individual-specific factors, including among other things—

A. Circumstances of the Misconduct.

1. the individual's role in the misconduct;
2. the number of instances of misconduct, the duration of misconduct, and

the isolated, repetitive, or ongoing nature of the misconduct;

3. the individual's education, training, experience, and position of responsibility when the misconduct occurred;

4. to what extent the individual benefitted, financially or otherwise, from the misconduct;

5. the type and egregiousness of any misconduct by the individual;

6. the level of intent, for example, whether the individual acted inadvertently, negligently, recklessly, intentionally, or willfully, both generally and in relation to others who participated in the misconduct; and

7. whether the individual undermined the integrity or effectiveness of a compliance or reporting system by, for example, interfering with a company's established legal, compliance, or audit procedures, or with the company's detection, investigation, or remediation of the misconduct.

B. **Prior Misconduct.** Including prior violations of the Act and Regulations or similar conduct charged as violations of other federal or state statutes.

C. **Mitigation.** Whether, where appropriate, the individual took available actions to mitigate or remediate any harm or losses caused by the misconduct, such as, for example, assisting in the recovery of the fruits and instrumentalities of the misconduct, or to the extent culpable, for example, making restitution to harmed persons or disgorging any gains.

D. **Acceptance of Responsibility**. Whether the individual has admitted or otherwise demonstrated an acceptance of responsibility for the misconduct.

E. **Opportunity for Future Violations.** The degree to which the individual will have an opportunity to commit future misconduct in light of his or her occupation and particular circumstances.

IV. Uncooperative Conduct

Even when an individual can demonstrate that other factors identified herein warrant credit for cooperation, certain actions by the individual or the individual's counsel may limit or offset the credit he or she might otherwise receive. For example, if an individual, while purporting to cooperate or taking certain cooperative steps, engages in conduct that actually impedes the Division's investigation or inappropriately consumes government resources, the Division may conclude that the individual's conduct does not warrant credit for cooperation.[3]

[3]Additionally, uncooperative conduct may subject an individual to criminal penalties for providing false information (18 U.S.C. § 1001), providing false information to the Commission in violation of Section 6(c)(2) of the Commodity Exchange Act (7 U.S.C. § 9), contempt (18 U.S.C. §§ 401-402), perjury (18 U.S.C. § 1621), making false statements or declarations in court proceedings (18 U.S.C. § 1623) and/or obstructing justice (18 U.S.C. § 1503 et seq.).

Uncooperative conduct includes, among others, such things as:

A. failing to respond to requests and subpoenas for documentary information and testimony in a complete and timely manner;

B. claiming that information is not available when it is;

C. failing to preserve relevant information under the individual's appropriate control, including documents and ESI as kept in the normal course of business, and/or to produce such information;

D. misrepresenting or minimizing the nature or extent of the individual's misconduct;

E. providing specious explanations for instances of misconduct that are uncovered;

F. advising or directing others (via counsel or otherwise) not to assist and cooperate with the Division, or not to participate fully and openly in the investigation(s) and enforcement action(s); and

G. engaging in evasive, misleading or obstructive conduct during investigative testimony, interviews, or otherwise interfering in any other part of the investigation(s) or action(s).

* * *

The Division's assessment of cooperation in any matter is a discretionary function of the Division's Director and staff and requires a case-by-case analysis of the specific facts and circumstances of each matter. Nothing in this Advisory should be deemed to oblige the Division or the Commission to consider one or more cooperation factors, or to give certain factors more weight than others. The Advisory also should not be read as requiring the Division staff to recommend, or the Commission to impose or authorize, a reduction of sanctions based on the presence or absence of particular cooperation factors. Further, nothing in the Advisory is intended to waive any pre-decisional or other privileges that may apply to the Commission's or Division's deliberations or decision-making regarding cooperation or otherwise.

Appendix C: Commodity Futures Trading Commission, Enforcement Advisory: Updated Advisory on Self Reporting and Full Cooperation

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ENFORCEMENT ADVISORY

UPDATED ADVISORY ON SELF REPORTING AND FULL COOPERATION

On January 19, 2017, the Division of Enforcement issued two new Enforcement Advisories (the "January 2017 Advisories") outlining the factors the Division will consider in evaluating cooperation by individuals and companies in the agency's investigations and enforcement actions.[1] Among other things, the Advisories explained that, in evaluating the value of cooperation, the Division would consider the "timeliness" of cooperation, including whether the company or individual "quickly made appropriate disclosure of the misconduct and notified the Division."[2] Through this Advisory, the Division is providing additional information regarding voluntary disclosures and the substantial credit companies and individuals can expect from the Division if they voluntarily disclose misconduct and fully cooperate with the Division's investigation.

The Division of Enforcement has long sought to promote voluntary compliance with the law while at the same time ensuring accountability for companies and individuals that violate the law. One way the Division seeks to achieve these dual goals is by providing companies and individuals with meaningful incentives to self-report wrongdoing, cooperate with Division investigations, and, where appropriate, remediate flaws in their controls and compliance

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[1] *See* Press Release, CFTC's Enforcement Division Issues New Advisories on Cooperation (Jan. 19, 2017), http://www.cftc.gov/PressRoom/PressReleases/pr7518-17.

[2] *See* Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Companies (Jan. 19, 2017), http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisorycompanies011917.pdf (Advisory for Companies); Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Individuals (Jan. 19, 2017), http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisoryindividuals011917.pdf.

programs.[3]

This updated Advisory on self-reporting and full cooperation should provide greater transparency about what the Division requires from companies and individuals seeking mitigation credit for voluntarily self-reporting misconduct, fully cooperating with an investigation, and remediating, as well as what companies and individuals can expect from the Division if they meet these requirements. Specifically, if a company or individual self-reports, fully cooperates, and remediates, the Division will recommend that the Commission consider a substantial reduction from the otherwise applicable civil monetary penalty. Consistent with the January 2017 Advisories, the Division may recommend a reduced civil monetary penalty even where a company or individual did not self-report wrongdoing but otherwise fully cooperated with the Division's investigation and remediated deficiencies in its compliance or control programs. But, as this Advisory makes clear, the Division will reserve its recommendations for the most substantial reductions in civil monetary penalty for those instances where a company or individual has self-reported the misconduct *and* fully cooperated with the Division's investigation and remediated.

The Division expects that this Advisory will encourage companies and individuals to detect, report, and remediate wrongdoing, thus increasing voluntary compliance with the law. At the same time, the Division expects that this Advisory will provide it with additional avenues to learn about misconduct, thus increasing the Division's ability to prosecute wrongdoers and promoting accountability for those who violate the law.[4]

<u>Requirements for full self-reporting and cooperation credit</u>:

1. Voluntary disclosure to the Division:

    - Voluntary disclosure must be made prior to an imminent threat of exposure of the misconduct.

    - The disclosure must be made to the Division within a reasonably prompt time after the company or individual becomes aware of the misconduct.

[3] "Company" as used in this Advisory means any type of business entity except a sole proprietorship.

[4] The Division recognizes that the attorney-client privilege and work product doctrine are fundamental to the American legal system and administration of justice. The Division does not intend to affect or alter these rights in any way by this Advisory.

- The disclosure must include all relevant facts known to the company or individual at the time of the disclosure, including all relevant facts about the individuals involved in the misconduct.

    - The Division recognizes that, at the time of the first voluntary disclosure, the company or individual may not yet know all of the relevant facts, or the full extent of the misconduct. To encourage voluntary disclosure at the earliest possible time, the Division will still recommend full credit for the company or individual—assuming compliance with the other requirements—where the company or individual made best efforts to ascertain the relevant facts at the time of disclosure, fully disclosed the facts known at that time, continued to investigate, and disclosed additional relevant facts as they came to light.

2. Full cooperation:

    - To receive full credit under this self-reporting program, the company/individual must adhere to the terms of the Division's January 2017 Advisories.

3. Timely and appropriate remediation of flaws in compliance and control programs:

    - Will be fact and circumstance dependent.

<u>Credit</u>:

- If the company or individual self-reports, fully cooperates, and remediates, the Division will recommend the most substantial reduction in the civil monetary penalty that otherwise would be applicable.

    - In extraordinary circumstances—for example where misconduct is pervasive across an industry and the company or individual is the first to self-report—the Division may recommend a declination of prosecution.

- In all instances, the company or individual will be required to disgorge profits (and, where applicable, pay restitution) resulting from any violations.

Appendix D: Commodity Futures Trading Commission, Enforcement Advisory: Advisory on Self Reporting and Cooperation for CEA Violations Involving Foreign Corrupt Practices

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ENFORCEMENT ADVISORY

Advisory on Self Reporting and Cooperation for CEA Violations
Involving Foreign Corrupt Practices

The Division of Enforcement ("Division") issues this Advisory to provide further guidance regarding circumstances under the Division's cooperation and self-reporting program in which it may recommend a resolution with no civil monetary penalty.

On January 19, 2017, the Division of Enforcement issued two Enforcement Advisories (the "January 2017 Advisories") outlining the factors the Division would consider in evaluating cooperation by individuals and companies in the Division's investigations and enforcement actions. On September 26, 2017, the Division issued an additional Enforcement Advisory (the "September 2017 Advisory") outlining the ways in which the Division would consider voluntary disclosures by a company or individual in the context of its broader cooperation program. Among other things, in the September 2017 Advisory, the Division explained that "[i]f the company or individual self-reports, fully cooperates, and remediates, the Division will recommend the most substantial reduction in the civil monetary penalty that otherwise would be applicable." The September 2017 Advisory further explained that, in certain circumstances, the Division may recommend a resolution with no civil monetary penalty on account of voluntary disclosure, cooperation, and remediation.

This Advisory applies to companies and individuals not registered (or required to be registered) with the CFTC that timely and voluntarily disclose to the Division violations of the Commodity Exchange Act involving foreign corrupt practices, where the voluntary disclosure is followed by full cooperation and appropriate remediation, in accordance with the January 2017 and September 2017 Advisories.[1] In those circumstances, the Division will apply a presumption that it will recommend to the Commission a resolution with no civil monetary penalty, absent aggravating circumstances involving the nature of the offender or the seriousness of the offense. In its evaluation of any aggravating circumstances, the Division will consider, among other things, whether: executive or senior level management of the company was involved; the misconduct was pervasive within the company; or the company or individual has previously engaged in similar misconduct.

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[1] CFTC registrants have existing, independent reporting obligations to the Commission requiring them, among other things, to report any material noncompliance issues under the CEA, which would include any foreign corrupt practices that violate the CEA. Nevertheless, registrants that timely and voluntarily self-report misconduct, fully cooperate, and appropriately remediate will receive a recommended "substantial reduction in the civil monetary penalty," as set forth in the January 2017 and September 2017 Advisories, but the presumption of a recommendation of no civil monetary penalty will not apply.

If the Division recommends a resolution without a civil monetary penalty pursuant to this Advisory, the Division would still require payment of all disgorgement, forfeiture, and/or restitution resulting from the misconduct at issue. In addition, the Division will seek all available remedies—including, where appropriate, substantial civil monetary penalties—with respect to companies or individuals implicated in the misconduct that were not involved in submitting the voluntary disclosure.

Appendix E: Federal Energy Regulatory Commission, Revised Policy Statement on Enforcement

123 FERC ¶ 61,156
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Enforcement of Statutes, Regulations and Orders Docket No. PL08-3-000

REVISED POLICY STATEMENT ON ENFORCEMENT

(Issued May 15, 2008)

1. The Commission issues this Revised Policy Statement to provide guidance to the regulated community as to our enforcement policies concerning our governing statutes, regulations and orders. We also include in the Statement information as to our two years of experience in applying our enhanced enforcement tools under the Energy Policy Act of 2005[1] which, among other things, granted the Commission new civil penalty authority under the Natural Gas Act (NGA)[2] and enhanced civil penalty authority under Part II of the Federal Power Act (FPA)[3] and the Natural Gas Policy Act of 1978 (NGPA).[4]

I. Introduction

2. On October 20, 2005, following enactment of EPAct 2005, the Commission issued its first Policy Statement on Enforcement.[5] Our goal in the 2005 Policy Statement was to set forth the remedies available to us in the event we determined a violation of a statute,

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[1] Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005) (EPAct 2005).

[2] 15 U.S.C. § 717t-1 (added by EPAct 2005, § 314(a)(1)).

[3] 16 U.S.C. § 825o-1 (2000) (as amended by EPAct 2005, § 1284(e)); 16 U.S.C. § 823b (2000).

[4] 15 U.S.C. § 3414(b)(6) (2000) (as amended by EPAct 2005, § 314).

[5] *Enforcement of Statutes, Orders, Rules, and Regulations*, 113 FERC ¶ 61,068 (2005) (2005 Policy Statement).

regulation, or order had occurred, to explain how we determined what remedy was appropriate, and specifically to discuss the factors we intended to consider in determining the amount of any penalty.

3.The 2005 Policy Statement has guided both the Commission and the Office of Enforcement staff (Enforcement staff) in the conduct of our audits, investigations, and other enforcement actions, including the approval of 14 settlements that included civil penalties. We have endeavored to ensure that every exercise of our penalty authority has been fair, and have sought to encourage compliance with our governing statutes, regulations, and orders both through the deterrent effect of our penalties, and through the compliance plans we have generally required from companies found to be in violation.

4.Notwithstanding our efforts to administer a balanced enforcement program, the public and the regulated community have been unable to see the overall results of our efforts because, by regulation, most of our enforcement work is non-public. And, because normally it is only in those cases where penalties or other remedies have been imposed that the results of our investigations have been made public, the public and regulated community have remained unaware of the many instances in which Enforcement staff has determined not to open an investigation, or has closed an investigation without recommendation of a penalty or other remedy. As a result, the Commission has received many expressions of concern about the application of our penalty authority.

5.To remedy this situation, Enforcement staff prepared a report summarizing the enforcement actions we have taken in the first two years since issuance of EPAct 2005.[6] The Commission also held a conference in November of 2007, to entertain comments and questions from the industry regarding our enforcement policies.[7] We received many thoughtful comments in connection with that conference, a number of which requested additional information as to how we apply the factors set forth in the 2005 Policy Statement. In light of the importance of the subject and the expressed need for further guidance, we believe it is desirable at this time to issue a Revised Policy Statement on Enforcement. This Statement is designed to give the industry a fuller picture as to how our investigative process works, including the considerations Enforcement staff takes into account in determining whether to open an investigation and, once opened, whether to close it without further action or to recommend sanctions. We also set forth in detail the factors we consider in determining whether a penalty is appropriate and, if so, the amount of the penalty.

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[6] Report on Enforcement, Docket No. AD07-13-000, Nov. 14, 2007 (Staff Report).

[7] Conference on Enforcement Policy, Docket No. AD07-13-000, Nov. 16, 2007 (Enforcement Conference).

II. Background

6.The Commission has a number of enforcement tools at its disposal in overseeing those areas of the electric, natural gas, hydroelectric, and oil pipeline industries within our jurisdiction. These tools include imposition of compliance plans; disgorgement of unjust profits; the ability to condition, suspend, or revoke market-based rate authority, certificate authority, or blanket certificate authority; the ability to refer matters to the Department of Justice for criminal prosecution; and civil penalty authority. These tools give us great flexibility in fashioning the most appropriate and effective remedies and sanctions for each violation, both to deter future violations and to compensate injured entities in those cases where profits have been wrongfully gained in violation of a statute, regulation, or order.

7.The ability granted under EPAct 2005 to impose sizable monetary penalties has generated a number of questions and concerns from the industry regarding our enforcement program. As noted, many of these questions arise because of the non-public nature of much of what our Enforcement staff does. For investigations closed without any action by the Commission, the existence of the investigation remains non-public in all but rare circumstances.[8] However, when we decide to either approve a settlement resolving an action or institute an Order to Show Cause proceeding, both of which may involve the imposition of monetary sanctions, the existence and particulars of the investigation become public information. This incomplete picture may foster the misperception that most investigations result in civil penalties.

8.To address this concern, and to entertain questions and suggestions regarding our enforcement policies, we held a widely attended and viewed Enforcement Conference on November 16, 2007. The conference featured a broad range of panelists, including former Commissioners and practitioners. In advance of the conference, Enforcement staff issued the Staff Report noted above, which cataloged the number and type of investigations, self-reports, settlements, and Orders to Show Cause that it has handled since October 2005.

9.As noted in the Staff Report, between 2005 and 2007, Enforcement staff closed approximately 75 percent of its investigations without any sanctions being imposed, even though Enforcement staff found a violation in about half of those closed investigations. Only the remaining one-quarter of the total investigations completed during the study period resulted in civil penalties. Additionally, more than half of the self-reports submitted to Enforcement staff were closed with no action. The information provided in the Staff Report demonstrates that Enforcement staff frequently exercises prosecutorial discretion to resolve minor infractions with voluntary compliance measures rather than with penalties.

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[8] *See* 18 C.F.R. § 1b.9 (2007).

10.Through April 1, 2008, all of the post-EPAct 2005 investigations resulting in the imposition of civil penalties have been resolved by settlement between Enforcement staff and the subject companies. The Commission has issued 14 orders approving these settlements.[9] The civil penalties ranged from $300,000 to $10 million, and reflect a wide variety in the type and seriousness of the violations at issue. In some of these cases, disgorgement or other monetary remedies were imposed as well, and all but three of the settlements included compliance plans designed to prevent reoccurrence of the violations. We believe that the record in each of these cases demonstrates our commitment to firm and fair resolution of violations, and our desire to ensure future compliance with our governing statutes, regulations, and orders. While circumstances in the future may warrant imposition of the maximum civil penalty authorized by law, we note that each of the civil penalties we have so far imposed was significantly less than the maximum.

11.Since the passage of EPAct 2005, we have also issued two Orders to Show Cause, based on Enforcement staff's allegations of possible violations of a former Market Behavior Rule[10] and the current Anti-Manipulation Rule.[11] We have yet to make a final determination on these pending matters.[12]

III. Scope of this Revised Policy Statement

12. The foregoing discussion suggests that the non-public nature of much of Enforcement staff's work, coupled with the potential for the imposition of significant monetary penalties, argues for a fuller explication than we have yet provided as to how

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[9] *In re Entergy New Orleans, Inc*., 122 FERC ¶ 61,219 (2008); *In re Constellation NewEnergy – Gas Division, L.L.C.*, 122 FERC ¶ 61,220 (2008); *In re BP Energy Co.*, 121 FERC ¶ 61,088 (2007); *In re MGTC, Inc*., 121 FERC ¶ 61,087 (2007); *In re Gexa Energy L.L.C.*, 120 FERC ¶ 61,175 (2007); *In re Cleco Power, LLC*, 119 FERC ¶ 61,271 (2007); *In re Columbia Gulf Transmission Co.*, 119 FERC ¶ 61,174 (2007); *In re Calpine Energy Services, L.P*., 119 FERC ¶ 61,125 (2007); *In re Bangor Gas Co*., 118 FERC ¶ 61,186 (2007); *In re NRG Energy, Inc*., 118 FERC ¶ 61,025 (2007); *In re NorthWestern Corp*., 118 FERC ¶ 61,029 (2007); *In re Entergy Services, Inc*., 118 FERC ¶ 61,027 (2007); *In re SCANA Corp*.; 118 FERC ¶ 61,028 (2007); *In re PacifiCorp*, 118 FERC ¶ 61,026 (2007).

[10] 18 C.F.R. §§ 284.288(a) and 284.403(a)(2005) (at the time of the alleged violations, these regulations included the now rescinded Market Behavior Rule 2).

[11] 18 C.F.R. § 1c.1-1c.2 (2007).

[12] *See Energy Transfer Partners, L.P*., 120 FERC ¶ 61,086 (2007) (Market Behavior Rule 2); *Amaranth Advisors L.L.C.*, 120 FERC ¶ 61,085 (2007) (Anti-Manipulation Rule).

we conduct our investigations and determine the imposition of remedies, including civil penalties. We have carefully considered the suggestions of the commenters at the Enforcement Conference, and determined that a revised policy statement is the best vehicle to convey to the public the manner in which our Enforcement work is conducted. We have also instructed Enforcement staff to release annual statistical reports summarizing our enforcement activities for the preceding year, to be issued at the close of our fiscal year, September 30. This report would include information on both investigations and audits.

13.Accordingly, we issue this Revised Policy Statement, which supersedes our 2005 Policy Statement.[13] It affirms and restates our existing policies but also makes adjustments as needed. In addition, it describes the steps involved in an audit and the steps involved in an investigation, including a description of the types of matters as to which Enforcement staff either determines not to open an investigation, or closes an investigation without a finding of violation or recommendation of sanction.

A. Audits

14.The Divisions of Audits within the Office of Enforcement helps ensure compliance with the Commission's statutes, regulations, and orders by conducting a wide array of audits of jurisdictional entities. In contrast to investigations, most of the audits conducted by the Commission are initiated without any information of or allegation regarding any specific wrongdoing.

15.The initiation of an audit is public and documented in an audit commencement letter and included in eLibrary. The commencement letter describes the purpose and scope of the audit, and audit staff's authority to perform the audit. The commencement letter also identifies the audit team members and provides appropriate contact information for Enforcement staff leadership. Shortly after the company receives the commencement letter, the audit team contacts the company and discusses the commencement letter with the company. Although the commencement letter is a public document, all information and documentation gathered during the audit fieldwork, with the exception of the company's written response to the draft audit report, is treated as non-public information.

16.The discovery techniques used in an audit typically consist of on-site interviews, conference calls, document reviews, transactional testing, observing and walking through processes and control procedures, and data requests accompanied by an affidavit to determine any area of non-compliance. When the audit team initiates a site visit, an

[13] The 2005 Policy Statement may, of course, continue to be consulted for its background discussion regarding the enforcement policies of other agencies and the considerations we looked to in developing the policies set forth in that document.

opening meeting with the company is held to explain the audit process and address any issues or concerns that have arisen since the issuance of the commencement letter. After the completion of a site visit, the audit team holds a wrap-up conference to discuss potential audit findings or areas of concerns, identify the work the audit team needs to complete, and clarify any outstanding data requests.

17.Once all the audit fieldwork is completed and documented, the audit team conducts an exit conference to discuss audit staff's preliminary audit findings and recommendations with the company. This conference may be conducted in person or through a conference call. The result of an audit is documented in a final audit report, which is publicly reported, that contains a detailed description of the audit findings and recommendations, the audit methodology, and the company's written response to a draft audit report. The audit methodology identifies the major audit work performed to satisfy the audit objectives. Audit reports are either issued under delegated authority by the Director of Enforcement or approved by the Commission.

18.In an effort to increase the transparency of the audit process, following the Enforcement Conference, the Office of Enforcement's audit staff began to include in final audit reports a section detailing the methodology used to test compliance in each major area within the scope of the audit, thereby enabling companies to be better informed and prepared in the event of a similar audit of their operations.[14] For instance, after identifying the time period covered by the audit, the Scope and Methodology section (SM Section) of the recent KCPL audit report explained that the methodology used to determine KCPL's compliance with Commission regulations included reviewing and analyzing publicly available and non-public information, such as KCPL's 10Q and 8-K filings with the Securities and Exchange Commission; FERC documents, such as KCPL's Form No. 1 filings; and previous KCPL audit reports. In addition, and as detailed above, the SM Section described how audit staff reviewed, tested, analyzed, and verified data received from the company in response to data requests, and conducted several site visits and conference calls. Next, the SM Section spelled out the specific techniques used and data examined in the various areas within the scope of the audit (*e.g.*, requirements relating to interlocking directorate activity, record retention, recovery of fuel costs, open access transmission service, standards of conduct, and uniform system of accounts). In regard to fuel cost recovery, for example, the audit staff identified the types of charges related to fossil fuel, purchased power, and nuclear fuel that KCPL passed through the wholesale FAC to verify that the costs were eligible for recovery under the company's wholesale FAC tariff.

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[14] *See*, *e.g.*, the Kansas City Power & Light Company (KCPL) audit report (PA06-6-000) (Nov. 27, 2007) at pp. 7-9.

19.Enforcement staff has posted on the Commission website audit process guidance that sets forth a detailed description of the entire audit process.[15] It also describes the various procedures for disposition of contested audit matters, as set forth in the Commission's regulations.[16] At any point during the audit process, Audit staff may refer suspected violations of the Commission's governing statutes, regulations or orders to Investigations staff for the possible opening of an investigation.

B. Investigations

20.The following sections of this Revised Policy Statement follow a chronological scheme and lay out the procedures used in the conduct of an investigation. First, we discuss the factors considered by staff during the pre-investigation stage to determine whether an investigation is warranted. Second, we describe the investigatory process, the ways in which an investigation can be closed without further action and, in the event further action is warranted, the options for resolution, namely settlement or show cause proceedings. Third, we enumerate the various remedies available to the Commission and the factors we look to in choosing the appropriate remedy. Finally, we focus on civil penalties in particular and discuss the factors considered in determining the appropriate amount of a penalty.

21.At the outset, however, we emphasize that we are committed to ensuring the fairness of our investigatory process from the commencement of an investigation until the time it is completed.[17] We will continue to hold Enforcement staff to the highest ethical

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[15] *See* the "Audits" tab under the "Enforcement" tab on the Commission's website, www.FERC.gov.

[16] *Procedures for Disposition of Contested Audit Matters*, Order No. 675, FERC Stats. & Regs. ¶ 31,209; *order on reh'g*, Order No. 675-A, FERC Stats. & Regs. ¶ 31,217 (2006).

[17] We are in accord with the approach taken by the U.S. Department of Justice in the "McNulty Memorandum," a directive issued on December 12, 2006 by Paul J. McNulty, then Deputy Attorney General, to the United States Attorneys. Although the memorandum addresses corporate criminal prosecutions, its principles apply as well to our investigations: "A prosecutor's duty to enforce the law requires the investigation and prosecution of criminal wrongdoing if it is discovered. In carrying out this mission . . . [p]rosecutors should also be mindful that confidence in the Department is affected both by the results we achieve and by the real and perceived ways in which we achieve them. Thus, the manner in which we do our job as prosecutors – the professionalism we demonstrate, our resourcefulness in seeking information, and our willingness to secure the facts in a manner that encourages corporate compliance and self-regulation – impacts public perception of our mission. Federal prosecutors recognize that they must maintain

(continued…)

standards throughout the process, and we are clarifying certain of our procedures to ensure that the subjects of an investigation receive due process both in perception and reality.

22.We also want to stress that a subject's good faith exercise of its rights under the relevant statutes and our regulations, including but not limited to good faith disputes regarding discovery or settlement issues, will not be considered in determining whether the subject of an investigation has cooperated with staff and will not cause the subject of an investigation to forego possible credit for exemplary cooperation.

1. Initiation of an Investigation

23.By regulation, Enforcement staff is authorized to initiate and conduct investigations relating to any matter subject to our jurisdiction.[18] Investigations Staff initiates investigations when it has reason to suspect violations or when it has received information from a variety of sources, both internal and external, including intra-office referrals such as from the Division of Audits and the Division of Energy Market Oversight; referrals from other Commission offices, such as the Office of Energy Market Regulation, the Office of Electric Reliability, and the Office of Energy Projects; referrals from the Commission; referrals from market monitors; tips from the industry; self- reports; and Hotline calls. Pursuant to section 1b.9 of our regulations, all information and documentation received during an investigation, as well as the existence of an investigation, is treated as non-public information. As noted above, disclosure is permitted only at the Commission's direction or authorization, or is otherwise required to be disclosed.[19]

24.Prior to opening an investigation, staff reviews the information received and typically conducts a preliminary examination of the identified activity. Staff may consult publicly or commercially available sources of data, seek input from Commission staff with expertise in the subject matter, or contact the entity involved for an explanation of its actions. In some situations, this preliminary examination establishes an adequate

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public confidence in the way in which they exercise their charging discretion, and that professionalism and civility have always played an important part in putting these principles into action." Pages 2-3.

