

The background of the slide features a complex financial chart with a blue grid. It includes a yellow line graph at the top, a blue line graph below it, and a candlestick chart at the bottom. Various numerical values are scattered across the chart, such as 1.7945, 1.7900, 1.7855, 1.7810, 1.7765, 11.12, 14.56, 19.00, and 05.14. Some areas of the chart are circled in white.

Overview of United States and United Kingdom Derivative and Commodity Market Enforcement Regimes

December 2016

C L I F F O R D
C H A N C E

Preface

This Overview 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 change the U.S. Commodity Futures Trading Commission's ("CFTC") jurisdiction and 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 Overview has grown.

The current edition has been expanded to include information on the CFTC, the U.S. Federal Energy Regulatory Commission, the Federal Trade Commission, the U.S. Department of Justice ("DOJ") and the United Kingdom's Financial Conduct Authority. The Overview's discussion of issues, which were less prominent in earlier editions, such as dual criminal-regulatory investigations and private civil suits have also been updated and expanded. The Overview also now contains significant discussions of concepts such as insider trading, spoofing and whistleblowers, issues which have historically been absent from discussions of U.S. derivatives and commodity law, as well as the new expansive EU Market Abuse Regulation (effective in July 2016).

Finally, in light of the CFTC's increased activity in prosecuting market manipulation, the Overview 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.

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OVERVIEW OF UNITED STATES AND UNITED KINGDOM DERIVATIVE AND COMMODITY MARKET ENFORCEMENT REGIMES

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OVERVIEW OF UNITED STATES. AND UNITED KINGDOM 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 Commodity Futures Trading Commission ("CFTC"), and for energy products, the Federal Energy Regulatory Commission ("FERC"), and the Federal Trade Commission ("FTC"), each of which has its own jurisdictional authority, set of standards, and enforcement tools. These various regulatory provisions are backstopped by criminal provisions enforced by the DOJ.

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

Congress's expansion of the regulatory authority of these agencies signals an increased interest in detecting, deterring, and punishing manipulation of the 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 paper outlines the regulatory jurisdiction and enforcement mechanism of each agency, along with example cases 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. Reach of the CEA

1. Product Coverage

The CFTC is responsible for enforcing the Commodity Exchange Act ("CEA"). As a result, the CFTC has broad enforcement authority over "commodities," which are broadly defined under the CEA to include "all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in." 7 U.S.C. § 1a(9). In effect, a commodity is any product which is or may in the future be traded on a futures exchange. *See Commodity Futures Trading Comm'n v. American 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."). This includes financial instruments and currencies, as well as traditional commodities such as wheat, corn, and eggs. 7 U.S.C. § 1a(9). Two notable exclusions from the definition of "commodity" are onions and, since the passage of the DFA, motion picture box office receipts. 7 U.S.C. § 1a(9).

Prior to DFA the CEA's core jurisdiction was over commodity futures and options contracts traded on regulated exchanges, but it also extended to other commodities trading in interstate commerce.

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, and particularly new section 2(a)(1)(A)(I), provide some clarity regarding the jurisdictional boundaries between the CFTC and FERC. Specifically, this new section preserves FERC 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.¹ 7 U.S.C. § 2(a)(1)(A)(1) (2012).

The DFA significantly expanded the CEA's jurisdiction by, among other changes, adding swaps. The DFA does so by creating a complex

¹ 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. *Exemption for Certain Contracts Involving Energy Products*, 58 Fed. Reg. 21,268-02 (CFTC Apr. 20, 1993) (Final Order).

definition of what constitutes a "swap." Among the products that are 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 (1) 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 (1) or more payments based on the value or level of one (1) 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. 7 U.S.C. § 1a(47)(A).

The DFA specifically excludes 10 types of contracts from the definition of "swap." 7 U.S.C. § 1a(47)(B). These 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;
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 section 6(a) of the Exchange Act;
5. any agreement, contract, or transaction providing for the purchase or sale of one (1) 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 (1) 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 section 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. 7 U.S.C. § 1a(47)(C)-(F).

2. Extraterritorial Application

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., Commodity Futures Trading Comm'n v. Lake Shore Asset Mgmt. Ltd.*, 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.

In light of the Supreme Court's holding in *Morrison v. National Australia Bank*, 130 S.Ct. 2869 (2010),² it is unlikely that the conduct and effects tests will continue to be applied in cases brought under the CEA.

Courts hearing CEA claims brought by private litigants have begun to apply *Morrison*. The Second Circuit Court of Appeals endorsed the application of *Morrison*'s transaction-based test to the CEA in *Loginovskaya v. Batratchenko*, 764 F.3d 266 (2d Cir. 2014). 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." 764 F.3d 266 (2d Cir. 2014). 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." *Id.* at 273. 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." *Id.* 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. *Id.* at 275.

In another case, *In re LIBOR-Based Financial Instruments Antitrust Litigation*, the court applied *Morrison* to a claim for manipulation under the CEA. 935 F. Supp. 2d 666 (S.D.N.Y. 2013), *vacated on other grounds*, *Gelboim v. Bank of America Corp.*, 823 F.3d 759 (2d Cir. 2016). The *LIBOR* court first found that because section 9(a) of the CEA gives no indication of extraterritorial application, it has none. *Id.* at 696. After concluding that section 9(a) of the CEA 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." *Id.* (internal quotation marks omitted). 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." *Id.* at 697. The court therefore held that although the CEA does not apply extraterritorially, the manipulation alleged in this complaint fell within the CEA's reach. *Id.*

² 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. 130 S. Ct. at 2884.

Whether *Morrison* applies to actions brought by the CFTC, rather than by private plaintiffs, has yet to be determined by a court. Although the DFA specifically provides for the Securities and Exchange Commission's ("SEC") continued use of the conduct and effects tests (*see* DFA § 929P; 15 U.S.C. § 78aa), no such provision was made for the CFTC.³

Regarding swaps, CEA section 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." The CFTC has stated that it will interpret "direct" to require "a reasonably proximate causal nexus" and not to require foreseeability, substantiality, or immediacy.⁴ 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. *Id.*

Although this language has not yet been tested in a court, the CFTC has noted that, in light of the DFA amendments, the CEA is no longer "silent" with respect to its extraterritorial application. *See Loginovskaya v. Batratchenko*, No. 13-1624, CFTC Letter to Clerk of Court at 2 (2d Cir. Sept. 10, 2014). 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. *Id.*

The DOJ also has the ability to bring criminal charges for certain violations of the CEA. Moreover, 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.

Practice Note: As discussed in more detail below at page 163, U.S. laws have significantly broader extraterritorial applications than the relevant English laws, which apply only to instruments trading on an EU market.

3. CEA Enforcement Methods

As discussed in Section II.F below, alleged violations of the CEA can be enforced by the CFTC, the DOJ, and/or by private plaintiffs. However, in

³ 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 section 929P. *See Sec. Exch. Comm'n v. A Chicago Convention Center, LLC*, 961 F. Supp.2d 905 (N.D. Ill. 2013).

⁴ Codified at 7 U.S.C. § 2(i)(1).

practice, most violations will be pursued by more than one of these entities.

First, the CFTC is empowered to impose a civil penalty for any violation of the CEA. For manipulation or attempted manipulation of commodities or derivatives market the CEA may seek a fine in an amount of \$1 million or triple the monetary gain to the defendant, whichever is greater, "for each such violation." 7 U.S.C. § 9(10). 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 \$140,000 or triple the monetary gain to the person, whichever is greater, for each violation. 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 undertakings as part of a settlement.

Willful violations of the CEA or CFTC rules or regulations promulgated under the CEA are also criminally punishable by a fine of not more than \$1 million or imprisonment for not more than 10 years. 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.

Finally, the CEA includes a private right of action against most individuals or entities 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, although strict privity of contract is not required. A large number of civil suits are currently pending, which stem from the benchmark rate investigations that the CFTC and DOJ conducted.

B. Principal CEA Violations

1. Introduction

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

- In fiscal year 2015, the CFTC filed 69 enforcement actions, bringing the total over the last five (5) 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. CFTC Releases Annual Enforcement Results for Fiscal Year 2015 (Nov. 6, 2015).
- 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. CFTC Releases Annual Enforcement Results for Fiscal Year 2014 (Nov. 6, 2014).
- 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. CFTC Releases Enforcement Division's Annual Results (Oct. 24, 2013).
- In fiscal year 2012, the CFTC filed 102 enforcement actions, an all-time high, and opened over 350 new investigations. The CFTC obtained orders imposing over \$416 million in civil monetary penalties and directed the payment of more than \$169 million in restitution and disgorgement. CFTC Releases Enforcement Division's Annual Results (Oct. 5, 2012).
- In fiscal year 2011, the CFTC filed 99 enforcement actions and opened over 450 new investigations. The CFTC obtained orders imposing over \$290 million in civil monetary penalties and directed the payment of more than \$160 million in restitution and disgorgement. CFTC Releases Annual Enforcement Results (Oct. 6, 2011).

Many of the CFTC's recent investigations have made headlines, including its investigations into the collapse of futures brokerage firms MF Global and Peregrine Financial Group, the multi-billion dollar trading losses at JPMorgan Chase in connection with the "London Whale," and the manipulation of benchmark interest rates such as the British Bankers' Association's London Interbank Offered Rate ("LIBOR").

Recent investigations have also been notable for their increased cooperation with law enforcement. In 2014, approximately 95% of the CFTC's major fraud and manipulation cases involved 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.

The CFTC has also pursued new, 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 from a legal and a policy point of view by the futures industry. It has also been rejected by at least one court.

In its budget request for fiscal year 2017, the CFTC identified the following enforcement goals and expectations:

- Shutting down fraudulent schemes and seeking to immediately preserve customer assets;
- Uncovering and stopping manipulative and disruptive trading;
- Ensuring that markets, firms and participants subject to the Commission's oversight meet their obligations, including their financial integrity and reporting obligations, as applicable;
- Banning defendants from trading and being registered in its markets; and
- Obtaining orders requiring defendants to pay restitution, disgorgement and civil monetary penalties.

The CFTC also requested an increase of approximately 20% in its budget for international support activities due to the need for robust and consistent standards in and across jurisdictions. The CFTC stated that it will work with international authorities to develop practical solutions to conflicting application of rules, identify inconsistent or duplicative

requirements and attempt to reduce the regulatory burdens associated with such requirements, while also identifying gaps that could lead to regulatory arbitrage. *See CFTC President's Budget for Fiscal Year 2017.*

2. Manipulation Violations

(a) Manipulation and Attempted Manipulation (Traditional)

The prohibition against price manipulation, Section 6(c)(3) of the CEA (7 U.S.C. §§ 9(1), 13(a)(2)), has existed since the CEA's 1936 enactment. However, although the CEA has prohibited "manipulat[ing] or attempt[ing] to manipulate the price of any commodity in interstate commerce"⁵ for more than 80 years, it does not define price manipulation.⁶ Nor has the CFTC ever provided any rule or interpretative guidance defining price manipulation. Instead, consistent with an early court decision on the issue, the CFTC has recognized that the means of price manipulation "are limited only by the ingenuity of man,"⁷ and has generally used "case-by-case judicial development" to determine whether trading is manipulative. This approach continues to be followed even after the adoption of Rule 180.2, which codifies the CFTC's prohibition against price manipulation.