[18] 18 C.F.R. §§ 1b.3 and 375.314 (2007). According to these regulations, staff can conduct a preliminary investigation or, if compulsory process is required, seek an order from the Commission commencing a formal investigation. *See* 18 C.F.R. §§ 1b.5 and 1b.6 (2007). Except for the subpoena authority available to staff in a formal investigation, preliminary and formal investigations are handled in the same manner.

[19] 18 C.F.R. §§ 1b.9(a)-(c), 388.112 (2007).

justification for the subject activity or otherwise indicates that no further inquiry is needed. In other cases, staff determines that a fuller inquiry into the subject conduct is required, and opens an investigation.

25. To determine whether there is a substantial basis for opening an investigation, staff considers available information concerning the following factors, as appropriate:

- Nature and seriousness of the alleged violation,
- Nature and extent of the harm, if any,
- Efforts made to remedy the alleged violation,
- Whether the alleged violations were widespread or isolated,
- Whether the alleged violations were willful or inadvertent,
- Importance of documenting and remedying the potential violations to advance Commission policy objectives,
- Likelihood of the conduct recurring,
- Amount of detail in the allegation or suspicion of wrongdoing,
- Likelihood that staff could assemble a legally and factually sufficient case,
- Compliance history of the alleged wrongdoer, and
- Staff resources.

26.If, based on a consideration of the foregoing factors, staff determines that an investigation is not warranted, it will so notify the subject of the inquiry, assuming the subject is aware that an investigation is under consideration. If, on the other hand, staff determines that an investigation should be opened, it will notify the subject of that fact.

2. Investigatory Process and Resolution of an Investigation

a. Communications with the Commission

27.At the Enforcement Conference and subsequently in written comments, various entities raised the issue of whether it is permissible for the subject of an investigation to communicate directly with the Commission during an investigation. We announce that, as a matter of Commission policy, neither the Commissioners nor their assistants will receive oral communications, in person or by telephone, from any person concerning an ongoing staff investigation as to which such person is the subject. However, this does not

prevent such person from communicating with the Commission regarding other matters, consistent with the Commission's ex parte rules,[20] nor does it bar such person from making written submissions to the Commission. The Commission's regulations provide that "any person may, at any time during the course of an investigation, submit documents, statements of facts or memoranda of law for the purpose of explaining said person's position or furnishing evidence which said person considers relevant regarding the matters under investigation."[21] The Commission clarifies that nothing in our regulations prohibits the submission of such written information directly to the Commission. Such a submission may be made at any time during an investigation, up to the point at which our procedures regarding Orders to Show Cause come into play, which follow specific rules and are addressed more fully below.

b. Discovery

28.Once opened, an investigation involves fact-gathering by Enforcement staff through customary discovery methods such as data and document requests, interrogatories, interviews, and depositions. The time to complete an investigation depends on many factors, including the complexity of the conduct involved and the nature of the alleged violations. During this process, staff is in frequent contact with the subject being investigated, and will meet or otherwise converse with company representatives to discuss relevant facts, data, and legal theories. We note that subjects of an investigation are always free to contact Enforcement staff to provide additional information or explanations of their conduct.[22]

29.Discovery in Commission investigations, as in all litigation endeavors, is crucial in determining the nature of the activities at issue. However, the Commission and staff recognize the financial and time burdens that compliance with discovery requests impose on companies, which must continue to conduct their ordinary business while at the same time meeting staff's needs. For this reason, staff targets its discovery requests to the specific demands of the investigation, refrains from seeking information unnecessary to the resolution of the issues and conduct examined, and works with the subject of an investigation to accommodate reasonable requests regarding the production of data. The Commission will ensure that this practice continues.

30.Some entities have asked the Commission to establish a mediation process to address discovery or other disputes that may arise during an investigation between

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[20] 18 C.F.R. § 2201 (2007).

[21] 18 C.F.R. § 1b.18 (2007).

[22] *See* 18 C.F.R. § 1b.18 (2007).

enforcement staff and the subject of an investigation. We conclude that such processes need not be established at this time. However, we will re-evaluate our conclusions if warranted by facts and circumstances.

c. Closing an Investigation

31.At any time during the course of its investigation, staff may determine to close the investigation without taking any further action. This happens when staff determines that no violation occurred, the evidence is insufficient to warrant further investigation, or no further action is otherwise called for based on a totality of the circumstances. In such a case, staff notifies the subject that the investigation is closed.

32.If staff reaches the conclusion that a violation occurred that warrants sanctions, staff shares with the subject of the investigation its views, including both the relevant facts and legal theories. This may be done either orally or in writing. At this time, the subject has an opportunity to respond and to furnish any additional information it may deem to be helpful. If this process alters the complexion of the investigation, staff reconsiders its views. In some situations, such reconsideration has resulted in staff closing an investigation without recommending sanctions, or revising its view of the appropriate sanction. If staff continues to believe that sanctions of some sort are warranted, the matter will follow one of two courses: either the subject of the investigation and Enforcement staff agree on a settlement, or the subject contests Enforcement's conclusions.

d. Settlement

33.Staff attempts to reach a settlement with the subject of an investigation before recommending an enforcement proceeding. Settlement is our preferred resolution to investigations that result in a recommendation of remedial action. From the subject's point of view, settlement can often result in penalty payments significantly lower than those that would result from contesting staff's conclusions, and avoids litigation risk as well as the time and costs of a hearing. From the Commission's point of view, the public interest is often better served through settlements because we are able to ensure that compliance problems are remedied faster and that disgorged profits may be returned to customers faster, and we are able to reallocate to other enforcement matters the resources that would have been spent in lengthy litigation.

34.If the subject's response to staff's presentation of its case does not persuade staff to close the investigation, staff requests settlement authority from the Commission and, in that request, seeks authority to negotiate within a range of potential civil penalties and/or disgorgement. This process ensures that the Commission, not staff, determines the appropriate range of remedies for purposes of settlement. Furthermore, when staff seeks such settlement authority, it will provide the Commission with the subject's written response to staff's views, if submitted as described in Paragraph 32. This process ensures that the Commission has both the views of its staff and the subject before it determines

whether to authorize settlement negotiations. If settlement authority is granted, staff and the subject proceed to settlement negotiations, which may involve several meetings. If staff and the subject are able to agree in principle on the terms of the settlement, staff drafts a proposed stipulation and consent agreement and sends it to the subject for review. Further negotiations over specific terms of the agreement may occur at this point. Once staff and the subject agree on the terms, an executed stipulation and consent agreement is submitted to the Commission for its consideration. Upon approval, the Stipulation and Consent Agreement and the order approving the settlement are generally released publicly.

e. Orders to Show Cause

35.If Enforcement staff and the subject of the investigation are unable to reach a settlement, staff may recommend that the Commission initiate enforcement proceedings. In such case, Enforcement staff, except in the most extraordinary circumstances,[23] notifies each subject of an investigation of its intention to make the recommendation. Along with this notification, staff advises the subject that it may make a submission to the Commission to present its case as to why an Order to Show Cause should not issue.[24] Staff then submits to the Commission both its report, containing recommended findings of fact and conclusions of law, and any submission made by the subject, if timely received, so that the Commission has both documents before it for its consideration.

36.After considering staff's recommendations and the subject's submission, the Commission determines whether an Order to Show Cause is appropriate. If so, we issue the Order to Show Cause with Enforcement staff's report attached. We will not issue any findings regarding the matter until after we have received the subject's response to the Order to Show Cause. In addition, once the Order to Show Cause issues, designated staff

[23] An example of such an extraordinary circumstance would be the need to seek an injunction to prevent immediate and irreparable harm.

[24] Although our rules currently permit staff discretion in deciding whether to offer this opportunity (*See* 18 C.F.R. § 1b.19 (2007)), in *Submissions to the Commission upon Staff Intention to Seek an Order to Show Cause*, Docket No. RM08-10-000, 123 FERC 61,159 (2008), issued concurrently with this Revised Policy Statement, we expand the ability of subjects of an investigation to make such submissions as a matter of right in all but the most extraordinary circumstances. This rule also clarifies the timing of such submissions.

are made non-decisional employees for the remainder of the proceeding.[25] Non-decisional employees are prohibited from conducting off-the-record communications about the investigation with any member of the Commission or its decisional staff.[26]

37.The Commission emphasizes that, in issuing an Order to Show Cause, it does not make any finding as to whether there has been a violation of the law. Rather, an Order to Show Cause commences a Part 385 proceeding.[27] As indicated, Enforcement staff who participate in that proceeding become non-decisional. The Office of General Counsel will take the lead in advising the Commission regarding the disposition of arguments made in response to, and support of, the Order to Show Cause.

38.Following issuance of the Order to Show Cause, potential settlement may proceed in accordance with the requirements of Rule 602 of the Commission's Rules of Practice and Procedure.[28] Under this Rule, any participant in the proceeding may submit an offer of settlement at any time, which is transmitted to the Commission and the presiding officer, if one has been appointed. If the offer is uncontested, the Commission may approve the settlement upon a finding that it is fair, reasonable, and in the public interest.[29] Commission approval of a settlement closes the investigation and concludes the enforcement proceedings with respect to all matters covered in the settlement.

39.In the event there is no settlement, the proceeding will continue according to the process prescribed by the particular statute governing the violation at issue, as well as in accordance with any additional procedures set forth by the Commission in orders issued in the particular proceeding. In 2006, we issued an order in which we provided a

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[25] Codification of the process is being proposed in a notice of proposed rulemaking, issued contemporaneously with this Revised Policy Statement. *See Ex Parte Contacts and Separation of Functions*, Docket No. RM08-8-000, 123 FERC ¶ 61,158 (2008) (Ex Parte NOPR).

[26] 18 C.F.R. §§ 2201(b), 2202 (2007). We are proposing revisions to these rules in the Ex Parte NOPR cited in the preceding footnote, which proposes that this restriction on off-the-record communications also apply to subjects of the investigation.

[27] 18 C.F.R. Part 385 (2007).

[28] 18 C.F.R. § 385.602 (2007).

[29] *Id. Petal Gas Storage v. FERC,* 496 F.3d 695, 701 (D.C. Cir. 2007)*; cf. Tejas Power Corp. v. FERC,* 908 F.2d 998 (D.C. Cir. 1990).

comprehensive review of the statutory requirements associated with the imposition of civil penalties under Parts I and II of the FPA, the NGA, and the NGPA, and outlined the process we follow in imposing civil penalties under each of the statutes.[30]

40.These enforcement procedures are designed to provide due process to those who are the subjects of an investigation or enforcement action. During every stage of an investigation, subjects being investigated have the opportunity to make submissions to Enforcement staff to demonstrate that a violation did not occur, or to offer an explanation of why one occurred.[31] Moreover, the Commission clarifies that, under section 1b.18, the subject of an investigation has the right, at any time during an investigation, to submit documents directly to the Commission, not just to Enforcement staff. Thus, throughout our Enforcement proceedings, the subject of an investigation has the right and the means to make its views known to staff and the Commission.

3. Choice of Remedy

41.In the event the Commission identifies a violation of a governing statute, regulation or order, we have available to us a panoply of remedies to sanction the behavior, recompense injured entities, and prevent reoccurrence of the conduct in question. We possess broad discretion in fashioning the appropriate remedy,[32] and our choice is carefully tailored to the facts and circumstances of each case. These remedies and sanctions include civil penalties for violations of the NGA, NGPA, and Parts I and II of the FPA; disgorgement of unjust profits; and compliance plans and various other forms of non-monetary relief, all of which are discussed in more detail below.

a. Disgorgement

42.In the event an entity acquires unjust profits through a violation of a statute, regulation or order, the Commission may require disgorgement and order restoration of the unjust profits. It is important to note that the Commission has discretion to order disgorgement not in lieu of, but in addition to, civil penalties or other remedies that may be imposed on the wrongdoer.

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[30] *Statement of Administrative Policy Regarding the Process for Assessing Civil Penalties*, 117 FERC ¶ 61,317 (2006).

[31] *See* 18 C.F.R. § 1b.18 (2007).

[32] *Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967) ("the breadth of agency discretion is . . . at [its] zenith when the action assailed relates primarily . . . to the fashioning of policies, remedies and sanctions, including enforcement and voluntary compliance programs."); *see also Consol. Edison Co. of New York v. FERC*. No. 06-1025, slip op. at 9 (D.C. Cir. 2007).

43.Requiring disgorgement of unjust profits is consistent with long-standing Commission practice,[33] the 2005 Policy Statement,[34] and the practice of other enforcement agencies such as the Securities and Exchange Commission (SEC)[35] and the Commodity Futures Trading Commission (CFTC).[36] Our practice in this regard has not altered since enactment of EPAct 2005, including in those cases involving the imposition of civil penalties. In *In re SCANA Corporation*, we ordered disgorgement of $1.4 million in unjust profits for the improper use of network transmission service, as well as a $9 million civil penalty.[37] In *In re Constellation NewEnergy – Gas Division, LLC,* we approved disgorgement of approximately $1.9 million, plus interest, for violations of the gas pipeline open-access requirements, as well as a $5 million civil penalty.[38] And *In re Gexa Energy, L.L.C.*, we approved the disgorgement of over $12,400, plus interest, for violations of sections 203(a) and 205 of the FPA, the Commission's regulations regarding the filing of electric quarterly reports, and a Commission order granting the company market-based rate authority, as well as a $500,000 civil penalty.[39]

b. <u>Compliance Plans</u>

44.Another enforcement tool at our disposal is the imposition of compliance plans on the company in violation. Most of the settlements that we have approved post-EPAct 2005 have included compliance plans, in addition to other remedies and sanctions.[40] The

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[33] *See, e.g., Transcon. Gas Pipe Line Corp. v. FERC*, 485 F.3d 1172, 1176-77 (D.C. Cir. 2007); *Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249 (5th Cir. 1986).

[34] 2005 Policy Statement at P 19.

[35] The Securities Exchange Act §§ 21-21C, 15 U.S.C. §§ 78u-78u-3 (2000).

[36] 7 U.S.C. §§ 13a & 13b (2000); Comm. Fut. L. Rep. (CCH) ¶ 26,265, P 42,247.

[37] *In re SCANA Corp.*, 118 FERC ¶ 61,028 (2007).

[38] *In re Constellation NewEnergy – Gas Division, LLC*, 122 FERC ¶ 61,220 (2008).

[39] *In re Gexa Energy, L.L.C.*, 120 FERC ¶ 61,175 (2007).

[40] *See, e.g., In re Constellation NewEnergy-Gas Division, LLC*, 122 FERC ¶ 61,220 (2008) (two to three year compliance monitoring plan, with third year at staff's sole discretion); *In re BP Energy Co.*, 121 FERC ¶ 61,088 (2007) (one to two year compliance monitoring plan, with second year at Enforcement staff's sole discretion); *In re MGTC, Inc.*, 121 FERC ¶ 61,087 (2007) (compliance report); *In re Cleco Power, LLC*, 119 FERC ¶ 61,271 (2007) (one to two year compliance monitoring plan, with second year at Enforcement staff's sole discretion); *In re Calpine Energy Services*, *L.P.*,

(continued…)

purpose of these plans is generally to monitor relevant activity by the company for a suitable period of time, to ensure that steps are taken within the company to improve compliance practices and thereby prevent reoccurrence of the violations.

45.Under a compliance plan, the company is required to submit sworn reports to Enforcement staff on a periodic basis for a specified period of time, most typically semi-annual reports for a period of one to three years. These reports describe measures taken by the company to end the practices that led to the violations and to alert staff to any additional violations that may have occurred and measures taken to correct them. In addition, the reports describe training and other activities taken by the company to implement and improve compliance. Staff reviews these reports and, where necessary, provides comments and suggestions to the company. Often, the compliance plan has called for the company to hire an independent third party auditor to review its business practices in order to ensure compliance.[41]

46.The Commission may also go further and approve, as part of the settlement, the development of a comprehensive compliance program addressing a broad area of Commission requirements.[42] Such a comprehensive program may be appropriate for companies with many wide ranging violations, for frequent violators, or for entities with a demonstrable absence of a compliance culture. Often the company will be required to support its internal compliance program with a specified amount of funding. A comprehensive program of this type not only addresses compliance procedures and mechanisms, it often entails the engagement of an independent consultant to conduct a review of the company's existing compliance program, or to identify industry best-practices for adoption by the company.

47.We have not imposed a single approach to the compliance plans that have been imposed by the Commission. In the case of a settlement, Enforcement staff and the

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119 FERC ¶ 61,125 (2007) (one to two year compliance monitoring plan, with second year at Enforcement staff's sole discretion); *In re Bangor Gas Co.,* 118 FERC ¶ 61,186 (2007) (one year compliance plan); *In re PacifiCorp*, 118 FERC ¶ 61,026 (2007) (one year compliance plan); *In re SCANA Corp*., 118 FERC ¶ 61,028 (2007) (one year compliance plan); *In re Entergy Services, Inc.*, 118 FERC ¶ 61,027 (2007) (one to two year compliance monitoring plan, with second year at Enforcement staff's sole discretion); *In re NorthWestern Corp*., 118 FERC ¶ 61,029 (2007) (two year compliance plan); *In re NRG Energy, Inc*., 118 FERC ¶ 61,025 (2007) (one year compliance monitoring plan).

[41] *See In re Cleco Power, LLC*, 119 FERC ¶ 61,271 (2007); *In re PacifiCorp*, 118 FERC ¶ 61,026 (2007); *In re Entergy Services, Inc*., 118 FERC ¶ 61,027 (2007).

[42] *Coral Energy Resources, L.P.*, 110 FERC ¶ 61,205 (2005).

company generally work out together the details of the plan, in order to best address the unique issues involved in the case.

48.Compliance plans are not always necessary. In some instances, a repetition of the violation may, due to external circumstances, be unlikely or impossible to occur.[43] In other instances, the violation at issue may have been discovered as the result of an existing strenuous internal compliance program, which argues against imposition of a new or different compliance plan. In a later section discussing civil penalties, we describe the typical elements we expect to see in a vigorous compliance program.

c. Other Non-Monetary Measures

49.The Commission is authorized to impose any of a number of other non-monetary measures to remedy violations. These measures include conditioning, suspending, or revoking market-based rate authority, certificate authority, or blanket certificate authority.[44] The decision of whether to impose one of these measures is based on an evaluation of the particular circumstances of the individual case, including the scope and seriousness of the violations. We also have the ability, in appropriate circumstances, to refer matters to the Department of Justice for criminal prosecution.[45]

d. Civil Penalties

50.EPAct 2005 significantly increased the scope of the Commission's civil penalty authority. The Commission is now authorized to impose civil penalties of up to $1

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[43] *See, e.g., In re Columbia Gulf Transmission Co.*, 119 FERC ¶ 61,174 (2007); *In re Gexa Energy L.L.C.*, 120 FERC ¶ 61,175 (2007).

[44] *See, e.g., Enron Power Marketing, Inc.,* 103 FERC ¶ 61,343, at P 52 (2003), *reh'g denied*, 106 FERC ¶ 61,024 (2004); *Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 99 FERC ¶ 61,272, at 62,154 (2002); *San Diego Gas & Electric Co.*, 95 FERC ¶ 61,418, at 62,548, 62,565 (2001), *order on reh'g*, 97 FERC ¶ 61,275 (2001), *order on reh'g*, 99 FERC ¶ 61,160 (2002); *accord Enron Power Marketing, Inc.*, 102 FERC ¶ 61,316 at P 8 & n.10. The Commission has revoked the market based rate authority of a number of other entities: *See Electric Quarterly Reports*, 115 FERC ¶ 61,073 (2006); *Electric Quarterly Reports*, 114 FERC ¶ 61,171 (2006); *Electric Quarterly Reports*, 69 Fed. Reg. 57,679 (Sept. 27, 2004); *Electric Quarterly Reports*, 105 FERC ¶ 61,219 (2003).

[45] NGA § 20(a), 15 U.S.C. § 717s(a) (2000); FPA § 314(a) (2000), 16 U.S.C. § 825m(a) (2000); NGPA § 504(b)(5) (2000),15 U.S.C. § 3414(b)(5) (2000).

million per day, per violation for any violation of the NGA, the NGPA, and Part II of the FPA. In addition, the Commission retains its existing penalty authority under Part I of the FPA.[46]

51. With this expanded authority comes added responsibility to ensure that the Commission's penalty determinations are fair and reasonable, and take into account the unique factors relevant to a given violation. The NGA was amended by EPAct 2005 to provide that "[i]n determining the amount of a proposed penalty, the Commission shall take into consideration the nature and seriousness of the violation and the efforts to remedy the violation."[47] The FPA retained almost identical language, which requires us to "take into consideration the seriousness of the violation and the efforts . . . to remedy the violation in a timely manner."[48] As we discussed in our 2005 Policy Statement, and as we describe more fully below, we implement these statutory mandates and our due process obligations by taking into account numerous factors in determining the appropriate civil penalty for a violation, including the nature and seriousness of the violation and the company's efforts to remedy it.

52. We continue to believe that this careful, considered approach provides the best method for determining whether civil penalties are appropriate and, if so, for determining the appropriate amount. Some commenters have suggested that the Commission should determine penalties in accordance with a pre-determined penalty schedule or formula. We rejected such an approach in our 2005 Policy Statement, explaining that we believed it was important to retain the discretion and flexibility to address each case on its merits, and to fashion remedies appropriate to the facts presented, including any mitigating factors.[49] Our two years of experience in administering the enhanced penalty authority granted under EPAct 2005 has not yet convinced us to revise our decision at this time.[50]

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[46] FPA § 31(c), 16 U.S.C. § 823b(c) (2000) (providing civil penalties of "an amount not to exceed $10,000 for each day that such violation or failure or refusal continues").

[47] 15 U.S.C. § 717t-1 (added by EPAct 2005, § 314(b)).

[48] 16 U.S.C. § 825o-1 (as amended by EPAct 2005, § 1284(e)). *See also* 16 U.S.C. § 824o(e)(6), requiring that any penalty imposed for violation of a reliability standard "shall bear a reasonable relation to the seriousness of the violation and shall take into consideration the efforts . . . to remedy the violation in a timely manner."

[49] 2005 Policy Statement at P 13.

[50] In the discrete area of reliability, we have permitted the Regional Entities and the Electric Reliability Organization to use a base penalty amount table in their initial determination of the appropriate amount of a civil penalty for violation of a Reliability

(continued…)

A penalty schedule is most feasible where the universe of regulatory requirements is fairly limited, the universe of regulated entities is small and reasonably homogeneous, and when the agency has significant experience in exercising its enforcement authority.

53. Our jurisdiction encompasses hydroelectric facilities, interstate natural gas pipelines and storage facilities, liquefied natural gas importation facilities, electric transmission facilities, regional transmission organizations, independent transmission system operators, and interstate oil pipelines. Indeed, our jurisdiction extends beyond the regulation of individual entities to include wholesale markets for the sale and purchase of physical natural gas and electric power. It also includes regulation of certain mergers and acquisitions involving certain jurisdictional assets or public utility holding companies. Moreover, the Commission's regulatory requirements are extensive, including statutes, regulations (including such wide-ranging areas as our anti-manipulation and fraud provisions[51]), tariffs, rules, and orders, which, taken together, address an extraordinarily broad panoply of prohibited activity. And, unlike a generic rulemaking, which may apply simply to one class of regulated entities, our universe of regulatory requirements can apply to anywhere from one entity to all the entities within our jurisdictional reach.[52] This complex mix of requirements cannot neatly be reduced to a penalty schedule or matrix, at least not until the Commission develops more experience in reviewing matters involving its enforcement authority. For that reason, we believe that it would be impractical to develop such a schedule at this time. Our current practice of applying a

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Standard. *North American Electric Reliability Corp*., 116 FERC ¶61,062, *order on reh'g and compliance,* 117 FERC ¶ 61,126 (2006). All such proposed penalties, however, are subject to review and approval by the Commission.

[51] 18 C.F.R. Part 1c (2007). *See Prohibition of Energy Market Manipulation*, Order No. 670, 71 Fed. Reg. 4244 (Jan. 26, 2006), FERC Stats. & Regs. ¶ 31,202, at P 25 (2006) (codified at 18 C.F.R. Part 1c) (explaining that the Commission's anti-manipulation and fraud authority "is modeled after section 10(b) of the Exchange Act, which has been interpreted as a broad anti-fraud 'catch-all clause'"); *Id*. at P 50 (explaining that "[t]he Commission defines fraud generally, that is, to include any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market").

[52] Indeed, under 18 C.F.R. Part 1(c) (2007), entities that are not regulated by the Commission are potentially subject to civil penalties or other sanctions.

case-by-case approach, one based on factors rather than formula, is the surest way of tailoring each remedy and sanction to the particular circumstances of the specific case before us.[53]

54.In the following sections, we address the factors we consider in determining whether a civil penalty should be imposed and, if so, the amount of that penalty. These factors are grouped under the following headings: seriousness of the offense, commitment to compliance, self-reporting, cooperation, and reliance on staff guidance. Of these factors, the most important in determining the amount of the penalty are the seriousness of the offense and the strength of the entity's commitment to compliance.

(i) Seriousness of the Offense

55.As required by the NGA[54] and the FPA,[55] one of the broad categories of factors we consider in determining the amount of a civil penalty is the seriousness of a violation. We base the seriousness of a violation on the scope of the violation, the circumstances giving rise to it, and the effect it has on other entities and the market. We carry forward from the 2005 Policy Statement the factors we examine in determining the seriousness of a violation. These are:

- What harm was caused by the violation? Was there loss of life or injury or endangerment to persons? Was there damage to property or the environment? Was the harm widespread across markets or customers, or was it limited in scope and impact? Did it involve significant sums of money? Were others indirectly affected by the wrongdoing? What benefit did the wrongdoer gain from the violation?

- Was the violation the result of manipulation, deceit, or artifice? Did the wrongdoer misrepresent material facts? Was the conduct fraudulent? Were the actions reckless or deliberately indifferent to the results?

- Was the action willful? Was the violation part of a broader scheme? Did the wrongdoer act in concert with others?

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[53] As we continue to issue orders under our enhanced enforcement authorities, a substantial body of case law will emerge that should assist the regulated community in understanding how we determine penalties.

[54] 15 U.S.C. § 717t-1 (added by EPAct 2005, § 314(b)).

[55] 16 U.S.C. § 825o-1 (as amended by EPAct 2005, § 1284(e)).

- Is this a repeat offense or does the company have a history of violations? Is this an isolated instance or a recurring problem? Was the wrongdoing systematic and persistent? How long did the wrongdoing last? [56]

- Was the wrongdoing related to actions by senior management, the result of pressure placed on employees by senior management to achieve specific results, or done with the knowledge and acquiescence of senior management? Did management engage in a cover-up?

- How did the wrongdoing come to light? Did senior management resist or ignore efforts to inquire into actions or otherwise impede an inquiry into the violation?

- What effect would potential penalties have on the financial viability of the company that committed the wrongdoing?

56.In addition to the factors identified in the 2005 Policy Statement, we also consider the following:

- What, if any, harm was there to the efficient and transparent functioning of the market? [57]

- What are the earnings, revenues and market share of the part of the company that is under investigation?

- What penalty amount best discourages improper conduct, while not excessively discouraging beneficial market participation?

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[56] We note that with respect to repeat violations, we are concerned not only with violations of the same type, but with any other violations of the Commission's governing statutes, regulations and orders.

[57] *See, e.g., In re BP Energy Co*., 121 FERC ¶ 61,088, at P 21 (2007) (explaining, "[the] violations [involving "flipping," i.e., a series of alternating short-term releases of discounted rate capacity to affiliated replacement shippers to avoid the competitive bidding requirement for discounted long-term capacity release] directly affected the transparency of the secondary market for natural gas transportation and storage. Market transparency was one of the primary goals of the Commission's pipeline open-access reforms, and remains an important priority today, as demonstrated by recent orders and notices.").

- What was the motivation of those accused of the improper conduct?
- Was the integrity of the regulatory process impaired? [58]
- Was there a risk of serious harm, even if the actual harm was slight or non-existent?[59]

(ii) Commitment to Compliance

57. A second broad category we consider in determining the amount of a civil penalty is the nature and extent of the company's internal compliance measures in existence at the time of the violation. Such compliance measures include: (i) systems and protocols for monitoring, identifying, and correcting possible violations, (ii) a management culture that encourages compliance among company personnel, and (iii) tools and training sufficient to enable employees to comply with Commission requirements. The presence of a robust internal compliance program is a mitigating factor that may result in a reduced penalty. We also consider in this category the actions taken by the company to correct the activity that produced the violation. This consideration, like seriousness of the offense, is mandated by statute.[60]

58. We carry forward from our 2005 Policy Statement the factors we examine in determining the existence of a robust internal compliance program. These are:

- Does the company have an established, formal program for internal compliance? Is it well documented and widely disseminated within the company? Is the program supervised by an officer or other high-ranking official? Does the compliance official report to or have independent access

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[58] *See, e.g., id.* (explaining, "these unlawful transactions impaired the effectiveness of the Commission's pipeline open-access policies."); *In re Columbia Gulf Transmission Co.*, 119 FERC ¶ 61,174, at P 13 (2007) (in light of staff's finding that the company's actions violated a Commission order by unreasonably delaying a Commission-approved interconnection, thus undermining the Commission's open-access program, the Commission found "harm to the orderly administration of the Natural Gas Act").

[59] This factor, for instance, would encompass an unsuccessful manipulation attempt that, had it succeeded, might have resulted in major disruptions or price fluctuations in the market. Another example would be the violation of a Reliability Standard that puts the bulk power system at serious risk, even if an outage is averted because of system conditions or other events.

[60] 15 U.S.C. § 717t-1 (2007); 16 U.S.C. § 825o-1 (as amended by EPAct 2005, § 1284(e).

to the chief executive officer and/or the board of directors? Is the program operated and managed so as to be independent? Are there sufficient resources dedicated to the compliance program?

- Is compliance fully supported by senior management? For example, is senior management actively involved in compliance efforts and do company policies regarding compensation, promotion, and disciplinary action take into account the relevant employees' compliance with Commission regulations and the reporting of any violations?

- How frequently does the company review and modify the compliance program? How frequently is training provided to all relevant employees? Is the training sufficiently detailed and thorough to instill an understanding of relevant rules and the importance of compliance?

- In addition to training, does the company have an ongoing process for auditing compliance with Commission regulations?

- How has the company responded to prior wrongdoing? Did it take disciplinary action against employees involved in violations? When misconduct occurs, is it a repeat of the same offense or misconduct of a different nature? Does the company adopt and ensure enforcement of new and more effective internal controls and procedures to prevent a recurrence of misconduct?

59.Most of the foregoing factors are self-explanatory. However, in order to give further guidance to the industry, we intend to hold periodic workshops in which we will discuss the elements we expect to see in vigorous compliance programs. We also offer the following suggested actions, which point to a strong compliance culture and which may aid companies in structuring their compliance programs, bearing in mind that each case is unique and no one size fits all:

- ✓ Prepare an inventory of current compliance risks and practices,

- ✓ Create an independent Compliance Officer who reports to the Chief Executive Officer and the Board, or to a committee thereof,

- ✓ Provide sufficient funding for the administration of compliance programs by the Compliance Officer,

- ✓ Promote compliance by identifying measurable performance targets,

- ✓ Tie regulatory compliance to personnel assessments and compensation, including compensation of management,

- ✓ Provide for disciplinary consequences for infractions of Commission requirements,
- ✓ Provide frequent mandatory training programs, including relevant "real world" examples and a list of prohibited activities,
- ✓ Implement an internal Hotline through which personnel may anonymously report suspected compliance issues, and
- ✓ Implement a comprehensive compliance audit program, including the tracking and review of any incidents of noncompliance, with submission of the results to senior management and the Board.

60. We also place great value on self-reporting, particularly when it points to a strong compliance program. However, self-reporting is no substitute for a strong compliance program; indeed, repeated self-reporting by an entity that persists in violations may be of little value. But good-faith self-reports are an important element of our enforcement efforts, and are discussed separately below.

(iii) Self-reporting

61. One of the highlights of the Commission's post-EPAct 2005 enforcement program has been the now common practice of companies submitting self-reports of possible violations, the third broad category we consider in determining the amount of a civil penalty. Between October 20, 2005, the date of the 2005 Policy Statement, and April 1, 2008, the Office of Enforcement has received 103 self-reports. In most cases, self-reported violations have resulted in the matters being closed without any enforcement action being taken. In the cases where a self-report did result in enforcement action, the penalties reflected mitigation credit for the self-reporting. While we do not articulate here the precise amount of mitigation credit that was earned for self-reporting in our recent enforcement actions, we reiterate that the penalties in these cases would have been greater absent self-reporting.

62. We continue to place importance on good-faith self-reporting, and will maintain our practice of awarding penalty credit for parties that promptly self-report violations, assuming such conduct is not negated by a poor compliance culture. We carry forward from the 2005 Policy Statement the factors we examine in determining the credit to be given for self-reporting:

- How did the company uncover the misconduct? Was it through a self-evaluation, internal audit, or internal compliance program? Did the company act immediately when it learned of the misconduct?

- Did the company notify the Commission promptly? Did senior management actively participate and encourage employees to provide information to identify the misconduct?

- Did the company take immediate steps to stop the misconduct? Did it implement or create an adequate response to the misconduct?

- Did the company arrange for individuals with full knowledge of the matter to meet with Commission Enforcement staff?

- Did the company present its findings to the Commission and provide all relevant evidence regarding the misconduct, including full disclosure of the scope of the wrongdoing; the identity of all employees involved, including senior executives; the steps taken by the company upon learning of the misconduct; communications among involved employees; documents evidencing the misconduct; and measures taken to remedy the misconduct?

63.The best self-reports will be in writing and will contain a discussion of all relevant factors from the foregoing list. In addition, it should provide any documents relevant to the matter being reported and sufficient information for Enforcement staff to understand the circumstances of how and why the violation occurred, along with the identity of the key personnel involved in the violation. Good self-reports also detail the steps taken to cure the violation and to prevent any recurrence.

64.We emphasize that not only is the comprehensiveness of a self-report important, but also the promptness in providing it to Enforcement staff. In fact, we encourage companies that discover a violation to contact Enforcement staff before submitting a full report of the incident or activity in question. This notification provides considerable benefit to the company. Early notification is one aspect of mitigation credit, and Enforcement staff can provide guidance as to the matters the company should explore and present in its written report. This may result in a more complete self-report and thus in both greater mitigation credit and a more rapid conclusion of staff's inquiry.

(iv) <u>Cooperation</u>

65.The NGA, NGPA and the FPA all require entities under the Commission's jurisdiction to respond to requests for information from the Commission in the course of its investigations, audits, and other inquiries.[61] Since cooperation is expected of all entities, we do not give penalty mitigation credit for ordinary cooperation, such as timely responses to data requests. However, we do give credit for exemplary cooperation.

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[61] FPA § 301(b), 16 U.S.C. § 825b(b) (2000); NGA § 8(b), 15 U.S.C. § 717g(b) (2000); NGPA § 304(a), 15 U.S.C. § 3314(a) (2000).

66.We carry forward from the 2005 Policy Statement the factors we examine in determining whether there has been exemplary cooperation. These are:

- Did the company volunteer to provide internal investigation or audit reports relating to the misconduct? Did the company hire an independent outside entity to assist the company's investigation?

- Did senior management make clear to all employees that their cooperation has the full support and encouragement of management and the directors of the company?

- Did the company facilitate Commission access to employees with knowledge and information bearing on the issue, and actively encourage such employees to provide the Commission with complete and accurate information?

- Did the company identify culpable employees and assist the Commission in understanding their conduct?

- Did the company make records readily available, with assistance on searching and interpreting information in the records?

- Did the company fairly and accurately determine the effects of the misconduct, including identifying the revenues and profits resulting from the misconduct and the customers or market participants adversely affected by the misconduct?

67.As discussed above in the description of staff's investigative process, we will continue to ensure that staff is sensitive to the time and financial burdens that discovery places on the subjects of investigations. We also note that the absence of a self-report does not preclude an entity from earning mitigation credit through exemplary cooperation.

68.Exemplary cooperation begins at the beginning of an investigation and continues through its resolution. Therefore, companies that initially earn cooperation credit can lose that credit through uncooperative conduct, such as untimely or incomplete responses, unresponsiveness to information requests, misrepresentation,[62] or any other conduct that

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[62] With respect to regulated entities engaging in sales for resale of electric energy at market-based rates, misrepresentation may rise to the level of a separately actionable matter subject to imposition of a civil penalty. *See* 18 C.F.R. § 35.41(b) (2008): "Seller will provide accurate and factual information and not submit false or misleading

(continued…)

obstructs a Commission investigation, audit or inquiry. Furthermore, engaging in obstructionist conduct may be viewed as an aggravating factor in determining the amount of a civil penalty. Obstructionist conduct in an investigation can include, among other things: misrepresentation, persistent delays in responding to information requests, or frivolous objections to information requests.

(v) Reliance on Staff Guidance

69. We are issuing, contemporaneous with this Revised Policy Statement, an Interpretive Order that, among other things, provides a description of each of the various methods of obtaining guidance from the Commission, including the avenues available for obtaining non-binding guidance from Commission staff.[63] We note that staff guidance, while not binding on the Commission, is informed by the experience and knowledge of the individuals who help shape and implement Commission policy, and therefore can provide a more readily accessible source of information than official Commission guidance.

70. In the event a company reasonably relies, in good faith, on staff guidance in pursuing conduct that is ultimately found to be in violation of a Commission requirement, mitigation credit will be considered. We therefore add reliance on staff guidance to the broad category of factors for determining a civil penalty amount that were set forth in the 2005 Policy Statement.

71. The application and degree of credit for reliance on staff guidance will be based on a case-by-case analysis, and will vary according to the nature and extent of the guidance and other surrounding circumstances. Conversely, we may also view it as an aggravating factor if the evidence shows that a violator ignored or otherwise disregarded staff guidance as to the conduct later found to be in violation. Such a determination will likewise be based on a case-specific analysis of all the circumstances.

IV. Conclusion

72. We have issued this Revised Policy Statement to inform and update the industry concerning our enforcement experience and procedures, and to provide detailed explanations of the factors we consider important in determining which remedies and

~~information, or omit material information, in any communication with the~~ Commission . . . unless seller exercises due diligence to prevent such occurrences." Furthermore, the United States Criminal Code provides that under certain circumstances, knowingly falsifying or concealing a material fact is a felony which may result in fines of up to $10,000, and/or five years imprisonment, or both. *See* 18 U.S.C. § 1001.

[63] *Interpretative Order Modifying No-Action Letter Process and Reviewing Other Mechanisms for Obtaining Guidance*, 123 FERC 61,157 (2008) (Interpretative Order).

sanctions to impose. We hope it provides guidance about our policies and increases public understanding of this vital area of our jurisdiction. Ultimately, it is our desire that our enforcement efforts foster increased compliance with our governing statutes, regulations, and orders, and minimize the occurrence of future violations.

By the Commission. Commissioner Moeller concurring with a separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Enforcement of Statutes, Regulations and Orders Docket No. PL08-3-000

(Issued May 15, 2008)

MOELLER, Commissioner *concurring*:

This policy statement will improve the Commission's existing procedures on the exercise of its penalty authority. The Energy Policy Act of 2005 provided the Commission with substantial penalty authority to ensure that market manipulation and other violations of our standards would be addressed swiftly and effectively. The Commission has worked diligently to establish an effective enforcement process. Nevertheless, as I have repeatedly expressed, the Commission can improve its procedures by adding context and transparency to certain aspects of its policies.

Those who are subject to Commission penalties need to know, in advance, what they must do to avoid a penalty. This policy statement provides that transparency and context, and that is why I strongly support it. The Commission can continue to improve its enforcement policies, just as it can always improve on all that it does. This policy statement recognizes that our policies will be subject to reconsideration and improvement as we gain more experience.

One area of future improvement may be in the guidance that the Commission provides the industry on its enforcement priorities. I believe that the Commission can and should provide more guidance on our enforcement priorities in a manner that classifies the severity and significance of prohibited conduct. While all violations of our rules and regulations are serious and subject to enforcement, given limited resources, we should identify and prioritize the types of violations that are most harmful. Notwithstanding, I am glad that we will be continuing our various outreach efforts and publishing an annual report that summarizes our enforcement activities for the preceding year, and it is my hope that the public will be able to use this report to discern trends in our enforcement priorities.

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Philip D. Moeller
Commissioner

Appendix F: Federal Energy Regulatory Commission, Policy Statement on Compliance

125 FERC ¶ 61,058
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Compliance with Statutes, Regulations, and Orders Docket No. PL09-1-000

POLICY STATEMENT ON COMPLIANCE

(Issued October 16, 2008)

1.The Commission believes it is in the public interest to encourage companies[1] subject to our regulatory requirements to develop rigorous compliance programs that will help minimize the potential for violations of applicable requirements, and to give significant weight to those programs when we determine whether to assess a civil penalty or other remedy for a violation. Achieving compliance, not assessing penalties, is the central goal of our enforcement efforts. Improved compliance as a result of a company's commitment to and successful implementation of a strong compliance program should result in fewer violations over time. In particular, improved compliance should result in a reduction of serious violations, that is, those violations that involve significant harm, risk of significant harm, or damage to the integrity of the Commission's regulatory program. Improved compliance by regulated companies will also improve the ability of the Commission to accomplish the public policy goals assigned to it by Congress.

2.Accordingly, the purpose of this Policy Statement is to provide additional guidance to the public on compliance with our governing statutes, regulations and orders. In response to input from participants in the Commission's July 8, 2008, staff workshop on compliance, and based on our experience in implementing our new civil penalty authority thus far, we discuss further some of the factors related to effective compliance that the Commission will take into account in considering whether to reduce or even to eliminate civil penalties for violations. These factors are: (1) the role of senior management in fostering compliance; (2) effective preventive measures to ensure compliance; (3) prompt detection, cessation, and reporting of violations; and

[1] For purposes of this Policy Statement, the term "company" or "companies" includes all entities and organizations subject to our regulatory requirements.

(4) remediation efforts. The Commission will provide additional guidance as necessary in the form of additional orders or periodic workshops.[2]

3.We also discuss the benefits of effective compliance efforts by companies subject to our statutes, regulations, and orders. For companies engaged in wholesale electric and natural gas market activities, the range of such requirements is substantial and the cost of implementing thorough systemic protections may be significant. Moreover, even when strong compliance measures are taken, violations may still occur. In order to demonstrate the benefits that inure to companies that undertake effective compliance programs, we describe in more detail the civil penalty credit we will provide, including complete forgiveness of civil penalties under certain circumstances.

4.This Policy Statement supplements the Revised Policy Statement on Enforcement issued May 15, 2008,[3] which discussed various other factors, such as harm from the violation, seriousness of the offense, self-reporting, cooperation, and other available remedies, all of which are relevant, along with a company's compliance efforts, in determining whether a civil penalty is appropriate for a violation. As discussed further herein, our policy is that if a company acts aggressively to adopt, foster, and maintain a effective corporate culture of compliance, and has in place rigorous procedures and processes that provide effective accountability for compliance, but a violation nonetheless occurs, the Commission may provide a significant reduction in, or even in some cases the elimination of, the civil penalty that otherwise would be imposed.

I. Background

5. The Commission's interest in compliance is long standing, and relates to the statutory requirement that the Commission consider what efforts a company has made to remedy a violation in a timely manner.[4] The importance of creating a strong atmosphere of compliance in a company—both to prevent violations in the first instance and to deal promptly and effectively with misconduct should it occur—was emphasized in the Commission's first Policy Statement on Enforcement, which listed a number of factors

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[2] *Enforcement of Statutes, Regulations, and Orders*, 123 FERC ¶ 61,156, at P 59 (2008) (Revised Policy Statement). As discussed below in P 7, the Commission has already held one of these workshops.

[3] Revised Policy Statement, 123 FERC ¶ 61,156 (2008).

[4] Section 22 of the Natural Gas Act, 15 U.S.C. § 717t-1 (2006); section 316A of the Federal Power Act, 16 U.S.C. § 825o-1 (2006). *Cf.* Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U.L. Rev. 687, 688 (1997) (mitigation credit appropriate for companies with effective compliance programs).

that would be considered in determining whether to provide mitigation credit for compliance efforts in any penalty decisions.[5] These factors include the nature and structure of a company's compliance program, the active support of senior management, the scope and depth of employee training, a process for auditing compliance, and the response of a company to misconduct by its employees.[6]

6. The Revised Policy Statement carries forward these elements and additionally emphasizes the importance of "(i) systems and protocols for monitoring, identifying and correcting possible violations, (ii) a management culture that encourages compliance among company personnel, and (iii) tools and training sufficient to enable employees to comply with Commission requirements," as well as the actions a company takes to correct the activity that produced the violation.[7] Significantly, the Revised Policy Statement elevates the importance of compliance programs by making clear that, among all the factors considered, "the most important in determining the amount of the penalty are the seriousness of the offense and the strength of the entity's commitment to compliance."[8] The Commission also suggested specific actions to aid companies in developing compliance programs, and recognized that each company's circumstances are unique and that no one size fits all.[9]

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[5] *Enforcement of Statutes, Orders, Rules, and Regulations*, 113 FERC ¶ 61,068, at P 21-23 (2005) (Policy Statement on Enforcement).

[6] *Id.* P 22.

[7] Revised Policy Statement at P 57.

[8] *Id.* at P 54. In addition, at the time we issued the Revised Policy Statement, we also reviewed the various mechanisms by which those seeking assistance on compliance issues can obtain guidance from the Commission or our staff. These options include declaratory orders, no-action letter requests, General Counsel opinion letters, accounting interpretations, the Enforcement Hotline, the recently-created Help Desk, pre-filing meetings, and other informal contacts with staff. *Obtaining Guidance on Regulatory Requirements*, 123 FERC ¶ 61,157 (2008). We encourage companies to make use of the appropriate Commission resources as part of their compliance efforts. Each source of guidance is somewhat different, and those who seek guidance should select the mechanism that best fits the circumstances presented.

[9] Revised Policy Statement at P 59. The actions noted by the Commission are:

- Prepare an inventory of current compliance risks and practices
- Create an independent Compliance Officer who reports to the Chief Executive Officer and the Board, or to a committee thereof

(continued…)

7.On July 8, 2008, the Commission's staff held a public compliance workshop, which was attended by more than 400 individuals. The workshop consisted of panel presentations by industry representatives with staff and audience questions and comments concerning the development of a sound compliance program. Many useful points were made, both at the workshop and in the comments filed after the workshop discussion. The Commission encourages all interested persons to continue to share appropriate compliance-related information and to work with industry associations to develop best practices and to facilitate adoption of effective compliance measures. The Commission also will consider whether to sponsor additional future workshops or other forums to encourage the continuing exchange of ideas and best practices among regulated companies and the Commission and our staff.

8.As discussed in the Policy Statement on Enforcement and emphasized in the Revised Policy Statement,[10] the Commission places great emphasis on a company's efforts to assure compliance with all applicable regulatory requirements. Given the breadth of the Commission's responsibilities, the nature of these requirements vary significantly. Some areas lend themselves to very specific mandatory compliance measures, such as hydroelectric dam safety and pipeline and liquefied natural gas construction and environmental impacts, where the Commission has developed active and prescriptive compliance programs through the Office of Energy Projects. More

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- Provide sufficient funding for the administration of compliance programs by the Compliance Officer
- Promote compliance by identifying measurable performance targets
- Tie regulatory compliance to personnel assessments and compensation, including compensation of management
- Provide for disciplinary consequences for infractions of Commission requirements
- Provide frequent mandatory training programs, including relevant "real world" examples and a list of prohibited activities
- Implement an internal Hotline through which personnel may anonymously report suspected compliance issues
- Implement a comprehensive compliance audit program, including the tracking and review of any incidents of noncompliance, with submission of the results to senior management and the Board

Taken as a whole, these actions facilitate senior management's demonstration of commitment to compliance, make preventive measures more effective, encourage detection and reporting of violations, and should lead to prompt and effective remediation of violations.

[10] Revised Policy Statement at P 57-60.

recently, through the Office of Electric Reliability, the Commission has addressed our new responsibilities to assure the reliability of the nation's bulk power system, including allowing the electric reliability organization and regional entities to use a matrix-based approach to civil penalties for violations of reliability standards.

9.Other areas where the Commission engages in economic regulation, including the reliance the Commission has placed in certain circumstances on open and competitive wholesale energy markets as a substitute for traditional regulation, are subject to a variety of requirements, including the recent rules prohibiting market manipulation.[11] In certain situations, companies are in the best position to determine the risks their activities entail and how best to train and monitor employees to assure compliance.[12] Moreover, an effective compliance program will differ based on the nature of the conduct regulated. A program designed to assure compliance with specific safety, reliability, or environmental conditions will differ from one designed to prevent market manipulation, which in turn will differ from one designed to prevent discrete tariff violations. This Policy Statement emphasizes the benefit to companies that take such compliance measures seriously and implement effective programs to assure compliance in their regulated activities.

10.The Commission expects companies to invest appropriate time and effort in the creation, monitoring, and growth of strong internal compliance programs. Depending on a company's size and organizational structure, the nature and complexity of the company's involvement in activities subject to Commission regulation, and the range of compliance risks resulting from those activities, a comprehensive and effective compliance program may be time and resource intensive. The needs and circumstances of each company are unique, and we recognize that a company may meet its compliance obligation with internal resources, outside assistance, or a combination of the two. Some workshop commenters agreed with our view that there is no one template or approach for a good compliance program, and that market participants are in the best position to assess their regulatory risks and to devise the optimum mix of measures that will provide the

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[11] 18 C.F.R. Part 1c (2008). As we noted in the Revised Policy Statement, the Commission found it impractical to develop a penalty schedule or matrix at this time given that the "complex mix of requirements cannot neatly be reduced to a penalty schedule or matrix, at least not until the Commission develops more experience in reviewing matters involving its enforcement authority." Revised Policy Statement at P 53.

[12] Charles Walsh & Alissa Pyrich, *Corporate Compliance Programs as a Defense to Criminal Liability: Can a Corporation Save its Soul?,* 47 Rutgers L. Rev. 605, 636-37 (1995) (corporations, given their knowledge of their own businesses, are in the best position to detect and deter wrongdoing).

best conditions for ongoing compliance.[13] The elements noted in the Revised Policy Statement can be helpful, but should be tailored, along with other appropriate measures, to create a compliance program that best fits the needs of each individual company.

11.We recognize that smaller companies have more limited resources. While all companies involved in activities subject to the Commission's jurisdiction should be proactive in developing appropriate compliance programs, there is no set amount that must be invested in compliance measures and no requirement to use outside resources to devise and implement compliance programs. At the same time, companies engaging in certain activities, such as construction and operation of hydroelectric facilities, or of interstate gas pipelines or liquefied natural gas facilities, must adhere to project-specific requirements regardless of the size of the company.

12.The Commission cannot spell out what constitutes a effective compliance program in all circumstances, but we can identify the compliance-related credit factors we will consider when companies, despite strong compliance efforts, have lapses that result in violations of Commission statutes, regulations, or orders.[14] A proactive approach to correcting such violations and reporting them to the Commission is demonstrably beneficial. For example, in *NRG Energy, Inc.*, NRG self-reported an intentional misrepresentation of unit availability by plant employees acting contrary to established company protocol. NRG took disciplinary action against the employees and provided exemplary cooperation with the Commission. The relatively modest penalty amount ($500,000) is directly attributable to NRG's proactive compliance actions.[15] While all of the facts and circumstances of each situation must be evaluated to determine the

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[13] These commenters also noted that smaller companies have more limited resources available to address compliance matters. *See, e.g.,* Post-Workshop Comments of the American Gas Association, Docket No. AD08-5-000, at 1-3 (filed July 22, 2008); Comments of the Process Gas Consumer Group, Docket No. AD08-5-000, at 3-5 (filed July 22, 2008).

[14] "Regardless of how good a company's compliance program is, violations will occur. This is especially true of large companies." Dr. John D. Copeland, *The Tyson Story: Building an Effective Ethics and Compliance Program*, 5 Drake J. Agric. L. 305 (2000).

[15] *NRG Energy, Inc.*, 118 FERC ¶ 61,025 (2007). A company's aggressive approach to correcting violations and improving compliance may also, in appropriate circumstances, lead staff to resolve violations with compliance measures rather than penalties, particularly where the violation is not serious. *Staff Report on Enforcement*, Docket No. AD07-13-000 at 22 (Nov. 14, 2007).

appropriate amount of credit given,[16] it is possible to describe four key compliance factors that may lead to the reduction or even elimination of a civil penalty.

II. Factors for Vigorous Compliance Programs

A. Actions of senior management

13.One recurring theme at the July 8 workshop was the critical importance of the role of senior management in fostering a strong compliance ethic within a company. While there are numerous issues to address and steps to take to create a sound compliance program, the best program will not succeed unless senior management actively embraces the importance of compliance and sets the standard within a company for proactive compliant behavior. Developing a strong and continuing culture of compliance is a critical task for every company subject to our statutes, regulations, and orders, and the responsibility for a culture of compliance rests squarely on the shoulders of senior management.[17]

14.In addition to providing adequate funds and resources for compliance, there are some common steps that senior management can take to instill a culture of compliance. As noted by one commenter,[18] senior management should communicate its commitment to compliance frequently, both formally and informally, to employees. Senior management should set aside the time necessary to address compliance issues as they arise, both to vet proposed actions to avoid violations and to address misconduct if it should occur. Senior management should actively encourage employees to raise questions and to obtain the views of supervisors or designated compliance personnel. Finally, senior management should assure that designated compliance personnel are actively included in the development of new transaction structures or business initiatives.[19]

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[16] We note that while credit may apply to civil penalties, if there are unjust profits, we will seek disgorgement as a matter of course. Revised Policy Statement at P 43.

[17] Charles Walsh and Alissa Pyrich, *supra* note 12 at 646-649 (senior management must support a compliance program for it to be effective and supervisory personnel should be responsible for maintaining and enforcing company policy).

[18] Post-Workshop Comments of JPMorgan Chase & Co., Docket No. AD08-5-000, at 2 (filed July 22, 2008).