As a result, the elements of manipulation have been defined through CFTC and judicial precedent. 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. . . . [T]here must be a purpose to create prices not responsive to the force of supply and demand." *Volkart Bros., Inc. v. Freeman*, 311 F.2d 52, 58 (5th Cir. 1962) (internal quotation marks omitted).

The leading case defining the elements of manipulation is *Indiana Farm Bureau*. In that case, over the course of a 39-page opinion, the Commission considered a variety of policy and economic issues with a particular emphasis on the purposes and operations of the market it regulates. The CFTC defined the elements of manipulation: as (1) that the defendant possessed an ability to influence market prices; (2) that the defendant specifically

⁵ 7 U.S.C. §§ 9(1), 13(a)(2).

⁶ *See In re Ind. Farm Bureau Coop. Ass'n, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) P 21, 796, 1982 WL 30249, at *3 (CFTC Dec. 17, 1982) (explaining that "[n]either manipulation nor attempted manipulation is defined in the Commodity Exchange Act").

⁷ *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971).

intended to do so; (3) that an artificial price existed; and (4) that the defendant caused the artificial price.⁸

That decision placed significant emphasis on the intent element of the test, concluding that the "specific intent to create an 'artificial' or 'distorted' price is a *sine qua non* of price manipulation."⁹ In particular, the Commission 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."¹⁰ In coming to this decision, the Commission 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."¹¹

An attempted manipulation is "simply a manipulation that has not succeeded, that is, the conduct engaged in has failed to create an artificial price." *Commodity Futures Trading Comm'n v. Enron Corp.*, 2004 WL 594752, at *7 (S.D. Tex. Mar. 4, 2004) (internal quotation marks omitted). To state a claim for attempted manipulation under the CEA, courts require a showing of (1) an intent to affect the market price of a commodity and (2) some overt act in furtherance of that intent. *See Commodity Futures Trading Comm'n v. Bradley*, 408 F. Supp. 2d 1214, 1220 (N.D. Okla. 2005) (citing *In re Hohenberg Bros. Co.*, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271 at ¶ 21,477 (CFTC Feb. 18, 1977)).

The means by which either an attempted or a completed manipulation might be accomplished may be of any sort. 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." 452 F.2d 1154, 1163 (8th Cir. 1971).

⁸ *Id.* at *4.

⁹ *Id.* at *6.

¹⁰ *Id.*

¹¹ *Id.*

"Artificial" price is not a statutory term, and the relevant legal authorities only vaguely define what constitutes an "artificial" price. Courts typically define an "artificial price" simply as a price "clearly outside the 'legitimate' forces of supply and demand." *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*, 1987 CFTC LEXIS 325, at *25 (July 15, 1987) ("An artificial price is one that does not reflect the market or economic forces of supply and demand"). 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, maintaining that its enforcement efforts were hampered by the need to establish intent and artificiality, neither of which is required under SEC's principal anti-fraud statute, Exchange Act section 10(b).¹² As a result, in recent enforcement actions alleging that traders have committed price manipulation and attempted price manipulation, the CFTC, through its Division of Enforcement, is claiming that it does not need to prove that a trader who was engaging in otherwise lawful open market transactions intended to cause an "artificial price," but rather must only prove an intent to "influence price."¹³

In one of these cases, the district court accepted an *amicus curiae* brief filed by five key participants in the futures market, including futures exchanges, clearinghouses, and trade associations, expressing 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." That is precisely the concern that led the CFTC in *Indiana Farm Bureau* to require a showing of specific intent to create artificial prices. There, the CFTC recognized that a lesser standard could "wreak havoc with the market place" by blurring the line between lawful and unlawful activity, leaving traders without adequate guidance on what constitutes manipulation. The *amici* share those concerns. Because the CFTC now seeks to punish *all* attempted price influences, even ones that would result in more accurate prices, the *amici* feared that traders

¹² See, e.g., Bart Chilton, Comm'r, U.S. Commodity Futures Trading Comm'n, *Speech before the Institutional Investors Carbon Forum: Moment of Inertia* (Sept. 15, 2009), available at www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-26.

¹³ Pl. Response in Opp. to Defs. Mot. For Summary Judgment, at 29, *Commodity Futures Trading Comm'n v. Donald R. Wilson*, No. 13-cv-7884 (S.D.N.Y. Sept. 30, 2016), ECF No. 119 (citing *U.S. Commodity Futures Trading Comm'n v. Wilson*, 27 F. Supp. 3d 517, 531-32 (S.D.N.Y. 2014)); Pl. Response in Opp. to Defs. Mot. To Dismiss, at 21, *U.S. Commodity Futures Trading Comm'n v. Kraft Foods Grp., Inc.*, No. 15 C 2881 (N.D. Ill. July 13, 2015), ECF No. 64 (citing *U.S. Commodity Futures Trading Comm'n v. Parnon Energy*, 875 F. Supp. 2d 233, 244 (S.D.N.Y. 2012)).

may “abstain from legitimate trading to avoid the risk of being branded an attempted manipulator.”

In that case, the court agreed with the defendant and the *amici*, holding that the "CFTC's interpretation is incorrect," and that the CFTC must prove that there is an intent to cause artificial prices.¹⁴ However, this ruling does not affect proceedings that may be brought under the CFTC's new Rule 180.1 (fraudulent manipulation) authority added pursuant to certain Dodd-Frank Act related statutory amendments, and discussed below. As discussed further below, the CFTC has also begun using this authority to bring enforcement actions based on new, more aggressive theories of price manipulation.

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

The Commission 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 by conducting a squeeze. According to CFTC enforcement staff, Indiana Farm Bureau conducted a squeeze in corn prices by standing for delivery on corn futures contracts that the enforcement staff claimed amounted to four times the amount of available deliverable supplies. Over the course of a 39-page opinion, the Commission 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." In particular, the Commission 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 Commission 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."

¹⁴ Memorandum and Order, *Commodity Futures Trading Comm'n v. Donald R. Wilson*, No. 13-cv-7884 (S.D.N.Y. Sept. 30, 2016), ECF No. 139 at 26.

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

The DFA significantly expanded the scope of the CFTC's jurisdiction under CEA section 6(c) (which historically has been interpreted as prohibiting the intentional creation of artificial prices) to cover (1) "fraud-based" manipulation, including (a) reckless manipulation and (b) insider trading, and (2) manipulation by false reports. New section 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. 7 U.S.C. § 9(1).

The DFA also expanded the CEA section that criminalized manipulation to apply to swaps. That section prohibits "[a]ny person [from] manipul[at]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."¹⁵

The CFTC finalized its new rules for manipulation, Rules 180.1 and 180.2, in July 2011 (effective August 15, 2011). 76 Fed. Reg. 41398, 41411 (July 14, 2011). Rule 180.1 broadly prohibits "intentionally or recklessly" using or attempting to use any manipulative device, scheme or artifice to defraud. Thus, the CFTC may charge manipulation under Rule 180.1's "reckless" scienter standard rather than charging a traditional manipulation, which requires proof of specific intent.

The CFTC has noted that 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." 76 Fed. Reg. 41398, 41399 (July 14, 2011). As a result, the CFTC has said that it "deems it appropriate and in the public interest to model final Rule 180.1 on SEC Rule 10b-5," and that **"the Commission will be guided, but not controlled, by the substantial body of judicial precedent applying the comparable language of SEC Rule 10b-5."** *Id.* (emphasis added).

¹⁵ 7 U.S.C.A. § 13.

Rule 180.1 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.

The CFTC has also 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.¹⁶ 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). According to the CFTC, it did not have to meet the heightened pleading standard because its self-described prohibition on "fraud and fraud-based manipulation"¹⁷ 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."¹⁸

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

The CFTC used Rule 180.1 to penalize reckless manipulation for the first time in relation to the JPMorgan "London Whale" matter. In *In re JPMorgan Chase Bank, N.A.*, 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.

¹⁶ Codified at 7 U.S.C. § 9(1).

¹⁷ *Id.* at 41,400 (emphasis added).

¹⁸ Complaint, *Commodity Futures Trading Comm'n v. Kraft Foods Grp., Inc.*, No. 15 C 2881 (N.D. Ill. filed on July 13, 2015).

As to scienter, the CFTC found it "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 therefore found that the traders acted "with reckless disregard to obvious dangers to legitimate market forces from their trading." Thus, the CFTC 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). The settlement order represented an expansive reading of 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). It is worth noting that CFTC used its first application of Rule 180.1 to so readily 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, as press reports later revealed, 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 violation of Rule 180.1, on CFTC's broad reading).¹⁹ CFTC's approach in penalizing JPMorgan for defending itself against such predatory trading seems to stand in stark contrast to SEC's recognition that, in some circumstances, defense of price is a legitimate goal.

The London Whale settlement also helped to emphasize 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 otherwise likely would 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.²⁰ The SEC acknowledges that stabilizing "is price-influencing activity

¹⁹ See, e.g., Azam Ahmed, *The Hunch, the Pounce and the Kill*, N.Y. TIMES, May 26, 2012, at B1.

²⁰ 17 C.F.R. § 242.104.

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 SEC deems sufficiently worthy to merit some exception to liability for trading that is intended to impact price.²¹ 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.

Other indications of how the CFTC could apply Rule 180.1 may be found in two July 2013 decisions by the Federal Energy Regulatory Commission (“FERC”). In 2005, Congress gave FERC fraud-based anti-manipulation authority similar to SEC Rule 10b-5. *See* Federal Power Act § 222, 16 U.S.C. § 824v.

In *In re Barclays Bank PLC et al.*, FERC found that Barclays had engaged in electricity market manipulation prohibited by FERC’s Rule 1c, which, like CFTC Rule 180.1, is patterned on SEC Rule 10b-5. Barclays argued that its conduct could not be manipulative because it consisted of legitimate open-market transactions. 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. FERC held instead 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. *In re Barclays Bank PLC, et al.*, No. IN08-8-000, 144 FERC ¶ 61,041 (July 16, 2013).

In another FERC enforcement action, a JPMorgan-affiliated energy trading company was found to have committed fraud-based market manipulation by utilizing various strategies to game the market, particularly by entering money-losing bids (which FERC found to be without economic substance or rationale) for the purpose of obtaining above-market payments on other transactions. FERC relied on securities-law precedent to conclude that conduct, as opposed to false written or oral statements, is sufficient to establish

²¹ *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).

fraud under its rule. Fines and disgorgement paid to resolve the matter totaled \$410 million. *In re Make-Whole Payments and Related Bidding Strategies*, 144 FERC ¶ 61,068 (July 30, 2013).

(c) False Reporting-Based Manipulation

False reporting has long been recognized as a means of accomplishing a manipulation. *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."). However, the DFA also created a new provision for "manipulation by false reporting," which treats as a manipulation a false report made while "knowing or acting in reckless disregard" of the fact that the report is false. 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.²²

This provision has been implemented through the CFTC's new manipulation rule, Rule 180.1. The final rule provides an exception if one "mistakenly transmits, in good faith, false or misleading information to a price reporting service." Rule 180.1(a)(4).

Prior to the DFA, false reporting was a criminal, non-manipulation offense under the CEA. 7 U.S.C. § 13(a)(2). The elements for a claim of false reporting under the CEA 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." *Commodity Futures Trading Comm'n v. Atha*, 420 F. Supp. 2d 1373, 1380 (N.D. Ga. 2006) (citing *United States v. Valencia*, 394

²² Codified at 7 U.S.C. § 9(1)(A).