[19] *Id.*

15.Senior management may designate one or more persons as compliance officials within the company.[20] This may be a position devoted exclusively to compliance matters or may be an assigned duty of an employee. Compliance official independence is an important hallmark of a strong commitment to compliance. For example, compliance officials should be able to bring compliance matters directly to the Board of Directors or a committee of the Board (or equivalent governance of other organizations). The compensation provisions and reporting structure of the company should encourage the compliance officials and all employees to follow senior management's lead in embracing a strong compliance culture.

B. Effective preventive measures

16.The second factor, systematic and effective preventive measures (such as careful hiring, training, accountability, and supervision), is fundamental to an effective compliance program. It is not enough to create a good compliance program on paper; the company must carry through to implement the program with effective accountability for compliance and periodic review and evaluation of the effectiveness of the program. Although we believe companies already have strong incentives to develop mechanisms to prevent violations,[21] it is appropriate for the Commission to give credit when companies invest in systematic preventive measures to keep the company in compliance with the Commission's statutes, regulations and orders. We also recognize that even the best efforts, fully and actively supported by senior management, may still not avoid a violation, particularly if the company is dealing with a rogue employee not adhering to clear direction from the company.[22] However, it is possible to assess in general the degree to which a company demonstrates consistent serious commitment to preventive compliance measures, and demonstrates that its compliance program generally satisfied the relevant actions identified in our Revised Policy Statement. Where there is evidence that the company has adopted effective preventive measures, with the appropriate accountability and review mechanisms, we may reduce the amount of penalty that might otherwise be applied.

17.The Commission recognizes that each company's situation may be different. Companies vary widely in their size and structure, in the degree to which they participate

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[20] Companies subject to the Standards of Conduct must designate a Chief Compliance Officer to be responsible for the company's compliance with the Standards of Conduct. 18 C.F.R. § 358.4(e)(6) (2008).

[21] Walsh & Pyrich, *supra* note 12 at 681 (implementation of corporate compliance programs ultimately will prove cost effective for corporations).

[22] As discussed earlier, this was the case for NRG, where the plant operators acted inconsistently with company protocol for reporting unit availability.

in markets or activities subject to the Commission's jurisdiction, and the compliance risks that those activities present. Because comprehensive compliance program measures can be expensive, each company has to determine the optimum investment to make in compliance measures in light of its resources and risks. The Commission will take into account the size of a company and the nature and extent of its jurisdictional activities in reviewing the adequacy of preventive measures undertaken.[23]

C. Prompt detection, cessation, and reporting of the offense

18.The third factor relates to the method by which a violation is detected and the behavior of the company thereafter. There is no specific amount of time by which a company must find or report a violation in order to be considered prompt. We recognize that in some circumstances a company's inquiry into conduct by its employees may take time to determine whether an act violates our regulations or requirements, how many times the violation occurred, or what the consequences of the violations are. Prompt detection may result from a high quality and comprehensive internal monitoring system, or actively-promoted company hotline, or other measures to ensure that transactions are reviewed for conformance to regulatory requirements on a real-time basis.

19.Because the Commission encourages companies to have effective controls in place to identify possible misconduct, violations discovered as a result of systematic internal auditing and supervision programs normally will be given substantial credit. Once discovered, we expect that companies will act expeditiously to end the wrongful conduct and will report it promptly.[24] A company will receive credit for prompt reporting if it reports a violation to Enforcement staff shortly after discovery, or if it calls Enforcement staff to let staff know the company is investigating a matter. In other words, based on the circumstances of each case, a company can demonstrate the extent to which it was diligent in discovering misconduct, correcting the problem, and reporting the offense promptly.

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[23] Under the Federal Sentencing Guidelines, discussed *infra*, small organizations are expected to "demonstrate the same degree of commitment to ethical conduct and compliance with the law as large organizations" but that "a small organization may meet the requirements . . . with less formality and fewer resources than would be expected of large organizations." Federal Sentencing Guidelines § 8B2.1 *commentary* n.2.c (2007).

[24] As we noted in the Revised Policy Statement at P 63, we expect companies to take appropriate steps to cure violations. For example, if a violation involves the failure to make a required filing or disclosure to the Commission or another regulator, companies are encouraged to cure the defect by making the appropriate filing or disclosure as well as reporting the lapse to the Office of Enforcement.

20.Implementation of an aggressive compliance program and strong direction by senior management to search out and report regulatory compliance issues may result in an increase of violations self-reported to the Commission. If a company demonstrates that such self-reported violations are the result of implementing increased compliance measures, the Commission will take these circumstances into account. There is no blanket waiver of sanctions in such instances, but companies that fail to report violations discovered as a result of improved compliance monitoring can expect to be penalized far more severely than if they self-report such violations.

D. Remediation

21.The fourth factor, remediation of the misconduct, is one of the statutory considerations[25] and is inherently case-specific. There will be fact-specific questions in each case about the steps taken by a company to end violations and remedy the misconduct. As to employees engaged in misconduct, the issue of whether disciplinary action is appropriate (e.g., reprimand, suspension, reduction in pay or bonus, termination, etc.) depends on the circumstances surrounding the offense and the involvement of supervisory personnel or senior management.[26] Similarly, the question of whether new or modified prospective controls are needed to prevent a recurrence is highly fact- specific. The Commission will weigh the response of a company to misconduct it discovers in determining whether civil penalty reduction is appropriate for this factor.

III. Penalty Credit

22. The factors discussed above will be applied in light of each company's commitment to compliance and the results of that compliance program. Because there are many factors to take into account in every situation, the appropriate result must be determined on a case-by-case basis. We will continue to determine whether to apply civil

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[25] *See supra* note 4.

[26] Another comment at the July workshop was that there is a delicate balance to be struck when tying regulatory compliance to compensation of employees and senior management. *See, e.g.,* panel comments of Jeff Guldner, Arizona Public Service Company; Post-Workshop Comments of the Edison Electric Institute, Docket No. AD08-5-000, at 6-7 (filed July 22, 2008). We recognize that compliance is one among several important goals for companies, and that incentives in compensation should recognize legitimate goals other than compliance. We also understand the risk that too great an emphasis on compliance in compensation may actually discourage employees or senior management from acknowledging compliance lapses within a company and self-reporting those matters to the Commission. Here again, each company must evaluate its circumstances and determine the appropriate degree to which compensation should relate to successful compliance.

penalties, or the amount of penalties, based on the totality of facts and circumstances presented, including those related to senior management's commitment and the presence of vigorous compliance measures. Such cases may provide an opportunity for the Commission to provide specific future guidance to the public on issues resolved in those cases.[27]

23. The Commission is aware that in other contexts, specific credit is given based on the existence of an effective compliance and ethics program. For instance, the Federal Sentencing Guidelines provide reductions to the "culpability score" used to determine fines for business organizations if there is an effective compliance and ethics program.[28] If the organization had an effective compliance and ethics program in place, it receives a reduction from the base culpability score.[29] Combined with credit for self-reporting and cooperation, the compliance credit can completely offset the culpability score points

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[27] We also note that in many instances violations reported to the Commission are closed without sanctions. These usually involve inadvertent violations or violations that resulted from errors or misunderstandings of regulatory requirements, and which were not serious. Such resolutions normally are not made public. During the first two years of enforcement activity since passage of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005), approximately 70 percent of staff investigations were terminated without any penalty, including many instances where a violation occurred. *Staff Report on Enforcement, supra* note 15, at 22.

[28] The Sentencing Guidelines require courts to calculate a culpability score as one step in determining the appropriate fine for an organization. Federal Sentencing Guidelines § 8C2.8(a)(8) (2007). The relationship of compliance programs to the culpability score is explained in Federal Sentencing Guidelines §§ 8B2.1 and 8C2.5 (2007). Compliance programs also may be taken into consideration in determining whether to take action against an organization. In this respect, the Sentencing Guidelines provide strong incentives for organizations to establish compliance programs. "Effective programs do not guarantee immunity from prosecution, but the existence of a qualifying compliance program may influence a prosecutor's decision to prosecute." Melissa Ku & Lee Pepper, *Corporate Criminal Liability*, 45 Am. Crim. L. Rev. 275, 297-300 (2008). Similarly, the existence of effective compliance protocols may be taken into account by the Commission in determining whether to investigate or sanction violations.

[29] Courts must consider whether "the offense occurred even though the organization had in place at the time of the offense an effective compliance and ethics program." Federal Sentencing Guidelines § 8C2.5(f)(1) (2007). If so, the culpability score is reduced.

otherwise applicable and, when combined with the other elements of determining fines, substantially reduce or even eliminate civil fines that otherwise would be assessed.[30]

24.Effective compliance and ethics programs are also recognized by other administrative agencies. The Securities and Exchange Commission (SEC) has issued orders providing guidance on the circumstances under which it will give credit for self- policing, self-reporting, remediation, and cooperation.[31] The Environmental Protection Agency (EPA) has adopted detailed incentives for self-policing to encourage discovery, disclosure, correction, and prevention of violations of environmental statutes and regulations.[32] The EPA assesses penalties based on both the economic benefit a company derived from the environmental violation and a punitive "gravity-based" component. Under the EPA's approach, the economic benefit component is still assessed, but the gravity-based component may be reduced to zero if all conditions of the self-policing policy are met fully. The Commission notes that the EPA economic benefit assessment is similar to disgorgement of unjust profits, which the Commission routinely requires.[33] The EPA's gravity-based component is similar to a civil penalty imposed by the Commission.

25.The Commission will take an approach to civil penalties similar to those of the Federal Sentencing Guidelines and the EPA. Where a violation is not serious, that is, the violation does not involve significant harm, risk of significant harm, or damage to the integrity of the Commission's regulatory program, and all four elements of vigorous compliance are present, the Commission may reduce the level of civil penalty that otherwise would be imposed to zero. The Commission adopts this approach to

[30] ~~Even if the combi~~nation of an effective compliance program and self-reporting and cooperation reduces the culpability score to zero, under the Federal Sentencing Guidelines the application of the multiplier (based on the culpability score) to the base fine and other elements of determining the appropriate fine may still result in a monetary fine. Federal Sentencing Guidelines, Chapter 8, Part C.

[31] *Accounting and Auditing Enforcement*, SEC Release No. 1470 (October 23, 2001).

[32] *Incentives for Self-Policing: Discovery, Disclosure, Correction, and Prevention of Violations*, Environmental Protection Agency, 65 Fed. Reg. 19,618 (April 11, 2000) (Audit Policy). The EPA has resolved thousands of violations through its Audit Policy and recently extended additional incentives to new owners of problem facilities on an interim basis further to increase remediation of violations. *Interim Approach To Applying the Audit Policy to New Owners*, Environmental Protection Agency, 73 Fed. Reg. 44,991 (August 1, 2008).

[33] Revised Policy Statement at P 42-43.

demonstrate the benefit to a company of developing and implementing strong compliance measures related to Commission regulatory requirements. On the other hand, where there is an inadequate or incomplete compliance program, or where despite a demonstrated commitment to compliance serious violations occur, a civil penalty will be imposed. In such circumstances, however, the Commission will consider whether, in light of all the circumstances, a reduction in the civil penalty is warranted.

26.Thus, for complete elimination of a civil penalty, a company must affirmatively demonstrate (1) that its violation was not serious and (2) that its senior management has made a commitment to compliance, that the company adopted effective preventive measures, that when a violation is detected it is halted and reported to the Commission promptly, and that the company took appropriate remediation steps. All of the components must be present for complete elimination of a civil penalty; reduction of the penalty will be considered where the company meets some but not all of the requirements. The Commission retains discretion to determine whether the actions taken by a company are sufficient to meet the requirements.

27.Given the scope and breadth of the Commission's regulatory responsibility, it is not feasible to catalog or to list examples of violations that might be eligible for an elimination of a civil penalty. We emphasize that where the violation is not serious and there is a demonstration of substantial commitment to compliance, the Commission is more likely to reduce or eliminate a civil penalty. In all instances, our goal is a firm but fair application of the Commission's civil penalty and remedial authority according to the unique facts of each case. We also emphasize that other sanctions, such as disgorgement of unjust profits and prospective compliance monitoring, may still be imposed.

IV. Conclusion

28. We remain committed to informing and updating the public concerning our enforcement policies, including our policies with respect to compliance programs. We will continue to provide guidance about our policies and to increase public understanding of all matters related to enforcement, including the importance of compliance programs by companies engaged in activities subject to our jurisdiction. As we noted in the

Revised Policy Statement, it is our desire that enforcement actions ultimately result in increased compliance with regulatory requirements and fewer violations of our governing statutes, regulations, and orders.[34]

By the Commission. Commissioner Moeller concurring with a separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

[34] Revised Policy Statement at P 72.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Compliance with Statutes, Regulations, and Orders Docket No. PL09-1-000

(Issued October 16, 2008)

MOELLER, Commissioner *concurring*:

As I stated in May, "[t]hose who are subject to Commission penalties need to know, in advance, what they must do to avoid a penalty."[1] This policy statement provides further guidance to the industry, and that is why I support it.

Nevertheless, I would also support the development of a model compliance program for the industries we regulate. Such a model program would need to be individualized to the needs of the companies adopting it, but that does not mean that the industry would not benefit from seeing a basic model containing the essentials that every program should contain. Perhaps we could even adopt several model programs; they could be tailored to each of the basic market activities and industries that we regulate.

Given that this Commission has not yet provided the industry with a model program or programs, I encourage trade associations within the industries we regulate to consider developing their own model programs. Such model programs would provide industry with an opportunity to share best practices and consider which aspects of a compliance program are so important that they belong in a model program.

Philip D. Moeller
Commissioner

[1] *See* Concurring Opinion of Commissioner Moeller, *Enforcement of Statutes, Regulations and Orders*, 123 FERC ¶ 61,156 (2008).

Appendix G: Department of Justice, 9-28.000 – Principles of Federal Prosecution of Business Organizations

9-28.000 - PRINCIPLES OF FEDERAL PROSECUTION OF BUSINESS ORGANIZATIONS

9-28.010	Foundational Principles of Corporate Prosecution
9-28.100	Duties of Federal Prosecutors and Duties of Corporate Leaders
9-28.200	General Considerations of Corporate Liability
9-28.210	Focus on Individual Wrongdoers
9-28.300	Factors to Be Considered
9-28.400	Special Policy Concerns
9-28.500	Pervasiveness of Wrongdoing Within the Corporation
9-28.600	The Corporation's Past History
9-28.700	The Value of Cooperation
9-28.710	Attorney-Client and Work Product Protections
9-28.720	Cooperation: Disclosing the Relevant Facts
9-28.730	Obstructing the Investigation
9-28.740	Offering Cooperation: No Entitlement to Immunity
9-28.750	Oversight Concerning Demands for Waivers of Attorney-Client Privilege or Work Product Protection By Corporations Contrary to This Policy
9-28.800	Corporate Compliance Programs
9-28.900	Voluntary Disclosures
9-28.1000	Restitution and Remediation
9-28.1100	Collateral Consequences
9-28.1200	Civil or Regulatory Alternatives
9-28.1300	Adequacy of Prosecution of Individuals
9-28.1400	Selecting Charges
9-28.1500	Plea Agreements with Corporations

9-28.010 - FOUNDATIONAL PRINCIPLES OF CORPORATE PROSECUTION

The prosecution of corporate crime is a high priority for the Department of Justice. By investigating allegations of wrongdoing and bringing charges where appropriate for criminal misconduct, the Department promotes critical public interests. These interests include, among other things: (1) protecting the integrity of our economic and capital markets by enforcing the rule of law; (2) protecting consumers, investors, and business entities against competitors who gain unfair advantage by violating the law; (3) preventing violations of environmental laws; and (4) discouraging business practices that would permit or promote unlawful conduct at the expense of the public interest.

One of the most effective ways to combat corporate misconduct is by holding accountable all individuals who engage in wrongdoing. Such accountability deters future illegal activity, incentivizes changes in corporate behavior, ensures that the proper parties are held responsible for their actions, and promotes the public's confidence in our justice system.

Prosecutors should focus on wrongdoing by individuals from the very beginning of any investigation of corporate misconduct. By focusing on building cases against individual wrongdoers, we accomplish multiple goals. First, we increase our ability to identify the full extent of corporate misconduct. Because a corporation only acts through individuals, investigating the conduct of individuals is the most efficient and effective way to determine the facts and the extent of any corporate misconduct. Second, a focus on individuals increases the likelihood that those with knowledge of the corporate misconduct will be identified and provide information about the individuals involved, at any level of an organization. Third, we maximize the likelihood that the final resolution will include charges against culpable individuals and not just the corporation.

[new November 2015]

9-28.100 - DUTIES OF FEDERAL PROSECUTORS AND DUTIES OF CORPORATE LEADERS

Corporate directors and officers owe a fiduciary duty to a corporation's shareholders (the corporation's true owners) and they owe duties of honest dealing to the investing public and consumers in connection with the corporation's regulatory filings and public statements. A prosecutor's duty to enforce the law requires the investigation and prosecution of criminal wrongdoing if it is discovered. In carrying out this mission with the diligence and resolve necessary to vindicate the important public interests discussed above, prosecutors should be mindful of the common cause we share with responsible corporate leaders who seek to promote trust and confidence. Prosecutors should also be mindful that confidence in the Department is affected both by the results we achieve and by the real and perceived ways in which we achieve them. Thus, the manner in which we do our job as prosecutors—including the professionalism and civility we demonstrate, our willingness to secure the facts in a manner that encourages corporate compliance and self-regulation, and also our appreciation that corporate prosecutions can harm blameless investors, employees, and others—affects public perception of our mission. Federal prosecutors must maintain public confidence in the way in which we exercise our charging discretion. This endeavor requires the thoughtful analysis of all facts and circumstances presented in a given case.

[revised November 2015]

9-28.200 - GENERAL CONSIDERATIONS OF CORPORATE LIABILITY

A.General Principle: Corporations should not be treated leniently because of their artificial nature nor should they be subject to harsher treatment. Vigorous enforcement of the criminal laws against corporate wrongdoers, where appropriate, results in great benefits for law enforcement and the public, particularly in the area of white collar crime. Indicting corporations for wrongdoing enables the government to be a force for positive change of corporate culture, and a force to prevent, discover, and punish serious crimes.

B.Comment: In all cases involving corporate wrongdoing, prosecutors should consider the factors discussed in these guidelines.[1] In doing so, prosecutors should be aware of the public benefits that can flow from indicting a corporation in appropriate cases. For instance, corporations are likely to take immediate remedial steps when one is indicted for criminal misconduct that is pervasive throughout a particular industry, and thus an indictment can provide a unique opportunity for deterrence on a broad scale. In addition, a corporate indictment may result in specific deterrence by changing the culture of the indicted corporation and the behavior of its employees. Finally, certain crimes that carry with them a substantial risk of great public harm—*e.g.*, environmental crimes or sweeping financial frauds—may be committed by a business entity, and there may therefore be a substantial federal interest in indicting a corporation under such circumstances.

In certain instances, it may be appropriate to resolve a corporate criminal case by means other than indictment. Non-prosecution and deferred prosecution agreements, for example, occupy an important middle ground between declining prosecution and obtaining the conviction of a corporation. These agreements are discussed further in JM 9-28.1100 (Collateral Consequences). Likewise, civil and regulatory alternatives may be appropriate in certain cases, as discussed in JM 9-28.1200 (Civil or Regulatory Alternatives).

Prosecutors have substantial latitude in determining when, whom, how, and even whether to prosecute for violations of federal criminal law. In exercising that discretion, prosecutors should consider the following statements of principles that summarize the considerations they should weigh and the practices they should follow in discharging their prosecutorial responsibilities. Prosecutors should ensure that the general purposes of the criminal law—appropriate punishment for the defendant, deterrence of further criminal conduct by the defendant, deterrence of criminal conduct by others, protection of the public from dangerous and fraudulent conduct, rehabilitation, and restitution for victims—are adequately met, taking into account the special nature of the corporate "person."

[1] While these guidelines refer to corporations, they apply to the consideration of the prosecution of all types of business organizations, including partnerships, sole proprietorships, government entities, and unincorporated associations.

[revised November 2015]

9-28.210 - FOCUS ON INDIVIDUAL WRONGDOERS

A.General Principle: Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation. Because a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing. Provable individual criminal culpability should be pursued, particularly if it relates to high-level corporate officers, even in the face of an offer of a corporate guilty plea or some other disposition of the charges against the corporation, including a deferred prosecution or non-prosecution agreement, or a civil resolution. In other words, regardless of the ultimate corporate disposition, a separate evaluation must be made with respect to potentially liable individuals.

Absent extraordinary circumstances or approved departmental policy such as the Antitrust Division's Corporate Leniency Policy, no corporate resolution should provide protection from criminal liability for any individuals. The United States generally should not release individuals from criminal liability based on corporate settlement releases. Any such release of individuals from criminal liability due to extraordinary circumstances must be personally approved in writing by the relevant Assistant Attorney General or United States Attorney.

B.Comment: It is important early in the corporate investigation to identify the responsible individuals and determine the nature and extent of their misconduct. Prosecutors should not allow delays in the corporate investigation to undermine the Department's ability to pursue potentially culpable individuals. Every effort should be made to resolve a corporate matter within the statutorily allotted time, and tolling agreements should be the rare exception. In situations where it is anticipated that a tolling agreement is unavoidable, all efforts should be made either to prosecute culpable

individuals before the limitations period expires or to preserve the ability to charge individuals by tolling the limitations period by agreement or court order.

If an investigation of individual misconduct has not concluded by the time authorization is sought to resolve the case against the corporation, the prosecution authorization memorandum should include a discussion of the potentially liable individuals, a description of the current status of the investigation regarding their conduct and the investigative work that remains to be done, and, when warranted, an investigative plan to bring the matter to resolution prior to the end of any statute of limitations period. If a decision is made at the conclusion of the investigation to pursue charges or some other resolution with the corporation but not to bring criminal charges or civil claims against culpable individuals, the reasons for that determination must be memorialized and approved by the United States Attorney or Assistant Attorney General whose office handled the investigation, or their designees.

Under the doctrine of *respondeat superior*, a corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent's actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In all cases involving wrongdoing by corporate agents, prosecutors should not limit their focus solely to individuals or the corporation, but should consider both as potential targets.

Agents may act for mixed reasons—both for self-aggrandizement (direct and indirect) and for the benefit of the corporation, and a corporation may be held liable as long as one motivation of its agent is to benefit the corporation. *See United States v. Potter*, 463 F.3d 9, 25 (1st Cir. 2006) (stating that the test to determine whether an agent is acting within the scope of employment is "whether the agent is performing acts of the kind which he is authorized to perform, and those acts are motivated, at least in part, by an intent to benefit the corporation."). In *United States v. Automated Medical Laboratories, Inc.*, 770 F.2d 399 (4th Cir. 1985), for example, the Fourth Circuit affirmed a corporation's conviction for the actions of a subsidiary's employee despite the corporation's claim that the employee was acting for his own benefit, namely his "ambitious nature and his desire to ascend the corporate ladder." *Id.* at 407. The court stated, "Partucci was clearly acting in part to benefit AML since his advancement within the corporation depended on AML's well- being and its lack of difficulties with the FDA." *Id.*; *see also United States v. Cincotta*, 689 F.2d 238, 241-42 (1st Cir. 1982) (upholding a corporation's conviction, notwithstanding the substantial personal benefit reaped by its miscreant agents, because the fraudulent scheme required money to pass through the corporation's treasury and the fraudulently obtained goods were resold to the corporation's customers in the corporation's name).

Moreover, the corporation need not even necessarily profit from its agent's actions for it to be held liable. In *Automated Medical Laboratories*, the Fourth Circuit stated:

[B]enefit is not a "touchstone of criminal corporate liability; benefit at best is an evidential, not an operative, fact." Thus, whether the agent's actions ultimately redounded to the benefit of the corporation is less significant than whether the agent acted with the intent to benefit the corporation. The basic purpose of requiring that an agent have acted with the intent to benefit the corporation, however, is to insulate the corporation from criminal liability for actions of its agents which may be *inimical* to the interests of the corporation or which may have been undertaken solely to advance the interests of that agent or of a party other than the corporation.

770 F.2d at 407 (internal citation omitted) (quoting *Old Monastery Co. v. United States*, 147 F.2d 905, 908 (4th Cir. 1945)).

[updated November 2018]

9-28.300 - FACTORS TO BE CONSIDERED

A.General Principle: Generally, prosecutors apply the same factors in determining whether to charge a corporation as they do with respect to individuals. *See* JM 9-27.220 et seq. Thus, the prosecutor must weigh all of the factors normally considered in the sound exercise of prosecutorial judgment: the sufficiency of the evidence; the likelihood of success at trial; the probable deterrent, rehabilitative, and other consequences of conviction; and the adequacy of noncriminal approaches. *See id.* However, due to the nature of the corporate "person," some additional factors are present. In conducting an investigation, determining whether to bring charges, and negotiating plea or other agreements, prosecutors should consider the following factors in reaching a decision as to the proper treatment of a corporate target:

1. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime (*see* JM 9-28.400);
2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management (*see* JM 9-28.500);
3. the corporation's history of similar misconduct, including prior criminal, civil, and regulatory enforcement actions against it (*see* JM 9-28.600);
4. the corporation's willingness to cooperate, including as to potential wrongdoing by its agents (*see* JM 9-28.700);
5. the adequacy and effectiveness of the corporation's compliance program at the time of the offense, as well as at the time of a charging decision (*see* JM 9-28.800);
6. the corporation's timely and voluntary disclosure of wrongdoing (*see* JM 9-28.900);
7. the corporation's remedial actions, including, but not limited to, any efforts to implement an adequate and effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, or to pay restitution (*see* JM 9-28.1000);
8. collateral consequences, including whether there is disproportionate harm to shareholders, pension holders, employees, and others not proven personally culpable, as well as impact on the public arising from the prosecution (*see* JM 9-28.1100);
9. the adequacy of remedies such as civil or regulatory enforcement actions, including remedies resulting from the corporation's cooperation with relevant government agencies (*see* JM 9-28.1200); and
10. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance (*see* JM 9-28.1300).

B.Comment: The factors listed in this section are intended to be illustrative of those that should be evaluated and are not an exhaustive list of potentially relevant considerations. Some of these factors may not apply to specific cases, and in some cases one factor may override all others. For example, the nature and seriousness of the offense may be such as to warrant prosecution regardless of the other factors. In most cases, however, no single factor will be dispositive. In addition, national law enforcement policies in various enforcement areas may require that more or less weight be

given to certain of these factors than to others. Of course, prosecutors must exercise their thoughtful and pragmatic judgment in applying and balancing these factors, so as to achieve a fair and just outcome and promote respect for the law.

[updated November 2018]

9-28.400 - SPECIAL POLICY CONCERNS

A. **General Principle:** The nature and seriousness of the crime, including the risk of harm to the public from the criminal misconduct, are obviously primary factors in determining whether to charge a corporation. In addition, corporate conduct, particularly that of national and multi-national corporations, necessarily intersects with federal economic, tax, and criminal law enforcement policies. In applying these Principles, prosecutors must consider the practices and policies of the appropriate Division of the Department, and must comply with those policies to the extent required by the facts presented.