F.3d 352, 356 (5th Cir. 2004), *cert denied*, 544 U.S. 1034 (2005)); 7 U.S.C. § 13(a)(2).

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." *Valencia*, 394 F.3d at 357; 7 U.S.C. § 9(a)(2).

Although the text of this new provision does not vary greatly from this preexisting false-reporting provision, false reporting is now classified as manipulation, and the CFTC may therefore seek the higher penalties associated with manipulation violations. 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.

Because false reporting is now classified as manipulation, there is now also a broader private right of action for false reporting. *See infra* Part II.E.3.

Example Case: *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. The CFTC alleged that Atha and others submitted 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 included fabricated price and volume information for natural gas transactions entered into for delivery at a specific location or hub. Atha agreed to a settlement based on charges of attempted manipulation, false reporting, and aiding and abetting (neither admitted nor denied), pursuant to which it paid a civil monetary penalty of \$200,000 and was barred from trading on commodity markets. *See also Commodity Futures Trading Comm'n 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*).

(d) New CFTC Rule for Traditional Manipulation

The CFTC's new Rule 180.2 mirrors the text of the CFTC's traditional manipulation provision (as now stated in new CEA section 6(c)(3)) by providing that "[i]t shall be unlawful for any

person, directly or 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." 17 C.F.R. § 180.2.

In its adopting release, the CFTC stated that in applying Rule 180.2 it will be guided by the traditional four-part test for manipulation developed in cases arising under CEA sections 6(c) and 9(a)(2).²³

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.²⁴ 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, in practice is being condensed into a three-part test turning principally on the defendant's state of mind.

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

The principal CFTC allegation, which Kraft moved to dismiss, 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. 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. The complaint further alleges that Kraft never intended – and did not actually – load out and use the majority of this futures market wheat. Instead, according to the CFTC, Kraft intended for other market participants to react to the enormous size of the futures position, resulting in reduced cash market prices and allowing Kraft to purchase its favored cash market wheat at lower prices while at the same time profiting from certain pre-existing wheat futures spread positions.

²³ Codified at 7 U.S.C. § 9(1)(A) and 7 U.S.C. § 13(a)(2).

²⁴ Because of this difficulty, although the CFTC has settled a number of cases, it did not have a successful prosecution for market manipulation until 2009. Bart Chilton, Comm'r, CFTC, Speech before the Institutional Investors Carbon Forum: Moment of Inertia (Sept. 15, 2009), *available at* www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-26.

The court in applying the four-part test at the motion to dismiss stage focused on the following allegations: (i) that 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;²⁵ (ii) that "[b]ecause Kraft's actions were not taken due to a legitimate demand," but rather to influence price, "the prices created by those actions were artificial;"²⁶ (iii) that 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;²⁷ and (iv) that internal strategy e-mails and Kraft's uneconomic market behavior show that Kraft intended to influence price.²⁸ As a result, Judge Blakely's decision either explicitly or implicitly looked at Kraft's intent as key in determining whether the CFTC had met its pleading burden for each element.

Accordingly, the 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 any price that results is *ipso facto* an artificial price.²⁹ Thus, the need to prove by extrinsic economic analysis, and 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 plead that Kraft intended to affect price and did affect price, it adequately plead a violation of Rule 180.2.

(e) Overlap between Antitrust Violations and Market Manipulation

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 US antitrust laws. For example, one court 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

²⁵ *Commodity Futures Trading Comm'n v. Kraft Foods Grp., Inc.*, 2015 WL 9259885, at *16 (N.D. Ill. Dec. 18, 2015).

²⁶ *Id.* at *19.

²⁷ *Id.* at *19.

²⁸ *Id.* at *17.

²⁹ *Id.* at *19.

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."³⁰ In other words, a corner – one of the most common forms of commodity market manipulation – is an attempt to take advantage of a short-term monopoly.

As a result, many of the CFTC's recent settlements for market manipulation included parallel investigations by DOJ prosecutors, including the DOJ Antitrust Division. As these settlements highlight, conduct that can be prosecuted as market manipulation by the CFTC often also constitutes conduct that can be prosecuted as an antitrust violation by the DOJ.

This close relationship between commodity market manipulation and antitrust violations has existed since before commodity market manipulation was made illegal. In fact, one of the first prosecution for commodity market manipulation was an antitrust case brought against trader James A. Sherman for violating the Sherman Act through his cornering of the cotton market in 1909. Similarly, the Federal Trade Commission concluded in a 1923 report on the grain trade that applying the Sherman Act to acts of manipulation such as corners would be appropriate, but that common law liability was more appropriate because proof of conspiracy is not required to show a violation.

Nonetheless, antitrust law continues to have a major impact on CEA market manipulation jurisprudence. For example, the definitions of terms such as "corner" are derived primarily from antitrust litigation.³¹ Additionally, the CFTC has authority pursuant to CEA § 6c 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."³² Language that echoes the prohibition on restraint of trade that lies at the heart of the antitrust laws.

Example Case: *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 investigation into LIBOR and EURIBOR manipulation, Deutsche Bank was charged

³⁰ *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1162 (8th Cir. 1971).

³¹ *See Peto v. Howell*, 101 F.2d 353, 357 (7th Cir. 1938) (antitrust case defining corners in the commodities market).

³² Codified at 7 U.S.C. § 9(1)(A).

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 from at least June 2005 through October 2008, in a scheme by Deutsche Bank traders to coordinate their EURIBOR requests with traders at other banks to benefit their trading positions.

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

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."

The complaint alleged that as a result of this behavior there was 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 refusing to deal with the entity or by taking control of the risk committees to create barriers to entry in the market. The complaint alleged further that the defendant banks also colluded to drive business to ICE Clear, which it claims was

created by the defendant banks and ICE for the purpose of furthering their market domination.

3. Disruptive Trading Practices on Exchanges

The DFA added section 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:

- (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).³³

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) CME, CBOT, NYMEX, and COMEX Rules

In August 2014, the CME, CBOT, NYMEX and COMEX adopted new 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:

- (4) Orders entered with the intent, at the time of entry, of cancelling the order.
- (5) 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.
- (6) 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

³³ Codified at 7 U.S.C. § 6c(a)(5).

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 Section 4c(a)(5)

The CFTC published an Interpretive Statement regarding disruptive trading practices in May 2013. *See* 78 Fed. Reg. 31890 (May 28, 2013). 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. (CEA Section 4c(a)(5)(A); (7 U.S.C. § 6c(a)(5)). *See* 78 Fed. Reg. 31890 (May 28, 2013).

The CFTC interprets section 4c(a)(5)(A) as a *per se* offense. Therefore, the CFTC 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 section 4c(a)(5)(A).

The CFTC has stated that section 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 CEA section 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 Commission 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.

- (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 take into account 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 section 4c(a)(5)(B); rather, a market participant must at least act recklessly. The CFTC has declined to interpret section 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." (CEA section 4c(a)(5)(B); 7 U.S.C. § 6c(a)(5)(B)). *See* 78 Fed. Reg. 31890 (May 28, 2013).

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 section 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 section 4c(a)(5)(B) if a closing period or daily settlement price exists for the particular swap.

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 section 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.

4. Intentional Spoofing

The CEA's anti-spoofing provision, (CEA Section 4c(a)(5)(C); 7 U.S.C. § 6c(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).³⁴ 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 \$140,000 per violation, or triple the gain.³⁵ The CFTC may also seek a range of other penalties, including a temporary or permanent trading ban.³⁶ 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 \$1,000,000 violation, or triple the gain.³⁷ Both spoofing and price manipulation are also criminal violations.³⁸ The first criminal conviction for spoofing futures markets occurred in Chicago in late 2015.³⁹

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.⁴⁰

³⁴ CEA § 4c(a)(5)(C). Codified at U.S.C. §§ 6c(a)(5)(C). 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). *Id.*

³⁵ CEA § 6c.

³⁶ *Id.*

³⁷ *Id.*

³⁸ CEA § 9(a).

³⁹ *See Spoofing: The First Criminal Conviction Comes in the U.S., Futures and Derivatives Law Report*, Vol. 36, Issue 1 (January 2016).

⁴⁰ *Id.*

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 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;⁴¹
- the CFTC 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;⁴²
- the CFTC 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.⁴³

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.⁴⁴ Thus, 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

⁴¹ 78 Fed. Reg. 31890, 31896 (May 28, 2013).

⁴² 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.*

⁴³ *Id.*

⁴⁴ 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 (DC 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).

felonies prosecutable by the DOJ.⁴⁵ There, the DOJ, which is required to prove its cases beyond a reasonable doubt unlike the CFTC's mere preponderance of evidence standard, 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.⁴⁶

Nevertheless, the CFTC guidance suggests that the CFTC will prioritize cases where specific intent is present, as reflected by trading that appears to be motivated by a desire to mislead, as 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*").⁴⁷ 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 section 4c(a)(5)(C) violation does not require a pattern of activity; rather, a single instance of trading activity can violate section 4c(a)(5)(C),⁴⁸ 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)," though the agency has explained that a pattern of trading is not a necessary element of spoofing.⁴⁹ 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

⁴⁵ 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).

⁴⁶ 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 (SEC April 4, 2014); *Briargate Trading, LLC, et al.*, Securities Act Release No. 9959 (SEC Oct. 8, 2015).

⁴⁷ 78 Fed. Reg. 31890, 31896 (May 28, 2013).

⁴⁸ Codified at 7 U.S.C. §§ 6c(a)(5)(C).

⁴⁹ 78 Fed. Reg. 31890, 31896 (May 28, 2013).

market interest;⁵⁰ (b) high volumes of cancelled trades (both in absolute terms and relative to other market participants)⁵¹ and (c) impact on price.⁵²

In August 2016, an Illinois federal court denied a constitutional challenge brought against the CEA anti-spoofing provision.⁵³ Defendants Igor Oystacher and 3Red Trading, LLC 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.⁵⁴ 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 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.

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 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.

⁵⁰ Order, *Panther Energy Trading LLC*, CFTC No. 13-26, 2013 WL 3817473, at *2-3 (July 22, 2013).

⁵¹ Complaint ¶ 48, *Commodity Futures Trading Comm'n v. Nav Sarao Futures Limited plc and Navinder Singh Sarao*, 1:15-cv-03398 (N.D. Ill.) ("Sarao Civil Complaint").

⁵² Complaint ¶¶ 17-19, 29, 32, *Commodity Futures Trading Comm'n v. Khara, et al.*, No. 15-cv-3497, 2015 WL 2066257 (S.D.N.Y. May 5, 2015).

⁵³ 7 U.S.C. § 1 *et seq.*

⁵⁴ *Commodity Futures Trading Comm'n v. Igor B. Oystacher, et al.*, 15-cv-9196 (N.D. Ill. Aug. 23, 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.

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 and the CEA. 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.*, 2016 WL 1271063 (S.D.N.Y. March 29, 2016). 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. *In re North Sea Brent Crude Oil Futures Litigation*, 2016 WL 1271063 (S.D.N.Y. March 29, 2016). The rest of the case is still pending.

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 did not admit or deny, 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 (August 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. 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 did not admit or deny, agreeing to pay a \$90,000 fine and serve a two week suspension.