B. **Comment:** In determining whether to charge a corporation, prosecutors should take into account federal law enforcement priorities as discussed above. *See* JM 9-27.230. In addition, however, prosecutors must be aware of the specific policy goals and incentive programs established by the respective Divisions and regulatory agencies. Thus, whereas natural persons may be given incremental degrees of credit (ranging from immunity to lesser charges to sentencing considerations) for turning themselves in, making statements against their penal interest, and cooperating in the government's investigation of their own and others' wrongdoing, the same approach may not be appropriate in all circumstances with respect to corporations. As an example, it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, *e.g.*, voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment. However, this would not necessarily be appropriate in an antitrust investigation, in which antitrust violations, by definition, go to the heart of the corporation's business. With this in mind, the Antitrust Division has established a firm policy, understood in the business community, that credit should not be given at the charging stage for a compliance program and that amnesty is available only to the first corporation to make full disclosure to the government. As another example, the Tax Division has a strong preference for prosecuting responsible individuals, rather than entities, for corporate tax offenses. Thus, in determining whether or not to charge a corporation, prosecutors must consult with the Criminal, Antitrust, Tax, Environmental and Natural Resources, and National Security Divisions, as appropriate.

[new August 2008]

9-28.500 - PERVASIVENESS OF WRONGDOING WITHIN THE CORPORATION

A. **General Principle:** A corporation can only act through natural persons, and it is therefore held responsible for the acts of such persons fairly attributable to it. Charging a corporation for even minor misconduct may be appropriate where the wrongdoing was pervasive and was undertaken by a large number of employees, or by all the employees in a particular role within the corporation, or was condoned by upper management. On the other hand, it may not be appropriate to impose liability upon a corporation, particularly one with a robust compliance program in place, under a strict *respondeat superior* theory for the single isolated act of a rogue employee. There is, of course, a wide spectrum between these two extremes, and a prosecutor should exercise sound discretion in evaluating the pervasiveness of wrongdoing within a corporation.

B. **Comment:** Of these factors, the most important is the role and conduct of management. Although acts of even low-level employees may result in criminal liability, a corporation is directed by its management and management is responsible for a corporate culture in which criminal conduct is either discouraged or tacitly encouraged. As stated in commentary to the Sentencing Guidelines:

> Pervasiveness [is] case specific and [will] depend on the number, and degree of responsibility, of individuals [with] substantial authority ... who participated in, condoned, or were willfully ignorant of the offense. Fewer individuals need to be involved for a finding of pervasiveness if those individuals exercised a relatively high degree of authority. Pervasiveness can occur either within an organization as a whole or within a unit of an organization.

USSG § 8C2.5, cmt. (n. 4).

[new August 2008]

9-28.600 - THE CORPORATION'S PAST HISTORY

A. **General Principle:** Prosecutors may consider a corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it, in determining whether to bring criminal charges and how best to resolve cases.

B. **Comment:** A corporation, like a natural person, is expected to learn from its mistakes. A history of similar misconduct may be probative of a corporate culture that encouraged, or at least condoned, such misdeeds, regardless of any compliance programs. Criminal prosecution of a corporation may be particularly appropriate where the corporation previously had been subject to non-criminal guidance, warnings, or sanctions, or previous criminal charges, and it either had not taken adequate action to prevent future unlawful conduct or had continued to engage in the misconduct in spite of the warnings or enforcement actions taken against it. The corporate structure itself (*e.g.*, the creation or existence of subsidiaries or operating divisions) is not dispositive in this analysis, and enforcement actions taken against the corporation or any of its divisions, subsidiaries, and affiliates may be considered, if germane. *See* USSG § 8C2.5(c), cmt. (n. 6).

[new August 2008]

9-28.700 - The Value of Cooperation

Cooperation is a mitigating factor, by which a corporation—just like any other subject of a criminal investigation—can gain credit in a case that otherwise is appropriate for indictment and prosecution. Of course, the decision not to cooperate by a corporation (or individual) is not itself evidence of misconduct, at least where the lack of cooperation does not involve criminal misconduct or demonstrate consciousness of guilt (*e.g.*, suborning perjury or false statements, or refusing to comply with lawful discovery requests). Thus, failure to cooperate, in and of itself, does not support or require the filing of charges with respect to a corporation any more than with respect to an individual.

A. General Principle: In order for a company to receive any consideration for cooperation under this section, the company must identify all individuals substantially involved in or responsible for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all relevant facts relating to that misconduct. If a company seeking cooperation credit declines to learn of such facts or to provide the Department with complete factual information about the individuals substantially involved in or responsible for the misconduct, its cooperation will not be considered a mitigating factor under this section. Nor, if a company is prosecuted, will the Department support a cooperation-related reduction at sentencing. *See* U.S.S.G. § 8C2.5(g), cmt. (n. 13) ("A prime test of whether the organization has disclosed all pertinent information" necessary to receive a cooperation-related reduction in its offense level calculation "is whether the information is sufficient … to identify … the individual(s) responsible for the criminal conduct.").[1]

If the company is unable to identify all relevant individuals or provide complete factual information despite its good faith efforts to cooperate fully, the organization may still be eligible for cooperation credit. *See* U.S.S.G. § 8C2.5(g), cmt. (n. 13) ("[T]he cooperation to be measured is the cooperation of the organization itself, not the cooperation of individuals within the organization. If, because of the lack of cooperation of particular individual(s), neither the organization nor law enforcement personnel are able to identify the culpable individual(s) within the organization despite the organization's efforts to cooperate fully, the organization may still be given credit for full cooperation."). For example, there may be circumstances where, despite its best efforts to conduct a thorough investigation, a company genuinely cannot get access to certain evidence or is legally prohibited from disclosing it to the government. Under such circumstances, the company seeking cooperation will bear the burden of explaining the restrictions it is facing to the prosecutor.

To be clear, a company is not required to waive its attorney-client privilege or attorney work product protection to be eligible to receive cooperation credit. *See* JM 9-28.720. The extent of the cooperation credit earned will depend on all the various factors that have traditionally applied in making this assessment (*e.g.,* the timeliness of the cooperation, the diligence, thoroughness and speed of the internal investigation, and the proactive nature of the cooperation).

B. Comment: In investigating wrongdoing by or within a corporation, a prosecutor may encounter several obstacles resulting from the nature of the corporation itself. It may be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred, or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in identifying potentially relevant actors and locating relevant evidence, among other things, and in doing so expeditiously.

This dynamic—*i.e.*, the difficulty of determining what happened, where the evidence is, and which individuals took or promoted putatively illegal corporate actions—can have negative consequences for both the government and the corporation that is the subject or target of a government investigation. More specifically, because of corporate attribution principles concerning actions of corporate officers and employees, *see* JM 9.28-210, uncertainty about who authorized or directed apparent corporate misconduct can inure to the detriment of a corporation. For example, it may not matter under the law which of several possible executives or leaders in a chain of command approved of or authorized criminal conduct; however, that information if known might bear on the propriety of a particular disposition short of indictment of the corporation. It may not be in the interest of a corporation or the government for a charging decision to be made in the absence of such information, which might occur if, for example, a statute of limitations were relevant and authorization by any one of the officials were enough to justify a charge under the law.

For these reasons and more, cooperation can be a favorable course for both the government and the corporation. Cooperation benefits the government by allowing prosecutors and federal agents, for example, to avoid protracted delays, which compromise their ability to quickly uncover and address the full extent of widespread corporate crimes. With cooperation by the corporation, the government may be able to reduce tangible losses, limit damage to reputation, and preserve assets for restitution. At the same time, cooperation may benefit the corporation—and ultimately shareholders, employees, and other often blameless victims—by enabling the government to focus its investigative resources in a manner that may expedite the investigation and that may be less likely to disrupt the corporation's legitimate business operations. In addition, cooperation may benefit the corporation by presenting it with the opportunity to earn credit for its efforts.

The requirement that companies cooperate completely as to individuals does not mean that Department attorneys should wait for the company to deliver the information about individual wrongdoers and then merely accept what companies provide. To the contrary, Department attorneys should be proactively investigating individuals at every step of the process—before, during, and after any corporate cooperation. Department attorneys should vigorously review any information provided by companies and compare it to the results of their own investigation, in order to best ensure that the information provided is indeed complete and does not seek to minimize, exaggerate, or otherwise misrepresent the behavior or role of any individual or group of individuals.

Department attorneys should strive to obtain from the company as much information as possible about responsible individuals before resolving the corporate case. In addition, the company's continued cooperation with respect to individuals may be necessary post-resolution. If so, the corporate resolution agreement should include a provision that requires the company to provide information about all individuals substantially involved in or responsible for the misconduct, and that is explicit enough so that a failure to provide the information results in specific consequences, such as stipulated penalties and/or a material breach.

[cited in JM 9-47.120]

[updated November 2018]

1Of course, in addition to cooperation in an investigation, the Department encourages early voluntary disclosure of criminal wrongdoing, *see* JM 9-28.900, even before all facts are known to the company, and does not expect that such early disclosures would be complete. However, the Department does expect that, in such circumstances, the company will move in a timely fashion to conduct an appropriate investigation and provide timely factual updates to the Department.

9-28.710 - ATTORNEY-CLIENT AND WORK PRODUCT PROTECTIONS

The attorney-client privilege and the attorney work product protection serve an extremely important function in the American legal system. The attorney-client privilege is one of the oldest and most sacrosanct privileges under the law. *See Upjohn v. United States*, 449 U.S. 383, 389 (1981). As the Supreme Court has stated, "[i]ts purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." *Id.* The value of promoting a corporation's ability to seek frank and comprehensive legal advice is particularly important in the contemporary global business environment, where corporations often face complex and dynamic legal and regulatory obligations imposed by the federal government and also by states and foreign governments. The work product doctrine serves similarly important goals.

For these reasons, waiving the attorney-client and work product protections has never been a prerequisite under the Department's prosecution guidelines for a corporation to be viewed as cooperative. Nonetheless, a wide range of commentators and members of the American legal community and criminal justice system have asserted that the Department's policies have been used, either wittingly or unwittingly, to coerce business entities into waiving attorney-client privilege and work-product protection. Everyone agrees that a corporation may freely waive its own privileges if it chooses to do so; indeed, such waivers occur routinely when corporations are victimized by their employees or others, conduct an internal investigation, and then disclose the details of the investigation to law enforcement officials in an effort to seek prosecution of the offenders. However, the contention, from a broad array of voices, is that the Department's position on attorney-client privilege and work product protection waivers has promoted an environment in which those protections are being unfairly eroded to the detriment of all.

The Department understands that the attorney-client privilege and attorney work product protection are essential and long-recognized components of the American legal system. What the government seeks and needs to advance its legitimate (indeed, essential) law enforcement mission is not waiver of those protections, but rather the facts known to the corporation about the putative criminal misconduct under review. In addition, while a corporation remains free to convey non-factual or "core" attorney-client communications or work product—if and only if the corporation voluntarily chooses to do so—prosecutors should not ask for such waivers and are directed not to do so. The critical factor is whether the corporation has provided the facts about the events, as explained further herein.

[new August 2008]

9-28.720 - COOPERATION: DISCLOSING THE RELEVANT FACTS

Eligibility for cooperation credit is not predicated upon the waiver of attorney-client privilege or work product protection. Instead, the sort of cooperation that is most valuable to resolving allegations of misconduct by a corporation and its officers, directors, employees, or agents is disclosure of the relevant *facts* concerning such misconduct. In this regard, the analysis parallels that for a non-corporate defendant, where cooperation typically requires disclosure of relevant factual knowledge and not of discussions between an individual and his attorneys.

Thus, when the government investigates potential corporate wrongdoing, it seeks the relevant facts. For example, how and when did the alleged misconduct occur? Who promoted or approved it? Who was responsible for committing it? In this respect, the investigation of a corporation differs little from the investigation of an individual. In both cases, the government needs to know the facts to achieve a just and fair outcome. The party under investigation may choose to cooperate by disclosing the facts, and the government may give credit for the party's disclosures. If a corporation wishes to receive credit for such cooperation, which then can be considered with all other cooperative efforts and circumstances in evaluating how fairly to proceed, then the corporation, like any person, must disclose the relevant facts of which it has knowledge.[1]

(a) Disclosing the Relevant Facts—Facts Gathered Through Internal Investigation

Individuals and corporations often obtain knowledge of facts in different ways. An individual knows the facts of his or others' misconduct through his own experience and perceptions. A corporation is an artificial construct that cannot, by definition, have personal knowledge of the facts. Some of those facts may be reflected in documentary or electronic media like emails, transaction or accounting documents, and other records. Often, the corporation gathers facts through an internal investigation. Exactly how and by whom the facts are gathered is for the corporation to decide. Many corporations choose to collect information about potential misconduct through lawyers, a process that may confer attorney-client privilege or attorney work product protection on at least some of the information collected. Other corporations may choose a method of fact-gathering that does not have that effect—for example, having employee or other witness statements collected after interviews by non-attorney personnel. Whichever process the corporation selects, the government's key measure of cooperation must remain the same as it does for an individual: has the party timely disclosed the relevant facts about the putative misconduct? That is the operative question in assigning cooperation credit for the disclosure of information—*not* whether the corporation discloses attorney-client or work product materials. Accordingly, a corporation should receive the same credit for disclosing facts contained in materials that are not protected by the attorney-client privilege or attorney work product as it would for disclosing identical facts contained in materials that are so protected.[2] On this point the Report of the House Judiciary Committee, submitted in connection with the attorney-client privilege bill passed by the House of Representatives (H.R. 3013), comports with the approach required here:

> [A]n ... attorney of the United States may base cooperation credit on the facts that are disclosed, but is prohibited from basing cooperation credit upon whether or not the materials are protected by attorney-client privilege or attorney work product. As a result, an entity that voluntarily discloses should receive the same amount of cooperation credit for disclosing facts that happen to be contained in materials not protected by attorney-client privilege or attorney work product as it would receive for disclosing identical facts that are contained in

> materials protected by attorney-client privilege or attorney work product. There should be no differentials in an assessment of cooperation (*i.e.*, neither a credit nor a penalty) based upon whether or not the materials disclosed are protected by attorney-client privilege or attorney work product.

H.R. Rep. No. 110-445 at 4 (2007).

In short, the company may be eligible for cooperation credit regardless of whether it chooses to waive privilege or work product protection in the process, if it provides all relevant facts about the individuals who were involved in the misconduct. But if the corporation does not disclose such facts, it will not be entitled to receive any credit for cooperation.

Two final and related points bear noting about the disclosure of facts, although they should be obvious. First, the government cannot compel, and the corporation has no obligation to make, such disclosures (although the government can obviously compel the disclosure of certain records and witness testimony through subpoenas). Second, a corporation's failure to provide relevant information about individual misconduct alone does not mean the corporation will be indicted. It simply means that the corporation will not be entitled to mitigating credit for that cooperation. Whether the corporation faces charges will turn, as it does in any case, on the sufficiency of the evidence, the likelihood of success at trial, and all of the other factors identified in JM 9-28.300. If there is insufficient evidence to warrant indictment, after appropriate investigation has been completed, or if the other factors weigh against indictment, then the corporation should not be indicted, irrespective of whether it has earned cooperation credit. The converse is also true: The government may charge even the most cooperative corporation pursuant to these Principles if, in weighing and balancing the factors described herein, the prosecutor determines that a charge is required in the interests of justice. Put differently, even the most sincere and thorough effort to cooperate cannot necessarily absolve a corporation that has, for example, engaged in an egregious, orchestrated, and widespread fraud. Cooperation is a potential mitigating factor, but it alone is not dispositive.

(b) Legal Advice and Attorney Work Product

Separate from (and usually preceding) the fact-gathering process in an internal investigation, a corporation, through its officers, employees, directors, or others, may have consulted with corporate counsel regarding or in a manner that concerns the legal implications of the putative misconduct at issue. Communications of this sort, which are both independent of the fact-gathering component of an internal investigation and made for the purpose of seeking or dispensing legal advice, lie at the core of the attorney-client privilege. Such communications can naturally have a salutary effect on corporate behavior—facilitating, for example, a corporation's effort to comply with complex and evolving legal and regulatory regimes.[3] Except as noted in subparagraphs (b)(i) and (b)(ii) below, a corporation need not disclose and prosecutors may not request the disclosure of such communications as a condition for the corporation's eligibility to receive cooperation credit.

Likewise, non-factual or core attorney work product—for example, an attorney's mental impressions or legal theories—lies at the core of the attorney work product doctrine. A corporation need not disclose, and prosecutors may not request, the disclosure of such attorney work product as a condition for the corporation's eligibility to receive cooperation credit.

(i) Advice of Counsel Defense in the Instant Context

Occasionally a corporation or one of its employees may assert an advice-of-counsel defense, based upon communications with in-house or outside counsel that took place prior to or contemporaneously with the underlying conduct at issue. In such situations, the defendant must tender a legitimate factual basis to support the assertion of the advice-of-counsel defense. *See*, *e.g.*, *Pitt v. Dist. of Columbia*, 491 F.3d 494, 504-05 (D.C. Cir. 2007); *United States v. Wenger*, 427 F.3d 840, 853-54 (10th Cir. 2005); *United States v. Cheek*, 3 F.3d 1057, 1061-62 (7th Cir. 1993). The Department cannot fairly be asked to discharge its responsibility to the public to investigate alleged corporate crime, or to temper what would otherwise be the appropriate course of prosecutive action, by simply accepting on faith an otherwise unproven assertion that an attorney—perhaps even an unnamed attorney—approved potentially unlawful practices. Accordingly, where an advice-of-counsel defense has been asserted, prosecutors may ask for the disclosure of the communications allegedly supporting it.

(ii) Communications in Furtherance of a Crime or Fraud

Communications between a corporation (through its officers, employees, directors, or agents) and corporate counsel that are made in furtherance of a crime or fraud are, under settled precedent, outside the scope and protection of the attorney-client privilege. *See United States v. Zolin*, 491 U.S. 554, 563 (1989); *United States v. BDO Seidman, LLP*, 492 F.3d 806, 818 (7th Cir. 2007). As a result, the Department may properly request such communications if they in fact exist.

[cited in JM 9-47.120]

[updated November 2017]

1This section of the Principles focuses solely on the disclosure of facts and the privilege issues that may be implicated thereby. There are other dimensions of cooperation beyond the mere disclosure of facts, such as providing non-privileged documents and other evidence, making witnesses available for interviews, and assisting in the interpretation of complex business records.

2By way of example, corporate personnel are usually interviewed during an internal investigation. If the interviews are conducted by counsel for the corporation, certain notes and memoranda generated from the interviews may be subject, at least in part, to the protections of attorney-client privilege and/or attorney work product. To receive cooperation credit for providing factual information, the corporation need not produce, and prosecutors may not request, protected notes or memoranda generated by the interviews conducted by counsel for the corporation. To earn such credit, however, the corporation does need to produce, and prosecutors may request, relevant factual information—including relevant factual information acquired through those interviews, unless the identical information has otherwise been provided—as well as relevant non-privileged evidence such as accounting and business records and emails between non-attorney employees or agents.

[3] These privileged communications are not necessarily limited to those that occur contemporaneously with the underlying misconduct. They would include, for instance, legal advice provided by corporate counsel in an internal investigation report. Again, the key measure of cooperation is the disclosure of factual information known to the corporation, not the disclosure of legal advice or theories rendered in connection with the conduct at issue (subject to the two exceptions noted in JM 9-28.720(b)(i-ii)).

9-28.730 - OBSTRUCTING THE INVESTIGATION

Another factor to be weighed by the prosecutor is whether the corporation has engaged in conduct intended to impede the investigation. Examples of such conduct could include: inappropriate directions to employees or their counsel, such as directions not to be truthful or to conceal relevant facts; making representations or submissions that contain misleading assertions or material omissions; and incomplete or delayed production of records.

In evaluating cooperation, however, prosecutors should not take into account whether a corporation is advancing or reimbursing attorneys' fees or providing counsel to employees, officers, or directors under investigation or indictment. Likewise, prosecutors may not request that a corporation refrain from taking such action. This prohibition is not meant to prevent a prosecutor from asking questions about an attorney's representation of a corporation or its employees, officers, or directors, where otherwise appropriate under the law.[1] Neither is it intended to limit the otherwise applicable reach of criminal obstruction of justice statutes such as 18 U.S.C. § 1503. If the payment of attorney fees were used in a manner that would otherwise constitute criminal obstruction of justice—for example, if fees were advanced on the condition that an employee adhere to a version of the facts that the corporation and the employee knew to be false—these Principles would not (and could not) render inapplicable such criminal prohibitions.

Similarly, the mere participation by a corporation in a joint defense agreement does not render the corporation ineligible to receive cooperation credit, and prosecutors may not request that a corporation refrain from entering into such agreements. Of course, the corporation may wish to avoid putting itself in the position of being disabled, by virtue of a particular joint defense or similar agreement, from providing some relevant facts to the government and thereby limiting its ability to seek such cooperation credit. Such might be the case if the corporation gathers facts from employees who have entered into a joint defense agreement with the corporation, and who may later seek to prevent the corporation from disclosing the facts it has acquired. Corporations may wish to address this situation by crafting or participating in joint defense agreements, to the extent they choose to enter them, that provide such flexibility as they deem appropriate.

Finally, it may on occasion be appropriate for the government to consider whether the corporation has shared with others sensitive information about the investigation that the government provided to the corporation. In appropriate situations, as it does with individuals, the government may properly request that, if a corporation wishes to receive credit for cooperation, the information provided by the government to the corporation not be transmitted to others—for example, where the disclosure of such information could lead to flight by individual subjects, destruction of evidence, or dissipation or concealment of assets.

[new September 2008]

[1] Questions regarding the representation status of a corporation and its employees, including how and by whom attorneys' fees are paid, sometimes arise in the course of an investigation under certain circumstances—for example, to assess conflict-of-interest issues. This guidance is not intended to prohibit such limited inquiries.

9-28.740 - OFFERING COOPERATION: NO ENTITLEMENT TO IMMUNITY

A corporation's offer of cooperation or cooperation itself does not automatically entitle it to immunity from prosecution or a favorable resolution of its case. A corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents. Thus, a corporation's willingness to cooperate is not determinative; that factor, while relevant, needs to be considered in conjunction with all other factors.

[new August 2008]

9-28.750 - **OVERSIGHT CONCERNING DEMANDS FOR WAIVERS OF ATTORNEY-CLIENT PRIVILEGE OR WORK PRODUCT PROTECTION BY CORPORATIONS CONTRARY TO THIS POLICY**

The Department underscores its commitment to attorney practices that are consistent with Department policies like those set forth herein concerning cooperation credit and due respect for the attorney-client privilege and work product protection. Counsel for corporations who believe that prosecutors are violating such guidance are encouraged to raise their concerns with supervisors, including the appropriate United States Attorney or Assistant Attorney General. Like any other allegation of attorney misconduct, such allegations are subject to potential investigation through established mechanisms.

[renumbered November 2015]

9-28.800 - CORPORATE COMPLIANCE PROGRAMS

A. General Principle: Compliance programs are established by corporate management to prevent and detect misconduct and to ensure that corporate activities are conducted in accordance with applicable criminal and civil laws, regulations, and rules. The Department encourages such corporate self-policing, including voluntary disclosures to the government of any problems that a corporation discovers on its own. *See* JM 9-28.900. However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal misconduct undertaken by its officers, directors, employees, or agents. In addition, the nature of some crimes, *e.g.*, antitrust violations, may be such that national law enforcement policies mandate prosecutions of corporations notwithstanding the existence of a compliance program.

B. Comment: The existence of a corporate compliance program, even one that specifically prohibited the very conduct in question, does not absolve the corporation from criminal liability under the doctrine of *respondeat superior. See United States v. Basic Constr. Co*., 711 F.2d 570, 573 (4th Cir. 1983) ("[A] corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if ... such acts were against corporate policy or express instructions."). As explained in *United States v. Potter*, 463 F.3d 9 (1st Cir. 2006), a corporation cannot "avoid liability by adopting abstract rules" that forbid its agents from engaging in illegal acts, because "[e]ven a specific directive to an agent or employee or honest efforts to police such rules do not automatically free the company for the wrongful acts of agents." *Id.* at 25-26. *See also United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1007 (9th Cir. 1972) (noting that a corporation "could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks"); *United States v. Beusch*, 596 F.2d 871, 878 (9th Cir. 1979) ("[A] corporation may be liable for acts of its employees done contrary to express instructions and policies, but ...the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation.").

While the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. The Department has no formulaic requirements regarding corporate compliance programs. The fundamental questions any prosecutor should ask are: Is the corporation's compliance program well designed? Is the program being applied earnestly and in good faith? Does the corporation's compliance program work? In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal misconduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including, for example, disciplinary action against past violators uncovered by the prior compliance program, and revisions to corporate compliance programs in light of lessons learned [1] Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government. In evaluating compliance programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are internal audit functions conducted at a level sufficient to ensure their independence and accuracy; and have the directors established an information and reporting system in the organization reasonably designed to provide management and directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law. *See*, *e.g.*, *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 968-70 (Del. Ch. 1996).

Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed, implemented, reviewed, and revised, as appropriate, in an effective manner. In addition, prosecutors should determine whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts. Prosecutors also should determine whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it. This will enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents or to mitigate charges or sanctions against the corporation.

Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business. Many corporations operate in complex regulatory environments outside the normal experience of criminal prosecutors. Accordingly, prosecutors should consult with relevant federal and state agencies with the expertise to evaluate the adequacy of a program's design and implementation. For instance, state and federal banking, insurance, and medical boards, the Department of Defense, the Department of Health and Human Services, the Environmental Protection Agency, and the Securities and Exchange Commission have considerable experience with compliance programs and can be helpful to a prosecutor in evaluating such programs. In addition, the Fraud Section of the Criminal Division, the Commercial Litigation Branch of the Civil Division, and the Environmental Crimes Section of the Environment and Natural Resources Division can assist United States Attorneys' Offices in finding the appropriate agency office(s) for such consultation.

[revised November 2015]

[1] For a detailed review of these and other factors concerning corporate compliance programs, see USSG § 8B2.1

9-28.900 - VOLUNTARY DISCLOSURES

In conjunction with regulatory agencies and other executive branch departments, the Department encourages corporations, as part of their compliance programs, to conduct internal investigations and to disclose the relevant facts to the appropriate authorities. Some agencies, such as the Securities and Exchange Commission and the Environmental Protection Agency, as well as the Department's Environmental and Natural Resources Division, have formal voluntary disclosure programs in which self-reporting, coupled with remediation and additional criteria, may qualify the corporation for amnesty or reduced sanctions. The Antitrust Division has a policy of offering amnesty to the first corporation that self-discloses and agrees to cooperate.

Even in the absence of a formal program, prosecutors may consider a corporation's timely and voluntary disclosure, both as an independent factor and in evaluating the company's overall cooperation and the adequacy of the corporation's compliance program and its management's commitment to the compliance program. *See* JM 9-28.700 and 9-28.800. However, prosecution may be appropriate notwithstanding a corporation's voluntary disclosure. Such a determination should be based on a consideration of all the factors set forth in these Principles. *See* JM 9-28.300.

[new November 2015]

9-28.1000 - RESTITUTION AND REMEDIATION

A.General Principle: Although neither a corporation nor an individual target may avoid prosecution merely by paying a sum of money, a prosecutor may consider the corporation's willingness to make restitution and steps already taken to do so. A prosecutor may also consider other remedial actions, such as improving an existing compliance program or disciplining wrongdoers, in determining whether to charge the corporation and how to resolve corporate criminal cases.

B.Comment: In determining whether or not to prosecute a corporation, the government may consider whether the corporation has taken meaningful remedial measures. A corporation's response to misconduct says much about its willingness to ensure that such misconduct does not recur. Thus, corporations that fully recognize the seriousness of their misconduct and accept responsibility for it should be taking steps to implement the personnel, operational, and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated.