Example Case: *In re Fredrik Nielsen*, CME 14-9869-BC (August 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. 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 did not admit or deny, agreeing to pay a \$65,000 fine and serve a three week suspension.

Example Case: *In re Geneva Trading USA, LLC*, COMEX 13-9490-BC-1 (October 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 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 did not admit or deny, agreeing to disgorge profits in the amount of \$12,683.

5. 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

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.

7 U.S.C. § 6c(a) (2012)

(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 negate each other so that there is no change in financial position." *Reddy v. Commodity Futures Trading Comm'n*, 191 F.3d 109, 115 (2d Cir. 1999); *see also Wilson v. Commodity Futures Trading Comm'n*, 322 F.3d 555, 559 (8th Cir. 2003) (Wash sales are "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.").

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. *Wilson*, 322 F.3d at 559 (citing *In re Gilchrist*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,993 at 37,653 (CFTC Jan. 25, 1991))

The CFTC must also prove intent. *Reddy*, 191 F.3d at 115; *Commodity Futures Trading Comm'n 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)).

The CFTC must also have provided advance notice to the market that it views a specific practice as constituting a wash sale. *Stoller v. Commodity Futures Trading Comm'n*, 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.").⁵⁵

The DFA amended section 4c(a) of the CEA⁵⁶ to apply specifically to swaps.

Example Case: *Wilson v. 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

⁵⁵ "Roll forward" trading occurs when the holder of a long position in a commodity seeks to sell that position and then repurchase an identical quantity of the same commodity in order to secure a later delivery date. *Id.* at 263.

⁵⁶ Codified at 7 U.S.C. § 6c.

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 Commission concluded that Wilson knowingly participated in wash sales because the evidence sufficiently demonstrated that Wilson knew that the orders underlying the transactions were designed to negate risk.

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

JSC VTB Bank and its UK subsidiary settled claims that it had engaged in noncompetitive block trades. The CFTC alleged that JSC VTB Bank ("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 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 (which was neither admitted nor denied) the VTB entities agreed to pay a \$5 million penalty, conduct staff training, and strengthen policies and procedures to deter non-competitive trading. 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.'" *Sundheimer v. Commodity Futures Trading Comm'n*, 688 F.2d 150, 152 (2d Cir. 1982) (citation omitted).

Example Case: *Sundheimer v. 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.

(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." *Transnor (Bermuda) Ltd. v. BP North America Petroleum*, 738 F. Supp. 1472, 1495 (S.D.N.Y. 1990) (citation omitted).

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

The CFTC found, by consent, that the respondents had engaged in fictitious sales by executing non-competitive transactions in NYMEX crude-oil futures. The traders prearranged trades by agreeing on the quantity and agreeing to take opposite positions, although they did not prearrange price. The traders then placed the trades with a NYMEX floor brokerage company, which executed the trades. The CFTC found that 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 agreeing to take

the opposite positions in the trades, established that the resulting trades were prearranged, and thus fictitious sales.

(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 section 4c(a)(B)⁵⁷ 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 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. *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* Part II.E.

(b) Block Trade Exceptions⁵⁸

(1) 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 on electronic or open outcry markets.

(i) Each relevant market's rules identify the types of contracts and minimum quantity requirements for a block trade

⁵⁷ Codified at 7 U.S.C. § 6c(a)(B).

⁵⁸ CME Rule 526; ICE Rule 407

- (ii) Each party to a block trade qualify as an "eligible contract participant" as defined in Section 1a (18) of the CEA
 - (2) Block trades must be executed at prices that are fair and reasonable in light of their size and various market factors.
 - (i) As a rule, block trades may be executed at any time, and may be used for "trades at settlement"
 - (3) Block trades require compliance with certain recordkeeping, audit track and timely reporting requirements set forth by market rules
 - (4) Wash Sales: a block trade under market rules, executed between affiliated accounts, will not be a prohibited wash sale, under market rules, if each party has a separate bona fide purpose for trading and each party decision to trade is made by 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. 7 U.S.C. § 6a (2012).

The DFA also amended the CEA to include swaps. 7 U.S.C. § 6a (2012). Section 4a(b) of the CEA 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.⁵⁹

⁵⁹ Codified at 7 U.S.C. § 6a.

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. *See ISDA Ass'n v. CFTC*, 887 F. Supp. 2d 259 (D.D.C. 2012). The CFTC is appealing that decision.

Example Case: *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, exceeded 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. Then, 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.

6. 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:

- (i) 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
- (ii) 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.

7 U.S.C. § 6b (2012).

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. *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).

(b) Insider Trading

Unlike the securities laws, which 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"),⁶⁰ historically the CEA viewed the

⁶⁰ See *Chiarella v. United States*, 445 U.S. 222 (1980) (articulating "classical theory" of insider trading); *United States v. O'Hagen*, 521 U.S. 642 (1997) (adopting "misappropriation theory" of insider trading).

“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.⁶¹ As recently as 2009, the CFTC asserted that it “has no jurisdiction over insider trading in any way.”

This changed with the passage of Dodd-Frank, 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.” 76 Fed. Reg. 41398, 41403. 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 or deception.”⁶² With this language, the CFTC has embraced the “misappropriation” theory of insider trading.

In 2015, the CFTC brought and settled its first insider trading case.⁶³ According to the settlement, Arya Motazed, 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.”⁶⁴ Motazed used 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.

⁶¹ 7 U.S.C. §§ 6c(a)(4), 13(c)-(e) (prohibiting disclosure of, or trading on basis upon, 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).

⁶² *Final Rule: Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation*, 76 Fed. Reg. 41,398, 41,403 (July 14, 2011) (codified at 17 C.F.R. pt. 180).

⁶³ *In re Arya Motazed*, CFTC Docket No. 16-02 (Dec. 2, 2015).

⁶⁴ Order at 3, *In re Arya Motazed*, CFTC Docket No. 16-02 (Dec. 2, 2015) (“Motazed Order”).

The CFTC's order in *Motazedi* unmistakably adopted the language of *securities* insider trading law, rather than charting some 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 Commission 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 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.⁶⁵ When proposing Rule 180.1, the CFTC suggested it would apply the objective definition of “materiality” utilized in the securities context.⁶⁶ 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.⁶⁷ 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 also interesting in that the Commission *chose* to brandish its new authority here, 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 trading charges, the CFTC put

⁶⁵ *Carpenters Pension Trust 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)).

⁶⁶ *Proposed Rulemaking: Prohibition of Market Manipulation*, 75 Fed. Reg. 67,657, 67,660 (Nov. 3, 2010) (to be codified at 17 C.F.R. pt. 180).

⁶⁷ See *Motazedi Order*, *supra* note 31, at 2.

traders on notice of its expanded authority, and its willingness to use it.

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.⁶⁸

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

The CFTC filed a complaint against CME/NYMEX and two former NYMEX employees, alleging that the employees disclosed to a commodities broker material non-public information regarding orders made on the CME ClearPoint Facilitation Desk. The CFTC is seeking civil monetary penalties, trading and registration bans, and a permanent injunction. The case is currently pending.

Practice Note: As discussed in more detail below at pages 143-145, the FCA takes a broader view of who is prohibited from trading on the basis of insider information. In particular, under UK law, an individual is prohibited on trading on the basis of inside information, regardless of how they acquired the knowledge.

(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.

Provided, however, that 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: (i) the party 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) The party 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.

⁶⁸ Aruna Viswanatha et al., *Questions About Leak at Federal Reserve Escalate to Insider-Trading Probe*, WALL STREET JOURNAL, Oct. 2015, available at <http://www.wsj.com/articles/questions-about-leak-at-federal-reserve-escalate-to-insider-trading-probe-1443650303>.

However, 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 sections 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) of the CEA also prohibits any person who acquires such information from a Commissioner or CFTC employee from using the information in a commodity transaction. 7 U.S.C. § 13(d).

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) of the CEA 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 section 9(e)(1). 7 U.S.C. § 13(e).

The DFA adds new section 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. 7 U.S.C. § 6c(a)(4)(C) (2012).

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

- (i) The CEA's new section 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." 7 U.S.C. § 9(1).

- (ii) CEA section 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." 7 U.S.C. § 9(1). 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. 17 C.F.R. § 180.1 (2013).

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

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

The CFTC found, by consent, that Coppola committed fraud 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 during the time period 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. Jon Ruggles would, while trading for his wife's accounts, 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. Jon Ruggles 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.

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 allegedly 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.

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. 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 did not admit or deny, agreeing to pay a fine of \$100,000, disgorge profits of \$236,530, and serve a three year suspension from CME Group.

(f) 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. 7 U.S.C. § 6s(h)(1) (2012).

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." 75 Fed. Reg. 80638, 80658 (Dec. 22, 2010). 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 Sections 4b, 4s(h)(4)(A), and 6(c)(1) of the CEA and Regulations §§ 23.410 and 180.1. 77 Fed. Reg. 9734, 9736 n.21 (Feb. 17, 2012).

(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.⁶⁹

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

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].⁷⁰

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." *Commodity Futures Trading Comm'n v. Amaranth Advisors, LLC*, 554 F. Supp. 2d 523, 535 (S.D.N.Y. 2008).

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

⁶⁹ Codified at 7 U.S.C. § 13(a)(2).

⁷⁰ Codified at 7 U.S.C. § 13(a)(4).

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. CEA section 6(c)(2) 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. 7 U.S.C. § 9(c)(2).

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

Butterfield worked for an introducing broker ("IB"), performing clerical and administrative tasks, including stamping order tickets. The CFTC took Butterfield's testimony in connection with an inquiry into the IB's procedures for documenting customer orders. In sworn testimony, Butterfield claimed 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. The CFTC found that she had made statements in violation of the CEA because they were false and/or misleading, Butterfield knew this, and the statements were material because they went to the heart of the CFTC's investigation.

(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." *Reddy v.*

Commodity Futures Trading Comm'n, 191 F.3d 109, 115 (2d. Cir 1999).

The DFA amended section 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

...

(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. 7 U.S.C. § 6b(a)

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 6 sales made to Bergamo at a price of 11.78, as well as 46 contracts to his own account at 11.80 and 11.81. The administrative law judge found that Reddy's purchase of the 46 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." *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.").

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

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

. . .

(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.

7 U.S.C. § 6b(a).

In addition, the CFTC has a regulation for Futures Commission Merchants (FCM) regarding cross trading. 17 C.F.R. § 155.3 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.

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

By consent, the CFTC found that Lui had crossed customer orders in violation of section 4c of the CEA. Lui controlled and traded 27 customer accounts. In November and December 2005, Lui traded at least 15 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, 11 of the 15 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 section 4c of the CEA.⁷¹

(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:

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

⁷¹ Codified at 7 U.S.C. § 6c.

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 section 4s(h), which provides the CFTC with authority to impose business conduct requirements on swap dealers and major swap participants. 7 U.S.C. § 6s(h). 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:

- (i) Disclose to any other person any material confidential information provided by or on behalf of a counterparty to the swap dealer or MSP; or
 - (ii) 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. 77 Fed. Reg. 9734, 9823 (Feb. 17, 2012).
- (k) Reckless Disregard for a Counterparty's Fraudulent Use of a Swap

The DFA created a new provision, CEA section 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. 7 U.S.C. § 6c(a)(7) (2012).