Among the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined wrongdoers, once those employees are identified by the corporation as culpable for the misconduct. Employee discipline is a difficult task for many corporations because of the human element involved and sometimes because of the seniority of the employees concerned. Although corporations need to be fair to their employees, they must also be committed, at all levels of the corporation, to the highest standards of legal and ethical behavior. Effective internal discipline can be a powerful deterrent against improper behavior by a corporation's employees. Prosecutors should be satisfied that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers

In addition to employee discipline, two other factors used in evaluating a corporation's remedial efforts are restitution and reform. As with natural persons, the decision whether or not to prosecute should not depend upon the target's ability to pay restitution. A corporation's efforts to pay restitution even in advance of any court order is, however, evidence of its acceptance of responsibility and, consistent with the practices and policies of the appropriate Division of the Department entrusted with enforcing specific criminal laws, may be considered in determining whether to bring criminal charges. Similarly, although the inadequacy of a corporate compliance program is a factor to consider when deciding whether to charge a corporation, that corporation's quick recognition of the flaws in the program and its efforts to improve the program are also factors to consider as to the appropriate disposition of a case.

[renumbered November 2015]

9-28.1100 - COLLATERAL CONSEQUENCES

A.General Principle: Prosecutors may consider the collateral consequences of a corporate criminal conviction or indictment in determining whether to charge the corporation with a criminal offense and how to resolve corporate criminal cases.

B.Comment: One of the factors in determining whether to charge a natural person or a corporation is whether the likely punishment is appropriate given the nature and seriousness of the crime. In the corporate context, prosecutors may take into account the possibly substantial consequences to a corporation's employees, investors, pensioners, and customers, many of whom may, depending on the size and nature of the corporation and their role in its operations, have played no role in the criminal conduct, have been unaware of it, or have been unable to prevent it. Prosecutors should also be aware of non-penal sanctions that may accompany a criminal charge, such as potential suspension or debarment from eligibility for government contracts or federally funded programs such as health care programs. Determining whether or not such non-penal sanctions are appropriate or required in a particular case is the responsibility of the relevant agency, and is a decision that will be made based on the applicable statutes, regulations, and policies.

Almost every conviction of a corporation, like almost every conviction of an individual, will have an impact on innocent third parties, and the mere existence of such an effect is not sufficient to preclude prosecution of the corporation. Therefore, in evaluating the relevance of collateral consequences, various factors already discussed, such as the pervasiveness of the criminal conduct and the adequacy of the corporation's compliance programs, should be considered in determining the weight to be given to this factor. For instance, the balance may tip in favor of prosecuting corporations in situations where the scope of the misconduct in a case is widespread and sustained within a corporate division (or spread throughout pockets of the corporate organization). In such cases, the possible unfairness of visiting punishment for the corporation's crimes upon shareholders may be of much less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity. Similarly, where the top layers of the corporation's management or the shareholders of a closely-held corporation were engaged in or aware of the wrongdoing, and the conduct at issue was accepted as a way of doing business for an extended period, debarment may be deemed not collateral, but a direct and entirely appropriate consequence of the corporation's wrongdoing.

On the other hand, where the collateral consequences of a corporate conviction for innocent third parties would be significant, it may be appropriate to consider a non-prosecution or deferred prosecution agreement with conditions designed, among other things, to promote compliance with applicable law and to prevent recidivism. Such agreements are a third option, besides a criminal indictment, on the one hand, and a declination, on the other. Declining prosecution may allow a corporate criminal to escape without consequences. Obtaining a conviction may produce a result that seriously harms innocent third parties who played no role in the criminal conduct. Under appropriate circumstances, a deferred prosecution or non-prosecution agreement can help restore the integrity of a company's operations and preserve the financial viability of a corporation that has engaged in criminal conduct, while preserving the government's ability to prosecute a recalcitrant corporation that materially breaches the agreement. Such agreements achieve other important objectives as well, like prompt restitution for victims.[1] The appropriateness of a criminal charge against a corporation, or some lesser alternative, must be evaluated in a pragmatic and reasoned way that produces a fair outcome, taking into consideration, among other things, the Department's need to promote and ensure respect for the law.

[renumbered and revised November 2015]

[1] Prosecutors should note that in the case of national or multi-national corporations, efforts should be made to determine the existence of other matters within the Department relating to the corporation in question. In certain instances, multi-district or global agreements may be in the interest of law enforcement and the public. Such agreements may only be entered into with the approval of each affected district or the appropriate Department official. *See* JM 9-27.641.

9-28.1200 - CIVIL OR REGULATORY ALTERNATIVES

A.General Principle: Prosecutors should consider whether non-criminal alternatives would adequately deter, punish, and rehabilitate a corporation that has engaged in wrongful conduct. In evaluating the adequacy of non-criminal alternatives to prosecution—*e.g.*, civil or regulatory enforcement actions—the prosecutor should consider all relevant factors, including:

1. the sanctions available under the alternative means of disposition;
2. the likelihood that an effective sanction will be imposed; and
3. the effect of non-criminal disposition on federal law enforcement interests.

See also JM 1-12.100 - Coordination of Corporate Resolution Penalties in Parallel and/or Joint Investigations and Proceedings Arising from the Same Misconduct.

[updated May 2018]

9-28.1300 - ADEQUACY OF THE PROSECUTION OF INDIVIDUALS

A.General Principle: In deciding whether to charge a corporation, prosecutors should consider whether charges against the individuals responsible for the corporation's malfeasance will adequately satisfy the goals of federal prosecution.

B.Comment: Assessing the adequacy of individual prosecutions for corporate misconduct should be made on a case-by-case basis and in light of the factors discussed in these Principles. Thus, in deciding the most appropriate course of action for the corporation – *i.e.,* a corporate indictment, a deferred prosecution or non-prosecution agreement, or another alternative – a prosecutor should consider the impact of the prosecution of responsible individuals, along with the other factors in JM 9-28.300 (Factors to be Considered).

[new November 2015]

9-28.1400 - SELECTING CHARGES

A.General Principle: Once a prosecutor has decided to charge a corporation, the prosecutor at least presumptively should charge, or should recommend that the grand jury charge, the most serious offense that is consistent with the nature of the defendant's misconduct and that is likely to result in a sustainable conviction.

B.Comment: Once the decision to charge is made, the same rules as govern charging natural persons apply. These rules require "a faithful and honest application of the Sentencing Guidelines" and an "individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the Federal criminal code, and maximize the impact of Federal resources on crime." *See* JM 9-27.300. In making this determination, "it is appropriate that the attorney for the government consider, *inter alia*, such factors as the [advisory] sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ...is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *Id.*

[renumbered November 2015]

9-28.1500 - PLEA AGREEMENTS WITH CORPORATIONS

A.General Principle: In negotiating plea agreements with corporations, as with individuals, prosecutors should generally *seek* a plea to an appropriate offense. In addition, the terms of the plea agreement should contain appropriate provisions to ensure punishment, deterrence, rehabilitation, and compliance with the plea agreement in the corporate context. Absent extraordinary circumstances or approved departmental policy such as the Antitrust Division's Corporate Leniency Policy, no corporate resolution should provide protection from criminal or civil liability for any individuals. *See also* JM 9-16.050, 5-11.114.

B.Comment: Prosecutors may enter into plea agreements with corporations for the same reasons and under the same constraints as apply to plea agreements with natural persons. *See* JM 9-27.400-530. This means, *inter alia*, that the corporation should generally be required to plead guilty to the most serious, readily provable offense charged. In addition, any negotiated departures or recommended variances from the advisory Sentencing Guidelines must be justifiable under the Guidelines or 18 U.S.C. § 3553 and must be disclosed to the sentencing court. A corporation should be made to realize that pleading guilty to criminal charges constitutes an admission of guilt and not merely a resolution of an inconvenient distraction from its business. As with natural persons, pleas should be structured so that the corporation may not later "proclaim lack of culpability or even complete innocence." *See* JM 9-27.420(b)(4), 9-27.440, 9-27.500. Thus, for instance, there should be placed upon the record a sufficient factual basis for the plea to prevent later corporate assertions of innocence.

A corporate plea agreement should also contain provisions that recognize the nature of the corporate "person" and that ensure that the principles of punishment, deterrence, and rehabilitation are met. In the corporate context, punishment and deterrence are generally accomplished by substantial fines, mandatory restitution, and institution of appropriate compliance measures, including, if necessary, continued judicial oversight or the use of special masters or corporate monitors. *See* USSG §§ 8B1.1, 8C2.1, *et seq*. In addition, where the corporation is a government contractor, permanent or temporary debarment may be appropriate. Where the corporation was engaged in fraud against the government (*e.g.*, contracting fraud), a prosecutor may not negotiate away an agency's right to debar or delist the corporate defendant.

In negotiating a plea agreement, prosecutors must also consider the deterrent value of prosecutions of individuals within the corporation. Therefore, one factor that a prosecutor should consider in determining whether to enter into a plea agreement is whether the corporation is seeking immunity for its employees and officers or whether the corporation is willing to cooperate in the investigation of culpable individuals as outlined herein. Absent extraordinary circumstances or approved departmental policy such as the Antitrust Division's Corporate Leniency Policy, no corporate resolution should include an agreement to dismiss charges against, or provide civil or criminal immunity for, individual offices or employees. Any such release due to extraordinary circumstances must be personally approved in writing by the relevant Assistant Attorney General or United States Attorney.

Rehabilitation, of course, requires that the corporation undertake to be law-abiding in the future. It is, therefore, appropriate to require the corporation, as a condition of probation, to implement a compliance program or to reform an existing one. As discussed above, prosecutors may consult with the appropriate state and federal agencies and components of the Justice Department to ensure that a proposed compliance program is adequate and meets industry standards and best practices. *See* JM 9-28.800.

In plea agreements in which the corporation agrees to cooperate, the prosecutor should ensure that the cooperation is entirely truthful. To do so, the prosecutor should request that the corporation make appropriate disclosures of relevant factual information and documents, make employees and agents available for debriefing, file appropriate certified financial statements, agree to governmental or third-party audits, and take whatever other steps are necessary to ensure that the full scope of the corporate wrongdoing is disclosed and that the responsible personnel are identified and, if appropriate, prosecuted. *See generally* JM 9-28.700. In taking such steps, Department prosecutors should recognize that attorney-client communications are often essential to a corporation's efforts to comply with complex regulatory and legal regimes, and that, as discussed at length above, cooperation is not measured by the waiver of attorney-client privilege and work product protection, but rather is measured, as a threshold issue, by the disclosure of facts about individual misconduct, as well as other considerations identified herein, such as making witnesses available for interviews and assisting in the interpretation of complex documents or business records.

[renumbered and revised November 2015]

These Principles provide only internal Department of Justice guidance. They are not intended to, do not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal. Nor are any limitations hereby placed on otherwise lawful litigative prerogatives of the Department of Justice.

‹ 9-27.000 - Principles Of Federal Prosecution up 9-34.000 - Preparation Of Reports On Convicted Prisoners For The Parole Commission ›

Appendix H: Department of Justice, Frequently Asked Questions about the Antitrust Division's Leniency Program and Model leniency Letters

DEPARTMENT OF JUSTICE

FREQUENTLY ASKED QUESTIONS
ABOUT THE ANTITRUST DIVISION'S LENIENCY PROGRAM
AND MODEL LENIENCY LETTERS
Originally Published November 19, 2008
Update Published January 26, 2017

The Antitrust Division's Leniency Program[1] allows corporations and individuals involved in antitrust crimes to self-report and avoid criminal convictions and resulting fines and incarceration. The first corporate or individual conspirator to confess participation in an antitrust crime, fully cooperate with the Division, and meet all other conditions that the Corporate Leniency Policy or the Leniency Policy for Individuals specifies receives leniency for the reported antitrust crime.

Several Division speeches explain the program and its requirements,[2] and describe what a prospective applicant can expect when deciding to approach the Division and apply for leniency. Model conditional leniency letters for both corporate and individual applicants are publicly available and show how the conditional leniency agreement between the Division and an applicant is memorialized.[3] The answers to these Frequently Asked Questions restate much of the information that is already available in the speeches and model letters. They are a comprehensive and updated resource that provides guidance with respect to common issues that leniency applicants encounter under the Division's Corporate Leniency Policy and Leniency Policy for Individuals. These Frequently Asked Questions address: 1) leniency application procedures; 2) the criteria for receiving leniency under the Corporate Leniency Policy; 3) the criteria for receiving leniency under the Leniency Policy for Individuals; 4) the conditional leniency letter; 5) the potential revocation of conditional leniency and the final unconditional leniency letter; and 6) confidentiality for leniency applicants.

The Leniency Program's success is in part due to the Division's consideration of the views and incorporation of the input of the private bar and business community. The Division continues to solicit suggestions on how to keep the program transparent, predictable, and fair. These Frequently Asked Questions are therefore periodically updated, with a new date on the title page identifying the current version.

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[1] The Division first implemented a leniency program in 1978. It issued its Corporate Leniency Policy in 1993, which substantially revised the program, and a Leniency Policy for Individuals in 1994. The Division's Corporate Leniency Policy and Leniency Policy for Individuals are available at https://www.justice.gov/atr/leniency-program.

[2] Speeches about the Leniency Program are available at https://www.justice.gov/atr/leniency-program.

[3] The model conditional leniency letters are available at https://www.justice.gov/atr/leniency-program.

I. Leniency Application Procedures

Application Contact Information

1. Who does counsel for a potential applicant contact to apply for leniency?

The Division's Deputy Assistant Attorney General for Criminal Enforcement ("Criminal DAAG") reviews and evaluates all requests for leniency, including the scope of any leniency marker extended.[4] An applicant's counsel should contact the Criminal DAAG or the Director of Criminal Enforcement at 202-514-3543 to request a marker. Marker requests made to one of the Division's criminal offices will be forwarded immediately to the Criminal DAAG for determination about the availability of a marker.

Securing a Marker

The Division understands that when corporate counsel first obtains indications of a possible criminal antitrust violation, authoritative personnel for the company may not have sufficient information to know for certain whether the corporation has engaged in such a violation, an admission of which is required to obtain a conditional leniency letter.[5] Counsel should understand, however, that time is of the essence in making a leniency application. The Division grants only one corporate leniency per conspiracy, and in applying for leniency, the company is in a race with its co-conspirators and possibly its own employees who may also be preparing to apply for individual leniency. On a number of occasions, the second company to inquire about a leniency application has been beaten by a prior applicant by only a matter of hours. Thus, the Division has established a marker system to hold an applicant's place in the line for leniency while the applicant gathers more information to support its leniency application.

2. What is a marker, and how is it used in the leniency application process?

The Division frequently gives a leniency applicant a "marker" for a finite period of time to hold its place at the front of the line for leniency while counsel gathers additional information through an internal investigation to perfect the client's leniency

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[4] Note that the Corporate Leniency Policy, which was issued in 1993, states that the Director of Operations reviews corporate leniency applications, and the Leniency Policy for Individuals, which was issued in 1994, states that the Deputy Assistant Attorney General for Litigation reviews individual leniency applications. Both of the leniency policies were written before the Division created the Criminal DAAG position and gave that position oversight of the Division's criminal enforcement program, including the Division's Leniency Program.

[5] *See* Question 5.

application. While the marker is in effect, no other company can "leapfrog" over the applicant that has the marker.

To obtain a marker, counsel must: (1) report that he or she has uncovered some information or evidence indicating that his or her client has engaged in a criminal antitrust violation; (2) disclose the general nature of the conduct discovered; (3) identify the industry, product, or service involved in terms that are specific enough to allow the Division to determine whether leniency is still available and to protect the marker for the applicant; and (4) identify the client.[6] As noted above, when corporate counsel first obtains indications of a possible criminal antitrust violation, authoritative personnel for the company may not have sufficient information to enable them to admit definitively to such a violation. While confirmation of a criminal antitrust violation is not required at the marker stage, in order to receive a marker, counsel must report that he or she has uncovered information or evidence suggesting a possible criminal antitrust violation, e.g., price fixing, bid rigging, capacity restriction, or allocation of markets, customers, or sales or production volumes. It is not enough for counsel to state merely that the client has received a grand jury subpoena or has been searched during a Division investigation and that counsel wants a marker to investigate whether the client has committed a criminal antitrust violation.

Because companies are urged to seek leniency at the first indication of wrongdoing, the evidentiary standard for obtaining a marker is relatively low, particularly in situations where the Division is not already investigating the wrongdoing. For example, if an attorney gave a compliance presentation and after the presentation an employee reported to the attorney a conversation the employee had overheard about his employer's potential price-fixing activities, this information would be sufficient to obtain a marker if one is available. However, when the Division is already in possession of information about the illegal activity, a more detailed report of the antitrust crime may be required to determine the availability and appropriate scope of a marker. Regardless of whether the Division already has information about the illegal activity, as noted above, counsel should request a marker as soon as possible and can discuss with the Division whether more detailed information is needed to secure his or her client's place at the front of the line for leniency.

In some cases, an identification of the industry may be sufficient for the Division to determine whether leniency is available. In many cases, however, it is necessary to identify specific products or services, other companies involved in the conspiracy, or the

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[6] It is possible in limited circumstances for counsel to secure a very short-term "anonymous" marker without identifying his or her client. An anonymous marker is given when counsel wants to secure the client's place first in line for leniency by disclosing the other information listed above, but needs more time to verify additional information before providing the client's name. For example, the Division might give counsel two or three days to gather additional information and to report the client's identity to the Division.

identity or location of affected customers for the Division to determine whether leniency is available and the proper scope of the marker.

A marker is provided for a finite period. The length of time an applicant is given to perfect its leniency application is based on factors such as the location and number of company employees counsel needs to interview, the amount and location of documents counsel needs to review, and whether the Division already has an ongoing investigation at the time the marker is requested. A 30-day period for an initial marker is common, particularly in situations where the Division is not yet investigating the wrongdoing. If necessary, the marker may be extended at the Division's discretion for an additional finite period as long as the applicant demonstrates it is making a good-faith effort to complete its application in a timely manner.

II. Corporate Leniency Criteria

3. What are the criteria for obtaining corporate leniency and is corporate leniency available both before and after an investigation has begun?

Leniency is available for corporations either before or after a Division investigation has begun. The Corporate Leniency Policy includes two types of leniency: Type A and Type B. Type A Leniency is available only before the Division has received any information about the activity being reported from any source, while Type B Leniency is available even after the Division has received information about the activity. Detailed below are the criteria for each type of leniency.

Leniency Before an Investigation Has Begun ("Type A Leniency")

Leniency will be granted to a corporation reporting illegal antitrust activity before an investigation has begun if the following six conditions are met:

1) At the time the corporation comes forward to report the illegal activity, the Division has not received information about the illegal activity being reported from any other source;

2) The corporation, upon its discovery of the illegal activity being reported, took prompt and effective action to terminate its part in the activity;

3) The corporation reports the wrongdoing with candor and completeness and provides full, continuing and complete cooperation to the Division throughout the investigation;

4) The confession of wrongdoing is truly a corporate act, as opposed to isolated confessions of individual executives or officials;

5) Where possible, the corporation makes restitution to injured parties; and

6) The corporation did not coerce another party to participate in the illegal activity and clearly was not the leader in, or originator of, the activity.

If the corporation does not meet all six of the Type A Leniency conditions, it may still qualify for leniency if it meets the conditions of Type B Leniency.

Alternative Requirements for Leniency ("Type B Leniency")

A company will be granted leniency even after the Division has received information—such as from an anonymous complainant, a private civil action, or a press report—about the illegal antitrust activity, whether this is before or after an investigation has begun, if the following conditions are met:

1) The corporation is the first one to come forward and qualify for leniency with respect to the illegal activity being reported;

2) The Division, at the time the corporation comes in, does not yet have evidence against the company that is likely to result in a sustainable conviction;

3) The corporation, upon its discovery of the illegal activity being reported, took prompt and effective action to terminate its part in the activity;

4) The corporation reports the wrongdoing with candor and completeness and provides full, continuing and complete cooperation that advances the Division in its investigation;

5) The confession of wrongdoing is truly a corporate act, as opposed to isolated confessions of individual executives or officials;

6) Where possible, the corporation makes restitution to injured parties; and

7) The Division determines that granting leniency would not be unfair to others, considering the nature of the illegal activity, the confessing corporation's role in it, and when the corporation comes forward.

The "First-in-the-Door" Requirement

4. ***Can more than one company qualify for leniency?***

No. Under both Type A Leniency and Type B Leniency, only the first qualifying corporation may be granted leniency for a particular antitrust conspiracy. Condition 1 of Type A Leniency requires that the Division has not yet received information about the illegal antitrust activity being reported from any other source, and Condition 1 of Type B

Leniency requires that the company is the first to come forward and qualify for leniency. Under the policy that only the first qualifying corporation receives conditional leniency,[7] there have been dramatic differences in the disposition of the criminal liability of corporations whose respective leniency applications to the Division were very close in time. Therefore, companies have a huge incentive to make a leniency application as quickly as possible.

Criminal Violation

5. *Does a leniency applicant have to admit to a criminal violation of the antitrust laws before receiving a conditional leniency letter?*

Yes. The Division's leniency policies were established for corporations and individuals "reporting their illegal antitrust activity," and the policies protect leniency recipients from criminal conviction. Thus, the applicant must admit its participation in a criminal antitrust violation involving price fixing, bid rigging, capacity restriction, or allocation of markets, customers, or sales or production volumes, before it will receive a conditional leniency letter. Applicants that have not engaged in criminal violations of the antitrust laws have no need to receive leniency protection from a criminal violation and will not qualify for leniency through the Leniency Program.

When the model corporate conditional leniency letter was first drafted, the Division did not employ a marker system. Thus, companies received conditional leniency letters far earlier in the process, often before the company had an opportunity to conduct an internal investigation. However, the Division's practice has changed over time. The Division now employs a marker system, and the Division provides the company with an opportunity to investigate thoroughly its own conduct. While the applicant may not be able to confirm that it committed a criminal antitrust violation when it seeks and receives a marker, by the end of the marker process, before it is provided a conditional leniency letter, it should be in a position to admit to its participation in a criminal violation of the Sherman Act. The Division may also insist on interviews with key executives of the applicant who were involved in the violation before issuing the conditional leniency letter. A company that argues that an agreement to fix prices, rig bids, restrict capacity, or allocate markets might be inferred from its conduct but that cannot produce any employees who will admit that the company entered into such an agreement generally has not made a sufficient admission of a criminal antitrust violation to be eligible for leniency. A company that, for whatever reason, is not able or willing to admit to its participation in a criminal antitrust conspiracy is not eligible for leniency.[8]

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[7] See Question 26 for a discussion of the conditional nature of the Division's leniency letters.

[8] Before the original version of these Frequently Asked Questions were issued in November 2008, the model conditional leniency letters referred to the conduct being reported as "*possible* [. . . price fixing, bid rigging, market allocation] or other conduct

Non-Antitrust Crimes

6. ***How does the Division's Leniency Program apply to non-antitrust crimes?***

In the model conditional leniency letter, the Antitrust Division commits to not prosecute a qualifying leniency applicant for the antitrust violation it reports or for acts or offenses integral to that violation. For example, conduct integral to the reported antitrust violation, such as mailing or emailing conspiratorially set bids, may itself constitute another offense such as mail or wire fraud. The Division's model conditional leniency letter provides that the Division will not prosecute a qualifying leniency applicant for these additional offenses "committed prior to the date of [the] letter in furtherance of" the reported antitrust violation.[9]

The conditional leniency letter, however, binds only the Antitrust Division; it does not bind other federal or state prosecuting agencies, including other components of the Department of Justice. The Division's Leniency Program does not protect applicants from criminal prosecution by other prosecuting agencies for offenses other than Sherman Act violations. For example, a leniency applicant that bribed foreign public officials in violation of the Foreign Corrupt Practices Act receives no protection from prosecution by any other prosecuting agency, regardless of whether the bribes were also made in furtherance of the reported antitrust violation. In addition, a leniency application does not discharge prior reporting obligations to other prosecuting agencies, nor does it insulate the leniency applicant from the consequences of violating earlier agreements not to commit crimes.

It has been the Antitrust Division's experience that other prosecuting agencies do not use other criminal statutes to do an end-run around leniency. At the same time, leniency applicants should not expect to use the Leniency Program to avoid accountability for non-antitrust crimes. Not every conspiracy among competitors amounts to an antitrust crime. And not every fraud that an applicant commits while engaged in an antitrust crime is committed in furtherance of that crime.

Leniency applicants with exposure for both antitrust and non-antitrust crimes should report all crimes to the relevant prosecuting agencies. Under the Department's

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violative of Section 1 of the Sherman Act." (emphasis added). Because applicants must report a criminal violation of the antitrust laws before receiving a conditional leniency letter, the word "possible" has been deleted from the model letter, and a reference to "or other conduct constituting a criminal violation of Section 1 of the Sherman Act" has been added to the model corporate and individual conditional leniency letters, which are available at https://www.justice.gov/atr/leniency-program.

[9] Model Corp. Conditional Leniency Letter ¶ 3; Model Individual Conditional Leniency Letter ¶ 3.

Principles of Federal Prosecution of Business Organizations, self-reporting is one factor that federal prosecuting agencies consider when making charging decisions. A list of factors that will be weighed in deciding whether to prosecute a company can be found at U.S. Attorneys' Manual 9-28.300 ("U.S.A.M.").[10] These Principles recognize special policy goals and incentive programs regarding antitrust violations, among other offenses, and note the Antitrust Division's "firm policy . . . that amnesty is available only to the first corporation to make full disclosure to the government."[11]

Scope of Markers and Leniency

7. *If during the course of its internal investigation, an applicant discovers and reports evidence that the anticompetitive activity was broader or narrower than originally reported, for example, in terms of its geographic scope or the number of products involved, can the scope of the applicant's marker or leniency protection change?*

Yes. Companies often request markers before completing their internal investigations. When the Division gives a marker to a company, this secures the company's place in line as the first and only leniency applicant. The scope of the marker is tailored to the facts that the applicant proffers at the time it requests it. Because the applicant must proffer facts indicating its participation in a criminal antitrust conspiracy, the scope of the marker is coextensive with the scope of the conspiracy that the applicant reports.

Because it uses a marker system, the Division often learns from an applicant, or its employees as part of the corporate confession, that the scope of the conspiracy is broader than the applicant originally reported. For example, an applicant's executives might provide evidence as part of the corporate confession showing that the anticompetitive activity was broader in terms of its geographic scope or the number of products involved in the conspiracy than originally reported. So long as the applicant has not tried to conceal the conduct, is providing truthful, full, continuing, and complete cooperation, and can meet the criteria for leniency on the broader activity, the marker or conditional leniency letter will be tailored to the scope of the conspiracy reported.

Occasionally, the investigation of a conspiracy that a leniency applicant reports reveals that the conspiracy is narrower than the applicant originally reported. The marker or conditional leniency letter will accordingly be tailored to the scope of the conspiracy that the evidence supports, so long as the applicant's original report was made in good faith, the applicant is providing truthful, full, continuing, and complete cooperation, and the applicant can meet the leniency criteria.

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[10] Offices of U.S. Attorneys, *U.S. Attorneys' Manual* 9-28.000, https://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations.

[11] U.S.A.M. 9-28.400, 9-28.800, and 9-28.900.

Sometimes while attempting to perfect a marker, an applicant will discover conduct that constitutes a separate conspiracy. In this case, if a marker is available for the separate conspiracy, the applicant can request another marker. If the Division gives the applicant the new marker, like all markers, it will be tailored to the facts that the applicant proffers when requesting it.

"Leniency Plus"

8. ***If a company is under investigation for one antitrust conspiracy but is too late to obtain leniency for that conspiracy, can it receive additional credit for substantial assistance in its plea agreement for that conspiracy by reporting its involvement in a separate antitrust conspiracy?***

Yes. Many of the Division's investigations result from evidence developed during an investigation of a completely separate conspiracy. This pattern has led the Division to take a proactive approach to attracting leniency applications by encouraging subjects and targets of investigations to consider whether they may qualify for leniency in other markets where they compete. For example, consider the following hypothetical fact pattern:

> *As a result of cooperation received pursuant to a leniency application in the widgets market, a grand jury is investigating the other four producers in that market, including XYZ, Inc., for their participation in an international cartel. As part of its internal investigation, XYZ, Inc., uncovers information of its executives' participation not only in a widgets cartel but also in a separate conspiracy in the sprockets market. The government has not detected the sprockets cartel because the leniency applicant was not a competitor in that market and no other investigation has disclosed the cartel activity. XYZ, Inc. is interested in cooperating with the Division's widgets investigation pursuant to a plea agreement and seeking leniency by reporting its participation in the sprockets conspiracy. Assuming XYZ, Inc. qualifies for leniency with respect to the sprockets conspiracy, what credit for substantial assistance can XYZ, Inc. receive?*

Assuming that XYZ, Inc. qualifies for leniency with respect to the sprockets conspiracy and provides truthful, full, continuing, and complete cooperation with the Division's investigation into the widgets conspiracy, XYZ, Inc. can obtain what the Division refers to as "Leniency Plus." The Division would grant leniency to XYZ, Inc. in the sprockets investigation, meaning that XYZ, Inc. would pay zero dollars in fines for its role in the sprockets conspiracy and none of its current[12] directors, officers and

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[12] See Question 24 regarding the potential inclusion of specific named former personnel in a corporate leniency agreement.

employees who admitted to the Division their knowledge of, or participation in, the sprockets conspiracy and provided truthful, full, continuing, and complete cooperation to the Division would receive prison terms or fines in connection with the sprockets conspiracy. *Plus*, in the sentencing hearing for the company's participation in the widgets cartel, the Division would recommend that the court, in calculating XYZ, Inc.'s fine, make a substantial assistance departure that takes into consideration the company's cooperation in both the widgets and sprockets investigations. The substantial assistance departure that the Division would recommend for XYZ, Inc., therefore, would be greater than if XYZ, Inc. had cooperated in the widgets investigation alone. Consequently, XYZ, Inc. would receive credit for coming forward and cooperating in the sprockets investigation both in terms of obtaining leniency in that matter *and* in terms of receiving a greater reduction in the recommended widgets fine.

9. *How is the substantial assistance for Leniency Plus measured?*

How much credit a company receives for reporting an additional conspiracy depend on a number of factors, including: (1) the strength of the evidence that the cooperating company provides with respect to the leniency investigation; (2) the potential significance of the violation reported in the leniency application, measured in such terms as the volume of commerce involved, the geographic scope, and the number of co-conspirator companies and individuals; and (3) the likelihood that the Division would have uncovered the additional violation without the self-reporting, e.g., if there were little or no overlap in the corporate participants and/or the culpable executives involved in the original cartel under investigation and the Leniency Plus matter, then the credit for the disclosure will be greater. Of these three factors, the first two are given the most weight.[13]

To receive any credit for Leniency Plus at sentencing, the company pleading guilty must also provide truthful, full, continuing, and complete cooperation with the investigation that led to the guilty plea.

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[13] For a fuller discussion of substantial assistance sentencing departures and the Division's Leniency Plus program, see Brent Snyder, Deputy Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Individual Accountability for Antitrust Crimes, Speech Before the Yale School of Management Global Antitrust Enforcement Conference (Feb. 19, 2016), https://www.justice.gov/opa/file/826721/download; Bill Baer, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Prosecuting Antitrust Crimes, Speech Before Georgetown University Law Center Global Antitrust Enforcement Symposium (Sept. 10, 2014), https://www.justice.gov/atr/file/517741/download; and Scott D. Hammond, Deputy Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Measuring the Value of Second-In Cooperation in Corporate Plea Negotiations, Speech Before the ABA Antitrust Section 2006 Spring Meeting (March 29, 2006), https://www.justice.gov/atr/file/518436/download.

10. What is Penalty Plus?

Like the Leniency Plus policy described above, the Division's Penalty Plus policy also creates substantial incentives for a company to conduct a thorough internal investigation to detect and report any additional antitrust crimes it uncovers. If a company pleads guilty to an antitrust offense but fails to report an additional antitrust crime it was also involved in, that company not only foregoes potential credit from the Division's Leniency Plus policy, but the Division will generally seek a more severe punishment under its Penalty Plus policy for the additional crime. Under the Penalty Plus policy, if the Division independently uncovers evidence that a company, which previously pleaded guilty to an antitrust crime, was also involved in one or more additional antitrust crimes that it did not report to the Division by the time of the prior guilty plea, then at sentencing for those additional crimes the Division will seek an appropriate sentencing enhancement.

The severity of the Penalty Plus enhancement the Division seeks depends on the reason the company failed to report the additional antitrust crime. If a company conducts an internal investigation and fails to discover the additional antitrust crime but, after the Division discovers that crime, agrees to plead guilty and cooperate with respect to that crime, the Division would begin any downward adjustment for that cooperation from a higher point in the Guidelines range for the additional antitrust crime. The sentencing consequences will be greater for a company that made no meaningful effort to conduct an internal investigation or was aware of the additional antitrust crime but elected not to report. In that case, the Division will seek a more severe Penalty Plus enhancement and will likely recommend that the district court impose probation on the company pursuant to U.S. Sentencing Guidelines §§8D1.1 - 8D1.4.[14]

In the most egregious cases, the Division will recommend that the district court consider the company's failure to report the additional antitrust crime as an aggravating sentencing factor which warrants a fine at the top end of the Guidelines range or an upward departure and a sentence above the Guidelines range. In such cases, the Division may also recommend that the district court appoint an external monitor to ensure that the company develops an appropriate culture of corporate compliance.

11.If the leniency applicant is a subject or target of, or a defendant in, a separate investigation, will the applicant's conditional leniency letter contain any changes from the model corporate conditional leniency letter?

Yes. An additional paragraph will be included when necessary in the model corporate conditional leniency letter to make clear that the protection afforded to the company and its executives pursuant to the letter, as well as their cooperation obligations,

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[14] The U.S. Sentencing Guidelines are available at http://www.ussc.gov/sites/default/files/pdf/guidelines-manual/2016/GLMFull.pdf.

extend only to the activity reported pursuant to the leniency application and not to the separate investigation. In so doing, the letter will detail the company's acknowledgement of its status and that of its directors, officers, and employees as subjects, targets, or defendants in the separate investigation; the lack of effect of the conditional leniency letter on the ability of the Division to prosecute it and its directors, officers, and employees in that separate investigation; and the lack of effect of the separate investigation on the cooperation obligations of the company and its directors, officers, and employees under the conditional leniency letter.[15]

In addition, directors, officers and employees of the applicant who are subjects, targets, or defendants in the separate investigation but who are interviewed by the Division in connection with his or her employer's leniency application will be given a separate letter in which the individual acknowledges his or her status in the separate investigation and acknowledges that the leniency letter governs the conditions of the individual's eligibility for leniency protection with respect to the anticompetitive activity being reported pursuant to the leniency letter.[16]

Meaning of "Discovery of the Illegal Activity"

12. ***Both Type A Leniency and Type B Leniency require that "[t]he corporation, upon its discovery of the illegal activity being reported, took prompt and effective action to terminate its part in the activity." How does the Division interpret "discovery of the illegal activity being reported," especially when high-level officials of the company participated in the cartel?***

Questions have arisen about what it means for the corporation to "discover" the illegal activity being reported. More specifically, in cases (usually involving small, closely held corporations) where the top executives, board members, or owners participated in the conspiracy, it has been suggested that the corporation may not be eligible for leniency because the corporation's "discovery" of the activity arguably occurred when those participants joined the conspiracy.

The Division, however, generally considers the corporation to have discovered the illegal activity at the earliest date on which either the board of directors or counsel for the corporation (either inside or outside) was first informed of the conduct at issue. Thus, the fact that top executives, individual board members, or owners participated in the conspiracy does not necessarily bar the corporation from eligibility for leniency. The purpose of this interpretation is to ensure that as soon as the authoritative representatives of the company for legal matters—the board or counsel representing the corporation—are

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[15] A copy of the Model Dual Investigations Leniency Letter is available at https://www.justice.gov/atr/leniency-program.

[16] A copy of the Model Dual Investigations Acknowledgement Letter for Employees is available at https://www.justice.gov/atr/leniency-program.

advised of the illegal activity, they take action to cease that activity. In the case of a small, closely held corporation in which the board of directors is never formally advised of the activity, because all members of the board are conspirators, the corporation still may qualify under this provision if the activity is terminated promptly after legal counsel is first informed of the activity.

13. ***Does the grant of conditional leniency always cover activity up until the date of the conditional leniency letter?***

The grant of conditional leniency usually protects the applicant for any activity committed in furtherance of a criminal antitrust violation prior to the date of the conditional leniency letter. This is because, in the vast majority of cases, leniency applicants approach the Division promptly after discovery of the anticompetitive activity in order to enhance the likelihood that they are the first applicant and that a co-conspirator or an employee does not beat them in the race to obtain leniency. In such cases, paragraph 3 of the Division's model corporate conditional leniency letter provides that "[T]he Antitrust Division agrees not to bring any criminal prosecution against Applicant for any act or offense it may have committed prior to the date of this letter in furtherance of the anticompetitive activity being reported." The introductory paragraph in the model leniency letters defines "date of this letter" as the date that the Division executes the conditional leniency letter.

In rare cases, leniency applicants do not approach the Division until a significant period of time has lapsed since discovery of the anticompetitive activity being reported. In such instances, there can be a significant lapse in time between the date the applicant discovered the conspiracy—and was required to take prompt and effective action to terminate its participation —and the date the applicant reported the activity to the Division. In these cases, the Division reserves the right to grant conditional leniency only up to the date the applicant represents that it terminated its participation in the activity. The Division will also likely insist on including both a discovery date and a termination date in paragraph 1 of the corporate conditional leniency letter. The discovery date and termination date representations would be that the applicant "discovered the anticompetitive activity being reported in or about [month/year] and terminated its participation in the activity in or about [month/year]."[17] The applicant bears the burden of proving the accuracy of these representations.[18]

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[17] *See* Model Corp. Conditional Leniency Letter n.3.

[18] *Id.* ¶ 1 ("Applicant agrees that it bears the burden of proving its eligibility to receive leniency, including the accuracy of the representations made in this paragraph and that it fully understands the consequences that might result from a revocation of leniency as explained in paragraph 3 of this Agreement.") The applicant, as the party seeking leniency and representing that it is eligible, has the burden of establishing its eligibility for leniency.

Termination of Participation in Anticompetitive Activity

14. ***What constitutes "prompt and effective action to terminate [the applicant's] participation in the anticompetitive activity being reported upon discovery of the activity?"***

The model corporate conditional leniency letter requires that a leniency applicant promptly terminated its participation in the anticompetitive activity being reported upon its discovery of the illegal conduct.[19] This prerequisite to obtaining leniency exists because, as a matter of good public policy, the Division does not believe that it would be appropriate to provide leniency to a company that discovers illegal conduct but then elects to continue engaging in that conduct. What constitutes prompt and effective action will, of course, depend on the particular circumstances in each leniency matter. A primary consideration is what steps are taken by management in response to the discovery of the anticompetitive activity being reported. For example, a company must not use managers or executives who were involved in the anticompetitive activity to investigate the activity, to formulate the company's response to the discovery of such activity, or to determine the appropriate disciplinary action against employees who participated in the activity. Other considerations are the size of the applicant corporation, its corporate structure, the complexity of its operations involved in the reported activity (including its geographic scope), and the nature of the reported activity.

A company terminates its part in anticompetitive activity by stopping any further participation in that activity, unless continued participation is with Division approval in order to assist the Division in its investigation. The Division will not disqualify a leniency applicant whose illegal conduct ended promptly after it was discovered merely because the applicant did not take some particular action. Moreover, as an exercise of prosecutorial discretion, if the Division is persuaded that the company and its high-level management had done everything that could reasonably be expected of them to terminate the company's involvement in the anticompetitive activity being reported, the Division would not revoke a company's conditional acceptance into the Leniency Program because a lower-level employee in one of the company's remote offices continued for some short period of time to have conspiratorial contacts with his or her counterpart. On the other hand, if any of the applicant's executives or high-level managers who were members of the conspiracy prior to discovery, continue to act in furtherance of the conspiracy despite that company's remedial actions, then the company should recognize that the Division may decide that the applicant did not promptly and effectively end its participation in the conspiracy.

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[19] *Id.* ("Applicant represents . . . that . . . it . . . took prompt and effective action to terminate its participation in the anticompetitive activity being reported upon discovery of the activity.")

A company that seeks a marker from the Division immediately after discovering anticompetitive activity, and that effectively terminates its involvement in that activity at about the same time, will be viewed by the Division as having taken prompt and effective action. To date, almost every company that has sought leniency from the Division has done so shortly after discovering the anticompetitive activity being reported. On the other hand, an applicant that discovers anticompetitive activity, but, instead of reporting it to the Division, keeps the culpable employees in the same positions with no repercussions or inadequate supervision, and fails to prevent those employees from continuing to engage in the anticompetitive activity, can expect the Division to decline to grant it leniency. As with the discovery representation, the applicant has the burden of proving that it took prompt and effective action, and will not receive final leniency unless it satisfies its burden of proof.[20]

Leniency applicants most commonly effectuate termination by reporting the anticompetitive activity to the Division and refraining from further participation—unless continued participation is with Division approval. Applicants may be asked to assist the Division with a covert investigation; for example, by participating in consensually monitored discussions with other members of the conspiracy.[21] Whether the Division's investigation is overt or covert, however, there is a risk of obstruction resulting from unauthorized disclosures about the application or the investigation. Therefore, at the outset of the leniency application, the applicant should discuss with Division staff who within the company it can tell about the leniency application, as well as when and how to inform them.

Not the Leader or Originator of the Activity

Part A of the Corporate Leniency Policy, section A6, requires that "[t]he corporation did not coerce another party to participate in the illegal activity and clearly was not the leader in, or originator of, the activity." Similarly, Part B of the Corporate Leniency Policy, section B7, requires that:

> The Division determine[] that granting leniency would not be unfair to others, considering the nature of the illegal activity, the confessing corporation's role in it, and when the corporation comes forward.

The model corporate conditional leniency letter incorporates this requirement in paragraph 1, which requires the applicant to represent that it "did not coerce any other party to participate in the anticompetitive activity being reported and was not the leader

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[20] *Id*. (see introductory paragraph and paragraph 1).

[21] When an applicant's employees are participating in cartel meetings and communications at the direction of the Division to assist with a covert investigation, the employees are deemed to be agents of the Division under U.S. law and are no longer deemed co-conspirators.

in, or the originator of, the activity." As with the discovery and termination representations, the applicant bears the burden of proving the accuracy of this representation.[22]

15.How does the Division define what it means to be "the leader in, or originator of, the activity"?

The Corporate Leniency Policy refers to "*the* leader" and "*the* originator of the activity," rather than "*a"* leader or "*an*" originator. Applicants are disqualified from obtaining leniency on this ground only if they were clearly the single organizer or single ringleader of a conspiracy. If, for example, there are two ringleaders in a five-firm conspiracy, then all of the firms, including the two leaders, are potentially eligible for leniency. Or, if in a two-firm conspiracy, each firm played a decisive role in the operation of the cartel, either firm is potentially eligible for leniency. In addition, an applicant will not be disqualified under this condition just because it is the largest company in the industry or has the greatest market share if it was not clearly the single organizer or single ringleader of the conspiracy. Exclusion under the condition is rare and wherever possible, the Division has construed or interpreted its program in favor of accepting an applicant into the Leniency Program in order to provide the maximum amount of incentives and opportunities for companies to come forward and report their illegal activity.

Cooperation Obligations

16. What are the corporate applicant's cooperation obligations?

Type A Leniency requires that "[t]he corporation reports the wrongdoing with candor and completeness and provides full, continuing and complete cooperation to the Division throughout the investigation." Type B Leniency requires that "[t]he corporation reports the wrongdoing with candor and completeness and provides full, continuing and complete cooperation that advances the Division in its investigation." Both Type A and Type B Leniency require that "[t]he confession of wrongdoing is truly a corporate act, as opposed to isolated confessions of individual executives or officials." Paragraph 2 of the model corporate conditional leniency letter describes specific cooperation obligations of the applicant, such as providing documents, information, and materials wherever located; using its best efforts to secure the cooperation of its current directors, officers, and employees;[23] and paying restitution to victims.

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[22] *See* Model Corp. Conditional Leniency Letter ¶ 1.

[23] In specific cases, the Division, in its discretion, may also agree to cover specific named former employees, as discussed in Question 24.

17.As part of the applicant's cooperation obligations, will the applicant be required to provide communications or documents protected by the attorney-client privilege or work-product doctrine?

Paragraphs 2 and 4 of the model corporate conditional leniency letter state that the applicant and its directors, officers, and employees are not required to produce communications or documents protected by the attorney-client privilege or work-product doctrine as part of their cooperation. Moreover, as stated in the introductory paragraph of the model corporate conditional leniency letter, the Division does not consider disclosures made by counsel in furtherance of the leniency application to constitute a waiver of the attorney-client privilege or the work-product protection. While the Division does not require or request the production of communications or documents protected by the attorney-client privilege or work-product doctrine, and does not refuse to grant leniency because a corporation has not produced such protected information, some corporations, after consulting counsel, conclude that a voluntary disclosure of such protected communications and/or documents is in the best interest of the corporation.

Effect of Refusal of Individual Executives to Cooperate

18.If one or more individual corporate executives refuse to cooperate, will the corporate applicant be barred from leniency on the basis that the confession is no longer a "corporate act" or that the corporation is not providing "truthful, full, continuing, and complete" cooperation?

In order for the confession of wrongdoing to be a "corporate act" and in order for the cooperation to be considered "truthful, full, continuing, and complete," the corporation must, in the Division's judgment, be taking all legal, reasonable steps to cooperate with the Division's investigation. The model corporate conditional leniency letter requires the company to use "its best efforts to secure the truthful, full, continuing, and complete cooperation" of its current directors, officers, and employees excluding any current personnel who are carved out of the letter. In those cases where the conditional leniency letter's cooperation requirements and leniency protections also cover specific named former directors, officers, or employees, the company is also required to use its best efforts to secure those individuals' cooperation. If the corporation is unable to secure such cooperation of one or more individuals, then that would not necessarily prevent the Division from granting the leniency application. However, the number and significance of the individuals who fail to cooperate, and the steps taken by the company to secure their cooperation, would be relevant to the Division's determinations of whether there is a corporate confession, whether the corporation's cooperation is truly "truthful, full, continuing, and complete," and whether the Division is receiving the benefit of the bargain if certain key executives are not cooperating. Of course, in such situations, the non-cooperating individuals would lose the protection given to cooperating employees under the corporate conditional leniency letter, and the Division would be free to prosecute such individuals for the antitrust crime and any related offenses.

Restitution

19. What is the meaning of the qualifier in the Corporate Leniency Policy that states "[w]here possible, the corporation makes restitution to injured parties"?

There is a strong presumption in favor of requiring restitution in leniency situations. Restitution is excused only where, as a practical matter, it is not possible. Examples of situations in which an applicant might be excused from making restitution include situations where the applicant is in bankruptcy and is prohibited by court order from undertaking additional obligations, or where there was only one victim of the conspiracy and it is now defunct. Another example of a situation where the Division will not require the applicant to pay full restitution is if doing so will substantially jeopardize the organization's continued viability. Paragraph 2(g) of the model corporate conditional leniency letter requires that the applicant make "all reasonable efforts, to the satisfaction of the Antitrust Division, to pay restitution." Thus, the applicant must demonstrate to the Division that it has satisfied its obligation to pay restitution before it will be granted final leniency. Restitution is normally resolved through civil actions with private plaintiffs. The Antitrust Criminal Penalty Enhancement and Reform Act of 2004, also referred to as ACPERA,[24] limits the liability for civil damages claims in private state or federal antitrust actions for a qualifying leniency applicant. For claims against a corporation that enters into an antitrust leniency agreement with the Division or a cooperating individual covered by such an agreement, a claimant cannot recover damages exceeding the "portion of the actual damages sustained by such claimant which is attributable to the commerce done by the applicant in the goods or services affected by the violation."[25] To qualify for this limitation, the corporation or cooperating individuals must meet the conditions of the Corporate Leniency Policy, including cooperating fully with the Division's investigation, and must meet certain requirements in connection with the claimant's civil action, including providing the claimant with a full account of all potentially relevant facts known to the corporation or cooperating individual and all potentially relevant documents.

20. What are the applicant's restitution obligations for injuries caused by the effects of the anticompetitive activity being reported on foreign commerce?

The model corporate conditional leniency letter reflects the holdings of the Supreme Court and the courts of appeals that damages for violations of the Sherman Act do not include foreign effects independent of and not proximately caused by any adverse

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[24] Pub. L. No. 108-237, Title II, §§ 211 to 214, 118 Stat. 661, 666-68 (2004), as amended Pub. L. No. 111-30, § 2, 123 Stat. 1775 (2009) and Pub. L. No. 111-190, §§ 1 to 4, 124 Stat. 1275, 1275-76 (2010) (set out as a note under 15 U.S.C. § 1).

[25] ACPERA § 213(a).

effect on U.S. commerce.[26] Accordingly, paragraph 2(g) of the model corporate conditional leniency letter states: "However, Applicant is not required to pay restitution to victims whose antitrust injuries are independent of, and not proximately caused by, any effect on (i) trade or commerce within the United States, (ii) import trade or commerce, or (iii) the export trade or commerce of a person engaged in such trade or commerce in the United States, which effect was proximately caused by the anticompetitive activity being reported."

21. ***What are the applicant's restitution obligations if the Division ultimately brings no criminal case?***

In certain cases where a corporation has otherwise met the requirements for leniency and has agreed to pay restitution, the Division may ultimately determine that either: (1) the leniency applicant has not engaged in any criminal antitrust conduct; or (2) even though the leniency applicant has engaged in criminal antitrust conduct, prosecution of the other conspiracy participants is not justified under the Principles of Federal Prosecution given the weakness of the evidence or other problems with the case. The issue has arisen as to whether, in such cases, the leniency applicant still has to pay restitution as agreed in the corporate conditional leniency letter.

If the Division's investigation ultimately reveals that the leniency applicant has not engaged in any criminal antitrust conduct, the Division will not grant leniency because it is unnecessary. Obligations placed on the applicant by the Corporate Leniency Policy or the applicant's conditional leniency letter with the Division no longer apply once the Division determines there is no underlying criminal antitrust conduct. In such cases, the Division will so advise the applicant in writing and the applicant will have no duty to pay restitution. If the leniency applicant has already paid restitution or is in the process of doing so, the applicant must resolve the matter with the recipient. Once the Division decides not to grant leniency, the applicant has no duty toward the Division, nor does the Division have any duty to help "reverse" any steps taken by the applicant to make restitution. Due to the Division's use of a marker system, however, this situation is not likely to occur. Through the marker system, the applicant has the opportunity to conduct a thorough internal investigation and the Division has the opportunity to interview key corporate executives before a conditional leniency letter is issued. Thus, any issues regarding whether a criminal antitrust violation occurred should be resolved during the marker stage.

If, on the other hand, the Division concludes that the leniency applicant has engaged in criminal antitrust activity and conditionally grants the leniency application,

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[26] *See F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004); *Lotes Co., Ltd. v. Hon Hai Precision Indus. Co.*, 753 F.3d 395 (2d Cir. 2014); *In re Dynamic Random Access Memory (DRAM) Antitrust Litig.*, 546 F.3d 981 (9th Cir. 2008); *In re Monosodium Glutamate Antitrust Litig.*, 477 F.3d 535 (8th Cir. 2007); *Empagran S.A. v. F. Hoffmann-La Roche Ltd.*, 417 F.3d 1267 (D.C. Cir. 2005).

but later closes the investigation without charging any other entity in the conspiracy, the obligation to pay restitution will remain in effect. In such a case, the Division will notify the leniency applicant and the subjects of the investigation in writing that the investigation has been closed. In such cases, the leniency applicant may withdraw its application if it so chooses, and, if it does, the obligations undertaken by the applicant pursuant to the conditional leniency letter—including the payment of restitution—will no longer be in effect. If the applicant withdraws its application, the Division, for its part, will technically no longer be prohibited from prosecuting the applicant and will not provide any additional assurances of nonprosecution. Again, the Division will not assist in restoring any restitution already paid if the leniency application is withdrawn. Moreover, if the applicant chooses to withdraw its leniency application, it will not qualify for detrebling of civil damages under the Antitrust Criminal Penalty Enhancement and Reform Act of 2004. Also, once an applicant has fulfilled all of the conditions for leniency and the Division has issued a final leniency letter, the Division does not permit the leniency recipient to withdraw its leniency application.

Leniency for Corporate Directors, Officers, and Employees

22. ***What are the conditions for leniency protection for the applicant's current directors, officers, and employees?***

If a corporation qualifies for Type A Leniency, all current directors, officers, and employees of the corporation who admit their involvement in the criminal antitrust violation as part of the corporate confession will also receive leniency if they admit their wrongdoing with candor and completeness and continue to assist the Division throughout the investigation. In addition, the applicant's current directors, officers, and employees who did not participate in the conspiracy but who had knowledge of the conspiracy and cooperate with the Division are also included in the scope of the conditional leniency letter, as explained below. If a current director, officer, or employee does not fully cooperate with the Division's investigation, he or she will be excluded from, or "carved out" of, the conditional leniency letter. Also, as discussed below, if a current director, officer, or employee fully cooperates with the Division's investigation before the conditional leniency letter is issued, but stops fully cooperating after the letter is issued, then that individual's protections under the corporate conditional leniency letter are void and the Division may notify that individual that his or her protection under the letter is revoked. As discussed in Question 24 below, the Division may also exercise its discretion to include in the scope of the conditional leniency letter the names of specific former directors, officers, and employees of the corporation.

If a corporation qualifies for Type B Leniency, the Corporate Leniency Policy states that individuals who come forward with the corporation will still be considered for immunity from criminal prosecution on the same basis as if they had approached the Division individually. Thus, the Division has more discretion with respect to personnel of Type B Leniency applicants. The Division often chooses to include protection for current directors, officers, and employees of Type B Leniency applicants. However, the Division may exercise its discretion to exclude from the protections that the conditional leniency

letter offers those current directors, officers, and employees who are determined to be highly culpable. As discussed in Question 24 below, the Division may also exercise its discretion to include in the scope of a Type B corporate conditional leniency letter specific named former directors, officers, and employees of the corporation.