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

The CFTC has provided little guidance on new CEA section 4c(a)(7),⁷² 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 section 4c(a)(7)." 77 Fed. Reg. 9734, 9746 (Feb. 17, 2012). 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:

- (i) Maintaining policies, procedures, and systems that are designed to identify elevated risk CSFTs and subject them to a heightened due diligence and approval processes;

⁷² Codified at 7 U.S.C. § 6c(a)(7).

- (ii) Focusing particularly on transactions that appear to lack economic substance, or that can be used for questionable accounting, regulatory or tax objectives;
- (iii) Conducting thorough due diligence in connection with CSFTs and requiring more onerous internal approval standards; and
- (iv) Creating and maintaining adequate documentation in connection with CSFTs. *See Exchange Act Release No. 34-55043, 89 S.E.C. Docket 2179 (Jan. 5, 2007).*

7. 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 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 swap data repository ("SDR") and that swap data must be reported in real time. 7 U.S.C. § 2(a)(13)(G). 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. 17 C.F.R. § 43.3(a)(1).

These records must also be available for inspection by the CFTC or the DOJ. 17 C.F.R. § 1.31. Registrants are required to keep books and records "readily accessible" for the first two years of the five-year period. *Id.* The CFTC has interpreted "readily accessible" to mean retrieval in real-time or at least on the same day as the request. 77 Fed. Reg. 2136, 2142 (Jan. 13, 2012).

Example Case: *In re Pioneer Futures, Inc.*, CFTC Docket No. 07-05 (Mar. 7, 2007).

During an investigation into the trading of floor brokers and floor traders at the Chicago Mercantile Exchange ("CME"), the CFTC requested copies of trading cards and records of orders filled. The CFTC found by consent that Pioneer Futures, an FCM, failed to provide 60 of the 1,856 trading cards requested by the CFTC. As

part of the settlement, Pioneer agreed to make a \$25,000 civil monetary payment.

Example Case: *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 alleged that Deutsche Bank failed to properly report cancellations of swap transactions, which resulted in between tens of thousands and hundreds of thousands of reporting violations and errors and omissions in Deutsche Bank's swap reporting. The CFTC further alleged that Deutsche Bank was aware of problems since its reporting obligations began on December 31, 2012, but failed to investigate and remediate the problems until it was notified of a CFTC investigation in June 2014. Deutsche Bank agreed to a settlement based on charges of violating swap reporting regulations (neither admitted nor denied), pursuant to which it paid a civil monetary penalty of \$2.5 million.

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.'"

(b) Failure to Supervise

A CFTC registrant may be held liable for a failure to supervise under 17 C.F.R. § 166.3. That 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.

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

Example Case: *In re SG Americas Securities, LLC, as successor to Newedge USA, LLC*, CFTC Docket No. 16-33 (Sept. 28, 2016).

The CFTC alleged that SG Americas Securities, LLC, as successor to Newedge USA, LLC, an FCM participated in unlawful wash trades and failed to diligently supervise its employees over a three and a half year period. The order alleged that Newedge participated in wash sales because it executed and confirmed EFP trades between parties that were under common control that were for the same contract, quantity, and same or similar price. The Order further alleged that certain Newedge employees either knew or should have known that their client was engaging in this behavior, as they either knew that the clients desired to net out futures positions across commonly owned and controlled accounts through the use of EFPs, or else failed to inquire why clients were routinely on both sides of the EFPs. SG Americas settled the claim agreeing to pay a \$750,000 civil monetary penalty and comply with an undertaking to improve its internal controls and procedures in order to detect and prevent the execution, clearing and reporting to an exchange of non-bona fide EFPs.

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, for deficient risk management and credit risk practices, and for 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.

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, procedures.

Example Case: *In re MF Global, Inc.*, CFTC Docket No. 10-03 (Dec. 17, 2009).

The CFTC found, by consent, that MF Global failed to supervise its employees on numerous occasions. On two occasions, a customer entered into certain natural gas "EFS" trades.⁷³ 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.

(c) Aiding and Abetting CEA Violations

Under section 13(a) of the CEA, an aider and abettor is liable for violations of the CEA as a principal. CEA section 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." 7 U.S.C. § 13c(a) (2012).

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

In order to establish aiding-and-abetting liability, the CFTC must establish an underlying CEA violation. "Without proof of an underlying violation, the Court cannot find any liability for aiding and abetting." *Commodity Futures Trading Comm'n 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).

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." *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

⁷³ An EFS trade involves an exchange of futures for, or in connection with, a swap.

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)). In the context of commodities manipulation, this aiding-and-abetting standard requires a showing that the defendant intended to cause artificial prices. *Id.* at 183.

(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 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. 7 U.S.C. § 2(a)(1)(B). 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." 7 U.S.C. § 2(a)(1)(B).

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." Am. Compl. at ¶ 80, *Commodity Futures Trading Comm'n v. MF Global Inc.*, No. 11-cv-07866 (S.D.N.Y. 2013). 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." Final Consent at 10, *CFTC v. MF Global Holdings Ltd.*, No. 11-7866 (USCFTC) (Dec. 23, 2014).

Despite potentially broad assertions of corporate parent liability under Section 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 Eleventh Circuit requires "(1) consent to the agency by both principal and agent, and (2) the control of the agent by the principal." *Commodity Futures Trading Comm'n v. Gibraltar Monetary Corp., Inc.*, 575 F.3d 1180 (11th Cir. 2009). 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 each entity and the other's agents. Likewise, common ownership of multiple entities does not create relationships of agency among them." Restatement of the Law Agency (Third) § 7.03 cmt. d(3).

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." *Id.*

(2) Control Person Liability.

Under section 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." 7 U.S.C. § 13c(b).

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. *See Commodity Futures Trading Comm'n v. Baragosh*, 278 F.3d 319, 330 (4th Cir. 2002).

In addition, section 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. 7 U.S.C. § 13c(b).

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

(3) Personal Liability for Principals.

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

(e) Whistleblower Protection

The DFA added section 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.⁷⁴

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 they have 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."⁷⁵

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.⁷⁶ As a result, courts have refused to create a bright-line standard for what constitutes adverse employment action and instead "pore over each case to determine whether the challenged employment action" constitutes an adverse action.⁷⁷ 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,⁷⁸ demotions,⁷⁹ or decreased compensation.

Based on judicial decisions construing similar anti-retaliation provisions, these cases are likely to be difficult to dismiss and to

⁷⁴ Codified at § 78u-6(h)(1)(A).

⁷⁵ 7 U.S.C. § 26(h)(1)(A) 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 id.* (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") (CEA provision); *with* 18 U.S.C.A. § 1514A(a) (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") (SOX provision). 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*, 2012 WL 4767200 at *7 (applying SOX case law to determine what constitutes retaliation under the whistleblower provision added to the Exchange Act by Dodd-Frank).

⁷⁶ Implementation Release at 19.

⁷⁷ *Wanamaker v. Columbian Rope Co.*, 108 F.3d 462, 466 (2d Cir. 1997) (ADEA anti-retaliation claim).

⁷⁸ *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).

⁷⁹ *See, e.g., In re Paradigm Capital Management, Inc.*, S.E.C. File No. 3-15930 (2014) (hedge fund settled claims by SEC that it retaliated against an employee who was relieved of his responsibilities following complaint).

defeat at the motion for summary judgment stage.⁸⁰ Under this framework, the plaintiff carries the initial burden of “proving by the preponderance of the evidence a prima facie case.”⁸¹ 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.⁸² Courts have stated that this prima facie burden for plaintiffs “is not onerous, and has been frequently described as minimal.”⁸³

Once a plaintiff makes this minimal showing, it “in effect creates a presumption that the employer unlawfully [retaliated] against the employee.”⁸⁴ The defendant must then articulate a legitimate, non-retaliatory reason for its employment decision.⁸⁵ In making this argument, companies generally try to sever the causal connection between the report and the termination.⁸⁶ However, it is difficult to make this showing at summary judgment.

The CFTC, unlike the SEC, did not initially assert a right to bring enforcement actions against companies that engage in retaliation. However, in August 2016, the CFTC sought public comments on proposed amendments to the whistleblower rule, which would allow the CFTC to bring enforcement actions.⁸⁷ Moreover, based on SEC precedent, it is possible that the CFTC will bring actions against employers who use confidential provisions that the CFTC believes may stifle whistleblower disclosures.⁸⁸

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

⁸⁰ *Cf. Ashmore v. CGI Group 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).

⁸¹ *Tex. Dep’t of Cmty. Affairs v. Burdine*, 450 U.S. 248, 252–53, 101 S.Ct. 1089, 1093 (1981).

⁸² *Bechtel v. Administrative Review Board*, 710 F.3d 443, 447 (2d Cir. 2013).

⁸³ *Scaria v. Rubin*, 117 F.3d 652, 654 (2d Cir. 1997).

⁸⁴ *Tex. Dep’t of Cmty. Affairs*, 450 U.S. at 254.

⁸⁵ *Reeves v. Sanderson Plumbing Prods., Inc.*, 530 U.S. 133, 142–43 (2000).

⁸⁶ *Fraser v. Fiduciary Trust 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).

⁸⁷ Whistleblower Awards Process, Notice of Proposed Rulemaking, 81 Fed. Reg. at 59,551.

⁸⁸ *See, e.g., In re KBR, Inc., Securities Exchange Act Release No. 74619 (Apr. 1, 2015)* (KBR agreed to settle charges that its standard form confidentiality provision, which stated that witnesses needed permission of the company to disclose matters discussed in internal investigation interviews, undermined SOX.).

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 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.

C. 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 in order 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."

- (1) *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. In seeking to dismiss the claims against it 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; rather, the bids were based on their "own calculations and beliefs about value," and thus reflected 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 characterizing the requisite intent as the intent to "influence market prices."

After the conclusion of discovery, DRW and CFTC both sought summary judgment. The CFTC, in its motion for partial summary judgment with respect to the *attempted* price manipulation claim asserted that, under the law of the case, it need only prove 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 of this test 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 a 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 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."

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 that there is an 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 a trial. That trial is likely to come down to the "battle of the experts," which a former CFTC Commissioner has stated makes proving artificial price "a daunting task."⁸⁹ A task made all the more difficult for the CFTC because 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.

The court's rejection of the CFTC's stance on intent, should provide some comfort to market participants concerned with the CFTC's more aggressive recent approach to price manipulation. However, it does not affect proceedings that may be brought under the CFTC's new Rule 180.1 (fraudulent manipulation) authority added pursuant to certain Dodd-Frank Act related statutory amendments.

- (2) *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

⁸⁹ Bart Chilton, Comm'r, CFTC, Speech before the Institutional Investors Carbon Forum: Moment of Inertia (Sept. 15, 2009), *available at* www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-26.

futures contracts in crude oil, heating oil, and gasoline traded on the New York Mercantile Exchange ("NYMEX") by "marking the close." 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. Optiver agreed to a settlement based on charges of manipulation, attempted manipulation, and making false statements (neither admitted nor denied), 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.

- (3) *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. Moore Capital agreed to a settlement based on charges of attempted manipulation and inadequate supervision of trading activities (neither admitted nor denied), 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.