Leniency must be fully earned. Paragraph 4 of the corporate conditional leniency letter details the specific conditions of leniency for the applicant's directors, officers, and employees who had knowledge of, or participated in, the anticompetitive activity being reported by the applicant. The conditions are: (1) verification of the applicant's representations in paragraph 1 of the corporate conditional leniency letter; (2) the applicant's truthful, full, continuing, and complete cooperation as defined in paragraph 2 of the corporate conditional leniency letter; (3) admission by the pertinent director, officer, or employee of his or her knowledge of, or participation in, the anticompetitive activity being reported; and (4) the individual's truthful, full, continuing, and complete cooperation with the Division in its investigation and resulting prosecutions. The specific cooperation obligations of the individuals are also defined in paragraph 4 of the corporate conditional leniency letter, such as the provision of documents, records and other materials and information; participation in interviews; and the provision of testimony.

As noted below, the Division reserves the right to revoke the conditional protections of the corporate conditional leniency letter with respect to any director, officer, or employee who failed to comply fully with his or her obligations under the letter, who the Division determines caused the corporate applicant to be ineligible for leniency, who continued to participate in the anticompetitive activity being reported after the corporation took action to terminate its participation in the anticompetitive activity and notified the individual to cease his or her participation in the anticompetitive activity, or who obstructed or attempted to obstruct an investigation of the anticompetitive activity at any time, whether the obstruction occurred before or after the date of the corporate conditional leniency letter.[27]

Definition of Current Employees

23. ***How is "current director, officer, or employee" defined for purposes of the cooperation obligations and leniency protection of the corporate conditional leniency letter?***

Status as a "current director, officer, or employee" is defined at the time the corporate conditional leniency letter is signed by the Division. Thus, leniency for individuals who are directors, officers, and employees of the applicant at the time the letter is signed by the Division will continue after they leave their employment so long as they satisfy their obligations under the corporate conditional leniency letter.

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[27] This issue is discussed further at Question 30 and addressed in paragraph 4 of the model corporate conditional leniency letter.

Leniency for Former Employees

24. Can an applicant's former directors, officers, and employees be included in the scope of the conditional leniency letter?

Former directors, officers, and employees are presumptively excluded from any grant of corporate leniency. The Corporate Leniency Policy does not refer to former directors, officers, or employees. The Division is under no obligation to extend leniency to former directors, officers, or employees.

At the Division's sole discretion, specific, named former directors, officers, or employees may receive nonprosecution protection under a corporate conditional leniency letter or by a separate nonprosecution agreement. Such protections are only offered when these specific former directors, officers, or employees provide substantial, noncumulative cooperation against remaining potential targets, or when their cooperation is necessary for the leniency applicant to make a confession of criminal antitrust activity sufficient to be eligible for conditional leniency.[28] In these circumstances, such decisions are made on an individualized, case-by-case basis, consistent with the Principles of Federal Prosecution. Former directors, officers, and employees must provide truthful, full, continuing and complete cooperation to the Division throughout its investigation and resulting prosecutions.

III. Criteria under the Leniency Policy for Individuals

25. What are the criteria for leniency under the Leniency Policy for Individuals?

An individual who approaches the Division on his or her own behalf to report illegal antitrust activity may qualify for leniency under the Leniency Policy for Individuals. As with a corporate applicant, an individual leniency applicant is required to admit to his or her participation in a criminal antitrust violation.[29] The individual must not have approached the Division previously as part of a corporate approach seeking leniency for the same conduct. Once a corporation attempts to qualify for leniency under the Corporate Leniency Policy, current directors, officers, and employees who come forward and admit their involvement in the criminal antitrust violation as part of the corporate confession will be considered for leniency under the provisions of the Corporate Leniency Policy. No current or former directors, officers, or employees of a company that has applied for leniency under the Corporate Leniency Policy may be considered for leniency under the Leniency Policy for Individuals.

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[28] See Question 5.

[29] See also the discussion at Question 6 regarding the Division's policy concerning coverage of non-antitrust crimes, which applies to individual leniency applicants as well as to corporate applicants.

Leniency will be granted to an individual reporting illegal antitrust activity before an investigation has begun if the following three conditions are met:[30]

(1) At the time the individual comes forward to report the activity, the Division has not received information about the activity being reported from any other source.

(2) The individual reports the wrongdoing with candor and completeness and provides full, continuing, and complete cooperation to the Division throughout the investigation.

(3) The individual did not coerce another party to participate in the activity and clearly was not the leader in, or the originator of, the activity.

Any individual who does not qualify for leniency under the Corporate Leniency Policy or Leniency Policy for Individuals may still be considered for statutory or informal immunity.

Paragraph 2 of the model individual conditional leniency letter describes specific cooperation obligations of the individual applicant, such as the production of documents, records, and other materials and information; participation in interviews; and provision of testimony. As is the case with a corporate applicant, an individual applicant is not required, and will not be asked, to produce communications or documents protected under the attorney-client privilege or work-product doctrine.[31]

Regarding the leadership condition, an individual leniency applicant is required to represent in his or her leniency letter that, "in connection with the anticompetitive activity being reported, [he/she] did not coerce any other party to participate in the activity and

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[30]As with the model corporate conditional leniency letter, the model individual conditional leniency letter provides that the leniency protection applies to "any act or offense [the applicant] may have committed prior to the date of this letter in furtherance of the anticompetitive activity being reported." Model Individual Conditional Leniency Letter ¶ 3. With respect to an individual leniency applicant, if a significant lapse in time occurs between the applicant's termination of his or her participation in the anticompetitive activity being reported and the date the applicant reported the activity to the Division, the Division reserves the right to grant conditional leniency only up to the date the applicant terminated his or her participation in the activity. Model Individual Conditional Leniency Letter n.2.

[31] Model Individual Conditional Leniency Letter ¶ 2(a), (d). As with a corporate applicant, an individual, after consulting with counsel, may conclude that a voluntary disclosure of such privileged communications or documents is in his or her best interest.

was not the leader in, or the originator of, the activity" in order to establish his or her eligibility for leniency. The applicant bears the burden of proving the accuracy of this representation.[32] As with a corporate applicant, an individual applicant would only be disqualified from obtaining leniency based on leadership role if he or she is clearly the single organizer or single ringleader of a conspiracy. Accordingly, in situations where individual conspirators are viewed as co-equals or where there are two or more individual conspirators that are viewed as leaders or originators, any of the participants are potentially eligible for leniency under the Leniency Policy for Individuals.

IV. The Conditional Leniency Letter

26. ***What is the conditional leniency letter, and why is it conditional?***

The conditional leniency letter is the initial leniency letter given to a leniency applicant. The Division has a model corporate conditional leniency letter and a model individual conditional leniency letter.[33] The initial grant of leniency pursuant to the letters is conditional because a final grant of leniency depends upon the applicant performing certain obligations over the course of the criminal investigation and any resulting prosecution of co-conspirators, such as: establishment of its eligibility; its truthful, full, continuing, and complete cooperation; and its payment of restitution to victims, as set forth in the letter. The final grant of leniency also depends on the Division verifying the applicant's representations regarding its eligibility. Only those who qualify for leniency should receive its rewards. After all of the applicant's obligations have been satisfied (usually after the investigation and prosecution of co-conspirators have been concluded) and the Division has verified the applicant's representations regarding eligibility, the Division will issue the applicant a final leniency letter confirming that the conditions of the conditional leniency letter have been satisfied and that the leniency application has been granted.

The conditional nature of the leniency initially granted is reflected in the model leniency letters. The introductory paragraph of the model corporate and individual conditional leniency letters states that the agreement "is conditional." Further, the letters state in paragraph 3 that, "[s]ubject to verification of Applicant's representations in paragraph 1 above, and subject to [its/Applicant's] truthful, full, continuing, and complete cooperation, as described in paragraph 2 above, the Antitrust Division agrees

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[32] Model Individual Conditional Leniency Letter ¶ 1 ("Applicant agrees that [he/she] bears the burden of proving [his/her] eligibility to receive leniency, including the accuracy of the representations made in this paragraph, and that [he/she] fully understands the consequences that might result from a revocation of leniency as explained in paragraph 3 of this Agreement.").

[33] Both model conditional letters are available at https://www.justice.gov/atr/leniency-program.

conditionally to accept Applicant into [Part A/Part B of the Corporate Leniency Program/the Individual Leniency Program].” The letters also state in the introductory paragraph that the agreement “depends upon Applicant (1) establishing that [it/he or she] is eligible for leniency as [it/he or she] represents in paragraph 1 of [the] Agreement, and (2) cooperating in the Antitrust Division’s investigation as required by paragraph 2 of [the] Agreement.” As noted above, the applicant, as the party seeking leniency, has the burden of establishing its eligibility for leniency.[34] The introductory paragraph further notes that, “[a]fter Applicant establishes that [it/he or she] is eligible to receive leniency and provides the required cooperation, the Antitrust Division will notify Applicant in writing that [it/he or she] has been granted unconditional leniency.”

Although many of the leniency requirements are fulfilled during the criminal investigation, the Division understands that applicants want assurances up front, even if conditional, that they will receive nonprosecution protection at the conclusion of the investigation if they fulfill the requirements of the Leniency Program. The Division’s conditional leniency letters address that need. In contrast, many voluntary disclosure programs of other prosecuting agencies do not provide any upfront assurances regarding nonprosecution. Thus, the alternative to the conditional letter would be for the Division to give no assurances until the conclusion of the investigation and prosecution of co-conspirators. The conditional leniency letters, however, provide companies and their executives with a transparent and predictable disclosure program, and have been very effective both for the Division in setting forth the requirements of leniency and for applicants in meeting those requirements.

V. Potential Revocation of Conditional Leniency and the Final Unconditional Leniency Letter

27. ***Under what circumstances can the Division revoke an applicant’s conditional leniency, and will the Division provide the applicant with any advance notice of a staff recommendation to revoke conditional leniency?***

If the Division determines, before it grants an applicant a final, unconditional leniency letter, that the applicant “(1) contrary to [its/his/her] representations in paragraph 1 of [the conditional leniency letter], is not eligible for leniency or (2) has not provided the cooperation required by paragraph 2 of [the conditional leniency letter],” the Division may revoke the applicant’s conditional acceptance into the Leniency Program.[35] Before the Division makes a final determination to revoke a corporate applicant’s conditional leniency, it will notify applicant’s counsel in writing of staff’s recommendation to revoke the leniency and provide counsel with an opportunity to meet with the staff, the Criminal

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[34] *See supra* note 18.

[35] Model Corp. Conditional Leniency Letter ¶ 3; Model Individual Conditional Leniency Letter ¶ 3.

DAAG, and the Director of Criminal Enforcement regarding the revocation.[36] During the time that a recommendation to revoke an applicant's leniency is under consideration, the Division will suspend the applicant's obligation to cooperate so that the applicant is not put in the position of continuing to provide evidence that could be used against it should the conditional leniency be revoked. In the history of the Division's Leniency Program, the Division has revoked only one conditional leniency letter out of the more than 200 conditional leniency letters issued.

28. When can an applicant or its employees judicially challenge a Division decision to revoke conditional leniency?

Paragraph 3 of the model corporate and individual conditional leniency letters states that the applicant "understands that the Antitrust Division's Leniency Program is an exercise of the Division's prosecutorial discretion, and [it/he/she] agrees that [it/he/she] may not, and will not, seek judicial review of any Division decision to revoke [its/his/her] conditional leniency unless and until [it/he/she] has been charged by indictment or information for engaging in the anticompetitive activity being reported." Paragraph 4 of the model corporate conditional leniency letter also notes that "[j]udicial review of any Antitrust Division decision to revoke [an individual's] conditional nonprosecution protection granted [under the corporate conditional leniency letter] is not available unless and until the individual has been charged by indictment or information." The Division's Leniency Program is an exercise of prosecutorial discretion generally not subject to judicial review. Accordingly, the proper avenue to challenge a revocation of a leniency letter is to raise the letter as a defense post-indictment.[37]

29. If a corporate conditional leniency letter is revoked, what will happen to the protection provided in the letter for the corporation's directors, officers, and employees?

If before granting the applicant unconditional leniency the Division determines that the applicant is not eligible for leniency or has not provided the required cooperation, the conditional leniency agreement "shall be void" and the Division may revoke the applicant's conditional acceptance into the Leniency Program.[38] Thus, the protection provided to employees pursuant to the letter no longer exists. However, as a matter of prosecutorial discretion, even if the Division revokes a company's conditional leniency letter, the Division will elect not to prosecute individual employees, so long as they had

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[36] Model Corp. Conditional Leniency Letter ¶ 3. The individual conditional leniency letter provides that this notice will be given absent exigent circumstances, such as risk of flight. Model Individual Conditional Leniency Letter ¶ 3.

[37] *Stolt-Nielsen, S.A. v. United States*, 442 F.3d 177, 183-187 (3d Cir. 2006).

[38] Model Corp. Conditional Leniency Letter ¶ 3.

provided truthful, full, continuing, and complete cooperation to the Division prior to the revocation and, in the Division's view, were not responsible for the revocation.

30. Under what circumstances can the protection granted to an individual under a corporate conditional leniency letter be revoked?

As noted in the model corporate conditional leniency letter, if a director, officer, or employee who is included in the scope of the leniency letter fails to comply fully with his or her obligations under the letter, the Division may revoke any conditional leniency, immunity, or nonprosecution granted to the individual under the letter.[39] The Division also reserves the right to revoke the conditional nonprosecution protections of the corporate conditional leniency letter with respect to any director, officer, or employee who the Division determines caused the corporate applicant to be ineligible for leniency under paragraph 1 of the corporate conditional leniency letter, who continued to participate in the anticompetitive activity being reported after the corporation took action to terminate its participation in the activity and notified the individual to cease his or her participation in the activity,[40] or who obstructed or attempted to obstruct an investigation of the anticompetitive activity at any time, whether the obstruction occurred before or after the date of the corporate conditional leniency letter.[41]

31. What notice or process will be given to an individual if the Division is contemplating revoking his or her conditional protections provided in a corporate conditional leniency letter?

Absent exigent circumstances, such as risk of flight, before the Division makes a final determination to revoke an individual's conditional leniency, immunity, or nonprosecution provided under a corporate conditional leniency letter, it will notify in writing the individual (or his or her counsel, if represented) and the corporate applicant's counsel of staff's recommendation to revoke the protections provided in the letter and provide an opportunity to meet with the staff, the Criminal DAAG, and the Director of

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[39] Model Corp. Conditional Leniency Letter ¶ 4.

[40] Such notice ordinarily is part of the corporation's prompt and effective action to terminate its participation in the anticompetitive activity being reported. It need not be specific to the individual or the individual's particular conduct so long as it reasonably notifies the director, officer, or employee that he or she should not participate in the illegal activity. General instructions or guidance by the corporation not to engage in cartel or illegal conduct generally, made prior to the corporation's discovery of the anticompetitive activity being reported, does not constitute such notice for purposes of this provision.

[41] Model Corp. Conditional Leniency Letter ¶ 4.

Criminal Enforcement regarding the revocation.[42] During the time that a revocation recommendation is under consideration, the Division will suspend the individual's obligation to cooperate so that the individual is not put in the position of continuing to provide evidence that could be used against him or her should his or her conditional protections be revoked. If the Division revokes conditional leniency, immunity, or nonprosecution granted to a director, officer, or employee of a corporate applicant, the Division may use against such individual any evidence provided at any time pursuant to the corporate conditional leniency letter by the corporate applicant, the individual, or other directors, officers, or employees of the applicant.[43]

32. How and when does an applicant receive a final, unconditional leniency letter?

As noted above and in the model corporate and individual conditional leniency letters, after the applicant "establishes that [it/he/she] is eligible to receive leniency," as represented in paragraph 1 of the conditional leniency letter, "and provides the required cooperation," as set forth in paragraph 2 of the conditional leniency letter, "the Antitrust Division will notify Applicant in writing that [it/he/she] has been granted unconditional leniency."[44] Normally this would occur after the investigation and any resulting prosecutions of the applicant's co-conspirators are completed.

VI. Confidentiality

33. What confidentiality assurances are given to leniency applicants?

The Division holds the identity of leniency applicants and the information they provide in strict confidence, much like the treatment afforded to confidential informants. Therefore, the Division does not publicly disclose the identity of a leniency applicant or information provided by the applicant, absent prior disclosure by, or agreement with, the applicant, unless required to do so by court order in connection with litigation.

34. Will the Division disclose information from a leniency applicant to a foreign government?

The Leniency Program has been the Division's most effective generator of international cartel prosecutions. Invariably, however, when a company is considering whether to report its involvement in international cartel activity, a concern is raised as to whether the Division will be free to disclose the information to any foreign governments

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[42] *Id.*

[43] *Id.*

[44] See the introductory paragraphs in the model corporate and individual conditional leniency letters.

in accordance with its obligations under bilateral antitrust cooperation agreements. As noted above, the Division's policy is to treat the identity of, and information provided by, leniency applicants as a confidential matter, much like the treatment afforded to confidential informants. Moreover, the Division has an interest in maximizing the incentives for companies to come forward and self-report antitrust offenses. In that vein, it would create a strong disincentive to self-report and cooperate if a company believed that its self-reporting would result in investigations in other countries and that its cooperation—in the form of admissions, documents, employee statements, and witness identities—would be provided to foreign authorities pursuant to antitrust cooperation agreements, and then possibly used against the company.

While the Division has been at the forefront in advocacy and actions to enhance international cartel enforcement, and the Division has received substantial assistance from foreign governments in obtaining foreign-located evidence in a number of cases, in the final analysis, the Division's overriding interest in protecting the viability of the Leniency Program has resulted in a policy of not disclosing to foreign antitrust agencies information obtained from a leniency applicant unless the leniency applicant agrees first to the disclosure. This aspect of the Division's leniency nondisclosure policy will not insulate the leniency applicant from proceedings in other countries. But it will ensure that cooperation provided by a leniency applicant will not be disclosed by the Division to its foreign counterparts pursuant to antitrust cooperation agreements without the prior consent of the leniency applicant. The Division first announced this policy in 1999, and it is the Division's understanding that virtually every other jurisdiction that has considered the issue has adopted a similar policy.

Appendix I: Department of Justice, FCPA Corporate Enforcement Policy

9-47.120 - FCPA Corporate Enforcement Policy

1. Credit for Voluntary Self-Disclosure, Full Cooperation, and Timely and Appropriate Remediation in FCPA Matters

Due to the unique issues presented in FCPA matters, including their inherently international character and other factors, the FCPA Corporate Enforcement Policy is aimed at providing additional benefits to companies based on their corporate behavior once they learn of misconduct. When a company has voluntarily self-disclosed misconduct in an FCPA matter, fully cooperated, and timely and appropriately remediated, all in accordance with the standards set forth below, there will be a presumption that the company will receive a declination absent aggravating circumstances involving the seriousness of the offense or the nature of the offender. Aggravating circumstances that may warrant a criminal resolution include, but are not limited to, involvement by executive management of the company in the misconduct; a significant profit to the company from the misconduct; pervasiveness of the misconduct within the company; and criminal recidivism.

If a criminal resolution is warranted for a company that has voluntarily self-disclosed, fully cooperated, and timely and appropriately remediated, the Fraud Section:

- will accord, or recommend to a sentencing court, a 50% reduction off of the low end of the U.S. Sentencing Guidelines (U.S.S.G.) fine range, except in the case of a criminal recidivist; and
- generally will not require appointment of a monitor if a company has, at the time of resolution, implemented an effective compliance program.

To qualify for the FCPA Corporate Enforcement Policy, the company is required to pay all disgorgement, forfeiture, and/or restitution resulting from the misconduct at issue.

2. Limited Credit for Full Cooperation and Timely and Appropriate Remediation in FCPA Matters Without Voluntary Self-Disclosure

If a company did not voluntarily disclose its misconduct to the Department of Justice (the Department) in accordance with the standards set forth above, but later fully cooperated and timely and appropriately remediated in accordance with the standards set forth above, the company will receive, or the Department will recommend to a sentencing court, up to a 25% reduction off of the low end of the U.S.S.G. fine range.

3. Definitions

a. *Voluntary Self-Disclosure in FCPA Matters*

In evaluating self-disclosure, the Department will make a careful assessment of the circumstances of the disclosure. The Department will require the following items for a company to receive credit for voluntary self-disclosure of wrongdoing:

- The voluntary disclosure qualifies under U.S.S.G. § 8C2.5(g)(1) as occurring "prior to an imminent threat of disclosure or government investigation";
- The company discloses the conduct to the Department "within a reasonably prompt time after becoming aware of the offense," with the burden being on the company to demonstrate timeliness; and
- The company discloses all relevant facts known to it, including all relevant facts about all individuals substantially involved in or responsible for the violation of law.

b. *Full Cooperation in FCPA Matters*

In addition to the provisions contained in the Principles of Federal Prosecution of Business Organizations to satisfy the threshold for any cooperation credit, see JM 9-28.000, the following items will be required for a company to receive maximum credit for full cooperation for purposes of JM 9-47.120(1) (beyond the credit available under the U.S.S.G.):

- Disclosure on a timely basis of all facts relevant to the wrongdoing at issue, including: all relevant facts gathered during a company's independent investigation; attribution of facts to specific sources where such attribution does not violate the attorney-client privilege, rather than a general narrative of the facts; timely updates on a company's internal investigation, including but not limited to rolling disclosures of information; all facts related to involvement in the criminal activity by the company's officers, employees, or agents; and all facts known or that become known to the company regarding potential criminal conduct by all third-party companies (including their officers, employees, or agents);
- Proactive cooperation, rather than reactive; that is, the company must timely disclose all facts that are relevant to the investigation, even when not specifically asked to do so, and, where the company is or should be aware of opportunities for the Department to obtain relevant evidence not in the company's possession and not otherwise known to the Department, it must identify those opportunities to the Department;
- Timely preservation, collection, and disclosure of relevant documents and information relating to their provenance, including (a) disclosure of overseas documents, the locations in which such documents were found, and who found the documents, (b) facilitation of third-party production of documents, and (c) where requested and appropriate, provision of translations of relevant documents in foreign languages;
    - Note: Where a company claims that disclosure of overseas documents is prohibited due to data privacy, blocking statutes, or other reasons related to

foreign law, the company bears the burden of establishing the prohibition. Moreover, a company should work diligently to identify all available legal bases to provide such documents;

- Where requested and appropriate, de-confliction of witness interviews and other investigative steps that a company intends to take as part of its internal investigation with steps that the Department intends to take as part of its investigation[1]; and
- Where requested, making available for interviews by the Department those company officers and employees who possess relevant information; this includes, where appropriate and possible, officers, employees, and agents located overseas as well as former officers and employees (subject to the individuals' Fifth Amendment rights), and, where possible, the facilitation of third-party production of witnesses.

c. *Timely and Appropriate Remediation in FCPA Matters*

The following items will be required for a company to receive full credit for timely and appropriate remediation for purposes of JM 9-47.120(1) (beyond the credit available under the U.S.S.G.):

- Demonstration of thorough analysis of causes of underlying conduct (i.e., a root cause analysis) and, where appropriate, remediation to address the root causes;
- Implementation of an effective compliance and ethics program, the criteria for which will be periodically updated and which may vary based on the size and resources of the organization, but may include:
    - The company's culture of compliance, including awareness among employees that any criminal conduct, including the conduct underlying the investigation, will not be tolerated;
    - The resources the company has dedicated to compliance;
    - The quality and experience of the personnel involved in compliance, such that they can understand and identify the transactions and activities that pose a potential risk;
    - The authority and independence of the compliance function and the availability of compliance expertise to the board;
    - The effectiveness of the company's risk assessment and the manner in which the company's compliance program has been tailored based on that risk assessment;
    - The compensation and promotion of the personnel involved in compliance, in view of their role, responsibilities, performance, and other appropriate factors;
    - The auditing of the compliance program to assure its effectiveness; and
    - The reporting structure of any compliance personnel employed or contracted by the company.
- Appropriate discipline of employees, including those identified by the company as responsible for the misconduct, either through direct participation or failure in oversight, as well as those with supervisory authority over the area in which the criminal conduct occurred;

- Appropriate retention of business records, and prohibiting the improper destruction or deletion of business records, including implementing appropriate guidance and controls on the use of personal communications and ephemeral messaging platforms that undermine the company's ability to appropriately retain business records or communications or otherwise comply with the company's document retention policies or legal obligations; and
- Any additional steps that demonstrate recognition of the seriousness of the company's misconduct, acceptance of responsibility for it, and the implementation of measures to reduce the risk of repetition of such misconduct, including measures to identify future risks.

4. Comment

Cooperation Credit: Cooperation comes in many forms. Once the threshold requirements set out at JM 9-28.700 have been met, the Department will assess the scope, quantity, quality, and timing of cooperation based on the circumstances of each case when assessing how to evaluate a company's cooperation under the FCPA Corporate Enforcement Policy.

"De-confliction" is one factor that the Department may consider in appropriate cases in evaluating whether and how much credit that a company will receive for cooperation. When the Department does make a request to a company to defer investigative steps, such as the interview of company employees or third parties, such a request will be made for a limited period of time and be narrowly tailored to a legitimate investigative purpose (e.g., to prevent the impeding of a specified aspect of the Department's investigation). Once the justification dissipates, the Department will notify the company that the Department is lifting its request.

Where a company asserts that its financial condition impairs its ability to cooperate more fully, the company will bear the burden to provide factual support for such an assertion. The Department will closely evaluate the validity of any such claim and will take the impediment into consideration in assessing whether the company has fully cooperated.

As set forth in JM 9-28.720, eligibility for cooperation or voluntary self-disclosure credit is not in any way predicated upon waiver of the attorney-client privilege or work product protection, and none of the requirements above require such waiver. Nothing herein alters that policy, which remains in full force and effect. Furthermore, not all companies will satisfy all the components of full cooperation for purposes of JM 9-47.120(2) and (3)(b), either because they decide to cooperate only later in an investigation or they timely decide to cooperate but fail to meet all of the criteria listed above. In general, such companies will be eligible for some cooperation credit if they meet the criteria of JM 9-28.700, but the credit generally will be markedly less than for full cooperation, depending on the extent to which the cooperation was lacking.

Remediation: In order for a company to receive full credit for remediation and avail itself of the benefits of the FCPA Corporate Enforcement Policy, the company must have effectively remediated at the time of the resolution.

The requirement that a company pay all disgorgement, forfeiture, and/or restitution resulting from the misconduct at issue may be satisfied by a parallel resolution with a relevant regulator (e.g., the United States Securities and Exchange Commission).

M&A Due Diligence and Remediation: The Department recognizes the potential benefits of corporate mergers and acquisitions, particularly when the acquiring entity has a robust compliance program in place and implements that program as quickly as practicable at the merged or acquired entity. Accordingly, where a company undertakes a merger or acquisition, uncovers misconduct through thorough and timely due diligence or, in appropriate instances, through post-acquisition audits or compliance integration efforts, and voluntarily self-discloses the misconduct and otherwise takes action consistent with this Policy (including, among other requirements, the timely implementation of an effective compliance program at the merged or acquired entity), there will be a presumption of a declination in accordance with and subject to the other requirements of this Policy.[2]

Public Release: A declination pursuant to the FCPA Corporate Enforcement Policy is a case that would have been prosecuted or criminally resolved except for the company's voluntary disclosure, full cooperation, remediation, and payment of disgorgement, forfeiture, and/or restitution. If a case would have been declined in the absence of such circumstances, it is not a declination pursuant to this Policy. Declinations awarded under the FCPA Corporate Enforcement Policy will be made public.

1: Although the Department may, where appropriate, request that a company refrain from taking a specific action for a limited period of time for de-confliction purposes, the Department will not take any steps to affirmatively direct a company's internal investigation efforts.

2: In appropriate cases, an acquiring company that discloses misconduct may be eligible for a declination, even if aggravating circumstances existed as to the acquired entity.

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