(b) Fraudulent Trading

- (1) *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 the Chicago Board of Trade ("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 is that Kraft took a large position to purchase December CBOT wheat futures without the intent to take delivery of physical wheat in respect of those futures contracts, but rather as a means to reduce its cost to purchase physical wheat in the cash market. Although the CFTC does not explain how an anonymous purchase on the futures market would accomplish this, according to the CFTC, Kraft's 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 cash market. This, the CFTC alleges, violates 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 is seeking certification for interlocutory appeal on two issues. First, does a large futures position, coupled with an alleged intent to affect market prices but absent any other false communications to the market, constitute "false signaling" market manipulation? Second, can prices be artificial when the cash and futures market prices converge? Kraft argued on motion to dismiss that the answer to both questions was no, because 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 addition, the CFTC charges 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.

(c) Spoofing

- (1) *Commodity Futures Trading Comm'n v. Nav Sarao Futures Limited plc and Navinder Singh Sarao*, 1:15-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 Chicago Mercantile Exchange ("CME"). This case is discussed in more detail under the Disruptive Trading Practices section below. 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: 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.

(d) Violating Offers

- (1) *DiPlacido v. 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. 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." *In re DiPlacido*, 2008 WL 4831204, at *28.

- (2) *Commodity Futures Trading Comm'n v. Moncada*, No. 12-cv-8791 (S.D.N.Y. Oct. 1, 2014).

The CFTC filed a civil complaint alleging that Eric Moncada attempted to manipulate the price of wheat futures by engaging in fictitious sales and non-competitive transactions, and specifically by entering and immediately canceling large-lot orders for the purpose of creating the misleading impression of increasing liquidity in the market. Moncada would then take advantage of any price movements by placing smaller orders on the opposite side of the large-lot transactions he had cancelled. In July 2014, the court granted the CFTC summary judgment, and in October 2014 the CFTC obtained a Consent Order, finding that Moncada attempted to manipulate the wheat futures markets on numerous occasions and imposing a \$1.56

million civil monetary penalty and trading and registration restrictions.

(e) Defending a Price

- (1) *In re JPMorgan Chase Bank, N.A.*, CFTC Docket No. 14-041 (Oct. 16, 2013).

The CFTC used its 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 ("CDX"). 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 system in connection with swaps trading activity.

(f) Corners and Squeezes

The CEA does not define the terms "corner" and "squeeze." Courts have held that "[a] corner occurs when a trader secretly acquires a long futures position, 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." *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.").

"[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." *Frey v. Commodity Futures Trading Comm'n*, 931 F.2d 1171, 1175 (7th Cir. 1991).

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." *Frey v. Commodity Futures Trading Comm'n*, 931 F.2d 1171, 1175 (7th Cir. 1991).

- (1) *In re Fenchurch Capital Mgmt.*, Comm. Fut. L. Rep. (CCH) ¶ 26,747 (CFTC July 10, 1996).

A trading manager settled an action by the CFTC by agreeing to a finding of price manipulation by "cornering" supply. The CFTC found that the manager used repo transactions for the purpose of taking 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.

- (2) *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.

- (3) *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 of false reporting and manipulation (neither admitted nor denied), the Hunts received a \$10 million penalty and were barred from trading on commodity markets.

2. Manipulation: Over the Counter Trading

(a) Marking the Close

- (1) *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 they had attempted to manipulate natural gas monthly index settlement prices at four major trading hubs during monthly settlement periods known as "bid-week." The CFTC alleged that during bid-weeks for September 2011, October 2011, March 2012, and April 2012, Total Gas attempted to manipulate monthly index settlement prices of natural gas through their physical fixed-price trading. According to the CFTC, during these periods Total 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. 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, on April 28, 2016, FERC issued an order to show cause directing Total Gas and two traders to show prohibition on market manipulation through this conduct. FERC's order to show cause alleges that the scheme occurred between June 2009 and June 2012. FERC in the order 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.

(b) Corners and Squeezes

- (1) *United States v. Radley*, 659 F. Supp. 2d 803 (S.D. Tex. 2009), *aff'd*, 632 F.3d 177 (5th Cir. 2011).

The court found that the mere act of placing orders could not legally create an "artificial" price, *i.e.*, one that was "clearly outside the 'legitimate' forces of supply and demand." Addressing allegations that BP traders manipulated price by posting "show" bids and by "stacking" its bids, the Court found that the traders' bids were legitimate because the indictment did not allege a "single lie or misrepresentation," and that the bids were "actually bids, and when they were accepted defendants actually went through with the transactions. . . . Since defendants were willing and able to follow through on all of the bids, they were not misleading."⁹⁰

- (2) *Commodity Futures Trading Comm'n v. BP Prods. North Am., 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 above, the CFTC reached a settlement with BP Products North America, Inc. ("BP"), pursuant to which 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 America and certain affiliates did, however, enter into a three-year Deferred Prosecution Agreement ("DPA") 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

⁹⁰ *Radley* can be understood to support the proposition that, in the absence of evidence of fraud or misrepresentations, trading with the intent to make a price does not constitute manipulation. However, *Radley* is an outlier decision, and several courts have criticized *Radley* (one court called it "a bridge too far") or declined to follow it. See *Commodity Futures Trading Comm'n v. Paron Energy Inc., et al.*, No. 11-cv-3543, at *18 n.2 (S.D.N.Y. Apr. 26, 2012) (declining to follow *Radley* and noting that "*Radley* contradicts [an] established principle"); *Anderson v. Dairy Farmers of Am., Inc.*, 2010 WL 3893601 (D. Minn. Sept. 30, 2010) ("*Radley*'s . . . focus on a party's self-interested or profit-making motives misses the mark. . . . [T]he inquiry must be whether the facts of a case support a finding that defendant specifically intended to subvert legitimate forces of supply and demand."); *Commodity Futures Trading Comm'n v. Hunter*, No. 07 Civ. 6682 (BSJ) (FM), 2012 WL 297838, at *2 n.1 (S.D.N.Y. Jan. 31, 2012) (declining to follow *Radley* and concluding that it has no controlling effect within the Second Circuit).

part of the DPA, BP America admitted 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. *United States v. BP America Inc.*, No. 07-cr-00683 (N.D. Ill.).

3. Manipulation: Cross-Market Trading

(a) Marking the Close

- (1) *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 (neither admitted nor denied), pursuant to which it paid a civil monetary penalty of \$7.5 million.

- (2) *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 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.

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 25 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." *Cargill, Inc.*, 452 F.2d at 1163. 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.

(a) LIBOR-Related Benchmark Interest Rate Investigation Settlements

(1) *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. 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.

- (2) *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. 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.

- (3) *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. 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.

- (4) *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. 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 with CFTC regulations. Concurrent with the CFTC settlement, UBS also settled charges with the DOJ, the FSA, and the Swiss Financial Market Supervisory Authority.

- (5) *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. 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.

- (6) *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. Deutsche Bank admitted 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 submitters 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.

- (2) *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 secured 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.

(b) Foreign Exchange Benchmark Cases

- (1) *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. 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 for HSBC.

- (2) *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. 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 disclosing confidential customer order information and trading positions, altering trading positions to accommodate the interests of the collective group, and agreeing 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.

(c) ISDAFIX Cases

- (1) *In re Barclays PLC, Barclays Bank PLC, and Barclays Capital Inc.* CFTC Docket No. 15-25 (May 20, 2015).

The CFTC issued an Order filing and settling charges that from at least as early as January 2007 to June 2012, Barclays attempted to manipulate and made false reports concerning the U.S. Dollar International Swaps and Derivatives Association Fix ("USD ISDAFIX"). According to the CFTC's order, Barclays, through its traders, bid, offered, and executed interest rate swap spread transactions in a manner deliberately designed — in timing, price, and other respects — to influence the published USD ISDAFIX. In addition, the Order alleged that Barclays, 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 customers. The CFTC order required Barclays to pay a \$115 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.

- (3) *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. 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.

- (d) *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 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.

- (e) *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 the CEA 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 alleges specific instances of defendants attempting to conceal their actions, it never alleges that defendants lied about their activity. Mere concealment is not sufficient to show that their actions were not legitimate forces of supply and demand."

5. Wash Sales, Non-Bona Fide Sales, and Other Section 4c Violations

- (a) *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." 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, by consent order, for \$35 million.

- (b) *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. 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.

- (c) *In re Gelber Group LLC*, CFTC Docket No. 13-15 (Feb. 8, 2013), and *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.

- (d) *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.

6. False Statements to the CFTC

- (a) *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. The CFTC further alleged that Moore made false and misleading statements of material fact in sworn testimony before the CFTC. In particular, the CFTC alleged that Moore false 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.

- (b) *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 ("FCM"). 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 section 6(c)(2). In a parallel criminal action, Wasendorf was also criminally convicted under sections 9(a)(3) and (4) of the CEA⁹¹ for making false statements to the CFTC and the National Futures Association ("NFA").

- (c) *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 section 6(c)(2) of the CEA⁹² 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.

- (d) *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

⁹¹ Codified at 7 U.S.C. § 13(a)(2).

⁹² Codified at 7 U.S.C. § 9(c)(2).

information and were allocating the most profitable trades to their proprietary account and most of the losing trades to their customers' accounts. The CFTC also charged Newell with falsely testifying during the investigation that he had provided account numbers when placing the orders. 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.

- (e) *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. 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 section 6(c)(2) of the CEA. 7 U.S.C. § 9(c)(2).

- (f) *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. 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.

- (g) *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. 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.

- (h) *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. 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.

- (i) *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. 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. 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.

7. Position Limits

- (a) *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), pursuant to which it paid a civil monetary penalty of \$600,000.

- (b) *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), pursuant to which it paid a civil monetary penalty of \$525,000.

- (c) *In re Interactive Brokers LLC*, CFTC Docket No. 12-27 (Jul. 25, 2012).

The CFTC alleged that Interactive Brokers failed to aggregate related accounts that would have resulted in a total speculative position held by Interactive Brokers in excess of the stated position limits. During 2010 and 2011, the CFTC notified Interactive Brokers on more than 20 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.

- (d) *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), pursuant to which it paid a civil monetary penalty of \$140,000.

8. Control Person Liability

- (a) *Commodity Futures Trading Comm'n v. MF Global Inc.*, No. 13-cv-04463 (S.D.N.Y. 2013).

The CFTC alleged that in October 2011, MF Global was in desperate need of cash and unlawfully used customer funds to satisfy its own obligations, ultimately leaving it nearly \$1 billion short of customer funds. The CFTC alleged that MF Global's former CEO, Jon Corzine, is liable as a controlling person for MF Global's CEA violations because he failed to act in good faith or knowingly induced MF Global's violations. The case is pending.

- (b) *Commodity Futures Trading Comm'n v. Baragosh*, 278 F.3d 319 (4th Cir. 2002).

Baragosh appealed the district court's grant of summary judgment against him based on a ruling that he was a control person and therefore liable as a matter of law for his employer's CEA violations. The Fourth Circuit vacated that aspect of the district court's opinion, holding that Baragosh was not indisputably a control person even though he concededly "was a key employee . . . who knew of the company's fraud and enthusiastically furthered it"; held the title of vice president; was a signatory on the company's bank accounts, on which he wrote checks for company expenses and commissions; appeared on the company's behalf at an arbitration; and signed a lease on the company's behalf only a day before the CFTC raided the company. The court noted that some record evidence militated against a finding of control-person status, such as Baragosh's lack of authorization to hire, fire, or discipline employees; the absence of any company documents listing him as an officer or director, despite his title of vice president; and the undisputed fact that the traders who actually conducted the fraudulent activities were not under his direct control. On this record, the court held, it was not possible to conclude as a matter of law that Baragosh exercised "general control" over the company's operations sufficient to support a finding that he was a control person.

- (c) *Monieson v. 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 traders who engaged in fraudulent trading practices — namely, bucketing — 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 traders; 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.

- (d) *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.

9. Disruptive Trading Practices

- (a) *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. 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, remaining visible to other traders, but staying 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: 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.

- (b) *Commodity Futures Trading Comm'n v. Igor B. Oystacher, et al.*, No. 15-cv-9196 (N.D. Ill. filed Oct. 19, 2015).

On October 19, 2015, the CFTC filed an anti-spoofing complaint against Igor Oystacher and his firm 3Red Trading LLC in Chicago federal court, and on November 9, 2015, the CFTC filed a motion for preliminary injunction, seeking to prevent Oystacher from trading futures contracts while the case against him is pending. The CFTC claims that Oystacher placed large CME Group futures orders on one side of the market at or near the best price, which were intended to be canceled before execution. Oystacher would then cancel the orders and "flip" his position by placing at least one aggressive order on the other side of the market to trade with participants that had been induced to enter the market by the spoof orders. Oystacher allegedly utilized the trading strategy in placing orders in COMEX copper contracts, NYMEX crude oil contracts, NYMEX natural gas contracts, CFE VIX contracts, and CME E-Mini S&P 500 contracts. The CFTC stated that Oystacher has continued to trade heavily since the complaint was filed against him in October and filed a series of documents demonstrating Oystacher's conduct of canceling open orders and quickly entering opposite orders.

- (c) *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. 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, 2015.⁹³

⁹³ 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).

On May 14, 2015, the New York 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, the court issued a Consent Order imposing a permanent injunction against Khara and Salim, 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.

- (d) *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 section 4c(a)(5)(C) of the CEA⁹⁴ 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.

10. Disclosure Violations

- (a) *In re JP Morgan Chase Bank, N.A.*, CFTC Docket No. 16-05 (Dec. 18, 2015).

The CFTC alleged that JP Morgan failed to disclose certain conflicts of interest to clients of its U.S.-based wealth management business, J.P. Morgan Private Bank. Specifically, the CFTC found by consent that JP Morgan failed to fully disclose its preference for investing its client funds in hedge funds and mutual funds managed and operated by an affiliate and subsidiary of JP Morgan. 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

⁹⁴ Codified at U.S.C. §§ 6c(a)(5)(C).

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.

11. Criminal Prosecutions

- (a) *United States v. UBS Securities Japan Co., Ltd.*, No. 12-cr-268 (D. Conn. filed Dec. 19, 2012); *United States v. RBS Securities Japan*, No. 13-CR-073 (D. Conn. filed Feb. 5, 2013); *United States v. The Royal Bank of Scotland Group plc*, No. 13-cr-74 (D. Conn. filed Feb. 6, 2013); *United States v. Hayes*, No. 12-MAG-3229 (S.D.N.Y. filed Dec. 12, 2012); *United States v. Read*, No. 13-MAG-2224 (S.D.N.Y. filed Sept. 13, 2013); *United States v. Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.*, No. 13-CR-200 (D. Conn. filed Oct. 29, 2013); *United States v. Deutsche Bank AG*, No. 15-cr-61 (D. Conn. filed Apr. 23, 2015); *United States v. DB Group Services UK Limited*, No. 15-CR-62 (D. Conn. filed Apr. 23, 2015).

The CFTC's benchmark interest rate investigations launched DOJ investigations resulting in criminal convictions for wire fraud 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, wire fraud, and price fixing arising from conduct related to the manipulation of JPY LIBOR. The DOJ has entered into deferred prosecution agreements with RBS, Rabobank and Deutsche Bank.

- (b) *United States v. Paul Robson, et al.*, No. 1:14-cr-00272 (S.D.N.Y. filed April 28, 2014).

The DOJ brought charges 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.

- (c) *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 also agreed to pay a criminal penalty of \$203 million.

- (d) *United States v. Barclays PLC*, No. 15-cr-00077 (D. Conn. filed May 20, 2015); *United States v. Citicorp*, No. 15-cr-00078 (D. Conn. filed May 19, 2015); *United States v. The Royal Bank of Scotland plc*, No. 15-cr-00080 (D. Conn. filed May 20, 2015); *United States v. JP Morgan Chase & Co*, No. 15-cr-00079 (D. Conn. filed May 19, 2015).

In May 2015, Citicorp, JPMorgan Chase & Co., Barclays PLC, and The Royal Bank of Scotland plc agreed to plead guilty to conspiring to manipulate the price of U.S. dollars and euros exchanged in the foreign currency exchange ("FX") spot market and to pay criminal fines totaling more than \$2.5 billion. 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 alleges 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.

12. Private Civil Litigation

- (a) *In re: Commodity Exch., Inc. Gold Futures and Option 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 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.

- (b) *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 above, 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. 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 used 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.

- (c) *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 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 Dec. 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," Schofield wrote in a 56-page decision.

- (d) *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, finding that plaintiffs had standing to assert antitrust claims because the alleged collusion of manipulating a benchmark rate that is then incorporated into the price of financial instruments can result in antitrust injury, and also found that plaintiffs had plausibly alleged a conspiracy among defendants to manipulate ISDAFIX.

- (e) *In re: Libor-Based Financial Instruments Antitrust Litigation*, 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."⁹⁵ 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.

⁹⁵ *Ellen Gelboim, et al. v. Bank of America Corporation et al.*, 823 F.3d 759, 767 (2d Cir. 2016).

D. CEA Investigations

1. The CFTC Investigation Process

(a) Types of Investigations

- (1) "Informal investigations." Conducted without the formal authorization of the CFTC. 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 pursuant to the CEA. 17 C.F.R. § 11.2. The DOE may ask investigation targets to volunteer statements or information, or may use the CFTC's inspection powers over persons required to register with the CFTC to gather information. 17 C.F.R. § 11.2. The information gathered may be used by the DOE to request that the CFTC authorize a formal investigation.
- (2) Investigations authorized under Section 6(b) of the CEA. Under 7 U.S.C. § 9(5), "for the purpose of any investigation . . . , any 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."

Most Section 6(b) investigations are conducted by the DOE, which submits a confidential request asking that the CFTC authorize an investigation. The CFTC will then issue a formal order of investigation that allows the DOE's investigation to proceed. The formal order of investigation 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. 17 C.F.R. § 11.2.

- (3) Trade-practice investigations. Trade-practice investigations review large-scale market activities and may be conducted by the Division of Trading and Markets or the Division of Economic Analysis. Trade-practice investigations are usually conducted through a review of trading data. Market

participants are required to report to the CFTC; subpoenas are rarely used.

- (4) Investigations authorized under Section 8 of the CEA. "For the efficient execution of the provisions of [the CEA], and in order to provide information for the use of Congress, the Commission may make such 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]." 7 U.S.C. § 12. 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. 7 U.S.C. § 12.
- (5) Assisting the investigations of foreign futures authorities. The CFTC may conduct such investigation as the CFTC deems necessary to collect information and evidence pertinent to a request for assistance from a foreign futures authority. 7 U.S.C. § 16(f). The CFTC has entered into Memoranda of Understanding ("MOUs") and cooperation agreements with regulators in more than 20 jurisdictions. MOUs typically provide for 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 financial and other types of information.

(b) The CFTC's Powers to Compel Production of Documents and Information

- (1) Futures commission merchants and other registrants are required to comply with CFTC record keeping requirements, such as maintaining daily trading records. 7 U.S.C. § 6g (2012). 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. 17 C.F.R. § 1.31. CFTC staff may seek inspection of these records without a formal order from the Commission. 7 U.S.C. § 6g; 17 C.F.R. § 11.2.

- (2) A formal order of the CFTC is required to authorize the use of subpoenas. 17 C.F.R. §§ 11.2, 11.4. Usually, such an order is included in the formal order of investigation. CFTC subpoenas are not self-enforcing, but the CFTC may seek the assistance of a U.S. district court to compel compliance. 7 U.S.C. § 9(5); 17 C.F.R. § 11.4.

(c) Testimony and Document Production

- (1) Technically, witnesses are supposed to be allowed to obtain a copy of the transcript of their testimony. "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 for good cause can be limited to inspection of the official transcript of his testimony." 17 C.F.R. § 11.7(b). 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.
- (2) Witnesses may be accompanied, represented, and advised by counsel. 17 C.F.R. § 11.7(c). 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. 17 C.F.R. § 11.7(c)(1).
- (3) 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"). 17 C.F.R. § 11.3. Parties must submit a written request 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.

(d) Wells Submissions

The CFTC has a process similar to the Wells process used in SEC actions. In certain instances, the submission of a white paper may be made in lieu of the CFTC's Wells process.

(e) Settlements and Cooperation

- (1) The DOE may take into consideration certain factors in weighing cooperation during an investigation for the purpose of reducing sanctions in settlements. For a company, these factors generally fall into three categories:
 - (i) The nature of the company's efforts to uncover and investigate violations;
 - (ii) The quality of the company's efforts in cooperating with the DOE and managing the aftermath of the misconduct; and
 - (iii) The company's efforts to prevent future wrongdoing.

CFTC Enforcement Advisory, Comm. Fut. L. Rep. (CCH) ¶ 30,487 (CFTC 2007).

- (2) Even if a company has satisfied some of these factors, the DOE may determine that the company's conduct nonetheless does not warrant credit for cooperation. Uncooperative conduct includes, for example: (i) failure to respond to subpoenas in a timely manner; (ii) failure to properly search computer hard drives for documents and electronic images; and (iii) falsely claiming that records are unavailable. *CFTC Enforcement Advisory*, Comm. Fut. L. Rep. (CCH) ¶ 30,487 (CFTC 2007) .

"[R]ecognition is most likely to be given for conduct that is sincere, aggressively cooperative and indicative of a willingness to accept responsibility for the wrongdoing. The [DOE] is least likely to recommend reduced sanctions when a company hides or misrepresents information about the misconduct, impedes [DOE] efforts to obtain information, and creates a drain on government resources by prolonging the [DOE's] investigation unnecessarily." *CFTC Enforcement Advisory*, Comm. Fut. L. Rep. (CCH) ¶ 30,487 (CFTC 2007) .

(f) Referral from the CFTC

If there has been no CFTC settlement, the DOE may recommend disciplinary action or may refer the action to the DOJ to seek criminal sanctions. If the CFTC decides to commence disciplinary proceedings, the DOE will file a complaint with the Office of Proceedings, and an administrative law judge will be appointed to

oversee all initial motions, discovery, and the hearing of evidence.
17 C.F.R. §§ 10.8, 10.21.

2. Interagency and International Investigations

(a) Interagency Cooperation

- (1) 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.
- (2) In fiscal year 2014, the CFTC worked actively with federal and state criminal and civil law enforcement authorities. Approximately 95% of the CFTC's major fraud and manipulation cases involved a parallel criminal proceeding. Judgments were entered in 12 of these federal criminal proceedings, resulting in prison sentences against 17 persons and restitution amounting to \$793 million. *See CFTC Releases Annual Enforcement Results for Fiscal Year 2014* (Nov. 6, 2014).
- (3) 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. *See CFTC President's Budget and Performance Plan for Fiscal Year 2014* at 26.
 - (i) Criminal investigations. Approximately 94% of the CFTC's major injunctive fraud cases involved related criminal investigations, and over 50 criminal indictments and judgments were filed that were related to CFTC enforcement matters.
 - (ii) Civil regulatory agency investigations. Approximately 50% of the major fraud actions involving related criminal investigations also involved parallel investigations with federal civil authorities. *Id.* at 55.
- (4) 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.

- (5) 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.
- (6) 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.
- (7) 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. *See Hunter v. Federal Energy Regulatory Comm'n*, 711 F.3d 155 (D.C. Cir. 2013).

(b) Multijurisdictional Investigations

- (1) 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.
- (2) In 2014, the CFTC reported that it had seen a significant increase in both the number of outgoing and incoming international requests over the last several years. This increase is directly related to the increase in enforcement cases in general; thus an escalation in international activity is expected to continue through FY 2015 and beyond. *See CFTC President's Budget and Performance Plan Fiscal Year 2015* at 37. During Fiscal Year 2012, the CFTC handled 446 international requests and referrals and entered into bilateral cooperative enforcement/information-sharing arrangements with more than 25 foreign authorities. *See CFTC President's Budget and Performance Plan Fiscal Year 2014* at 56.
- (3) The CFTC also received responses to more than 300 requests for assistance that the CFTC made of more than 70 different regulators under the International Organization of Securities Commission (IOSCO) Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, and other information-sharing arrangements. *Id.* at 26.

E. MOUs Between the CFTC and FERC

1. Introduction

On January 2, 2014, the CFTC and FERC entered into two Memoranda of Understanding ("MOUs") to govern the two agencies' interactions in cases regarding which their authority may overlap. The first MOU addresses issues of jurisdiction, while the second concerns information requests between the two agencies.

2. Jurisdiction

(a) 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 assistance in obtaining 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.

(b) 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 agreed to share information requested by the other to inform its determination of interest in the matter.

(c) 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, it will be elevated 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.

(d) Confidentiality

Both agencies agreed to keep confidential, to the extent permitted by law, any non-public information provided pursuant to the MOU.

3. Information Requests

(a) CFTC Requests

- (1) CFTC will make written requests to FERC for information from:
 - (i) a Regional Transmission Organization ("RTO") or Independent System Operator ("ISO");
 - (ii) the North American Electric Reliability Corporation ("NERC"), or interstate pipelines and storage facilities; or
 - (iii) market participant information in FERC's possession.
- (2) FERC will take steps to promptly obtain responsive information and furnish it to the CFTC.
- (3) 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.

(b) FERC Requests

- (1) FERC will make written requests to the CFTC for information from:
 - (i) a designated contract market;
 - (ii) a registered swap execution facility;

- (iii) a registered derivatives clearing organization;
 - (iv) any other board of trade, exchange, or derivatives market or swap data repository; or
 - (v) market participant information in the CFTC's possession.
 - (2) The CFTC will take steps to promptly obtain responsive information and furnish it to FERC.
 - (3) 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 section 8 of the CEA. 7 U.S.C. § 12 (2012).
- (c) General Information Request Provisions
- (1) 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.
 - (2) The MOU does not interfere with or affect the rights of either agency to obtain information directly from regulated entities.
 - (3) The agencies will take steps to avoid duplicative information requests and to coordinate oversight (including market surveillance), investigative, and enforcement activities of mutual interest.
- (d) Privileged and Proprietary Information
- (1) 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.
 - (2) Unless otherwise required by law or by a court order, neither agency may disclose information provided by the other pursuant to the MOU, without the other agency's prior written consent.
 - (3) 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.

- (4) Each agency will refer to the other any FOIA request pertaining to information shared by the other agency pursuant to the MOU.
- (5) The agencies agree 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.

F. Consequences of CEA Violations

1. The CFTC may bring civil or administrative actions under the CEA.

Under CEA section 6(c)(10), the CFTC may impose a civil penalty for any manipulation or attempted manipulation in violation of CEA section 6(c) or 9(a)(2), in an amount of \$1 million or triple the monetary gain to the defendant, whichever is greater, "for each such violation." 7 U.S.C. § 9(10). 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 \$140,000 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." *United States v. Radley*, 659 F. Supp. 2d 803, 814 (S.D. Tex. 2009), *aff'd*, 632 F.3d 177 (5th Cir. 2011).

The CFTC may also seek disgorgement of profits (CEA section 6c(d), 7 U.S.C. § 13a-1(d)); an asset freeze, a temporary restraining order, or an injunction (CEA section 6c(a), 7 U.S.C. § 13a-1(a)); monetary redress for consumers (CEA section 6(c)(10)(D), 7 U.S.C. § 9(10)(D)); a bar or suspension of trading privileges (CEA section 6(c)(10)(B), 7 U.S.C. § 9(10)(B)); or disqualification from registration (CEA section 8a, 7 U.S.C. § 12a (2012)).

Finally, the CFTC may seek to impose undertakings as part of a settlement, including establishing extensive compliance programs and/or the imposition of a court-appointed independent monitor. *See, e.g.*, Consent Order, *Commodity Futures Trading Comm'n v. BP Prods. North Am., Inc.*, No. 06-C-3503 (N.D. Ill. Oct. 25, 2007).

2. 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 million or imprisonment for not more than 10 years, or both, together with the costs of prosecution. 7 U.S.C. § 13(a)(5). 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 can 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."
18 U.S.C. § 1343.

The elements of a wire fraud charge are (1) a scheme to defraud; (2) money, property, or honest services; (3) use of the wires in furtherance of the scheme; and (4) fraudulent intent. *See United States v. Brooks*, 2009 WL 3644122, at *3 (E.D.N.Y. Oct. 27, 2009).

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 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.

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. 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.

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 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. 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. 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. The case is still pending.

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. 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. 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. 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, 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.

3. 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, although strict privity of contract is not required. *See* 7 U.S.C. § 25(a)(1). In addition, the CEA provides a broader private right of action in relation to manipulation violations, which does not require privity. 7 U.S.C. § 25(a)(1)(D).

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. 7 U.S.C. § 25(a)(1)(D).

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. 7 U.S.C. § 25(a)(3).

The private right of action has a two-year statute of limitations. 7 U.S.C. § 25(c).

A large number of civil suits are currently pending, which stem from the benchmark rate investigations that the CFTC and DOJ conducted.

Example Cases:

Aspire Commodities, LP v. GDF Suez Energy N. Am., 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 N. Am., Inc.*, 640 F. App'x 358 (5th Cir. 2016), *reh'g denied sub nom. Aspire Commodities, L.P. v. GDF Suez Energy N. Am., Inc.*, No. 15-20125, 2016 WL 3211288 (5th Cir. Mar. 25, 2016)

Plaintiffs alleged that the GDF Suez Energy North America and its US 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. 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,⁹⁶ 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 Section 22 of the CEA⁹⁷, 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 Section 22.

In re Dairy Farmers of America, Inc. Cheese Antitrust Litigation, 2015 WL 5102613 (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 manipulate 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.

Relying on the Fifth Circuit's decision in *Hershey v. Energy Transfer Partners, L.P.*, 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." *Id.* at *5. 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." *Id.*

The court also addressed plaintiffs' claim that defendants had aided and abetted the manipulation of CME Class III milk futures. The court held

⁹⁶ 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.

⁹⁷ Codified at 7 U.S.C. § 25(b)(5).

that plaintiffs "evidence simply does not support an inference that anyone" was "aware of the alleged plan to affect Class III milk futures market," and affirmed summary judgment for defendants. *Id.* at *6.

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.

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[d] 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" 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." *Id.* at 247.

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. *Id.* 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." *Id.* at 249. 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." *Id.*

4. Potential Collateral Consequences of CEA Violations

(a) Consequences under the CEA

- (1) Under CEA sections 8a(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. 7 U.S.C. § 12a(2)-(4).

- (i) Under CEA section 8a(4), the CFTC can suspend or revoke registration for any person if that person could be refused registration under section 8a(3). Section 8a(3), in turn, states that the CFTC can refuse registration of anyone if it (or its principal) consented to a finding of a violation of the CEA. 7 U.S.C. § 12a(3)-(4).
 - (ii) CEA section 8a(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. 7 U.S.C. § 12a(2).
- (2) CEA violations may also result in loss of relief from the CFTC introducing broker registration requirements under CFTC No-Action Letter 12-70.
- (3) 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 Section 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 Section 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. *See, e.g.*, FINRA Bylaws art. III, sec 1 (a)-(b).

(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 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. *See* PTCE 84-14 § I(g). 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.

III. U.S. FEDERAL ENERGY REGULATORY COMMISSION JURISDICTION AND MARKET ENFORCEMENT REGIME

A. Statutory Basis of Jurisdiction

FERC's authority to regulate market abuse violations is a relatively new authority and one that FERC was only granted in 2005, as part of the Energy Policy Act of 2005. Under its power granted by the Energy Policy Act to promulgate regulations enforcing the anti-manipulation provisions in the statute, FERC promulgated regulations under both the Natural Gas Act ("NGA") and the Federal Power Act ("FPA"), which are designed to prohibit market abuse.

FERC modeled its anti-manipulation authority on Securities and Exchange Commission Rule 10b-5 and intends it to "be interpreted consistently with analogous SEC precedent." Prohibition of Energy Mkt. Manipulation, 114 FERC ¶ 61,047 at PP 2, 30 (Jan. 19, 2006) (Order No. 670).

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 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). *See FERC Issues Annual Enforcement Report* (Nov. 20, 2014); *CFTC Releases Annual Enforcement Results for Fiscal Year 2014* (Nov. 6, 2014).
2. 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) and nearly \$141 million in disgorgement (approximately 70% of the value of disgorgements obtained by the CFTC in the same year). *See FERC Office of Enforcement Releases Fiscal 2013 Report* (Nov. 21, 2013); *CFTC Releases Enforcement Division's Annual Results* (Oct. 24, 2013).
3. 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). *See FERC Reviews Fiscal 2012 Enforcement Activities* (Nov. 15, 2012); *CFTC Releases Enforcement Division's Annual Results* (Oct. 5, 2012).
4. 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). *See Federal Energy Regulatory Commission, 2011 Report on Enforcement, Docket No. AD07-13-004* (Nov. 17, 2011); *Press Release, Commodity Futures Trading Commission, CFTC Releases Annual Enforcement Results* (Oct. 6, 2011).

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." 15 U.S.C. § 717c-1 (2006).

Using 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." 18 C.F.R. § 1c.1.

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. *Federal Energy Regulatory Comm'n v. Brian Hunter*, 130 FERC ¶ 63,004 at 35 ¶ 85 (2010).

- 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." *Id.* ¶ 83.
- Scienter may be proven by evidence that the conduct at issue was willful, deceitful, or reckless. *See id.* at 36-37 ¶ 85.
- Jurisdictional natural-gas transactions are interstate transactions resulting in the physical delivery of natural gas. *See id.* at 75-75 ¶ 208.

Example Case: *Federal Energy Regulatory Comm'n 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 Section 4A of the NGA and section 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, which took place on a futures market and therefore fell within the exclusive jurisdiction of the CFTC. *See* discussion of limitations on FERC's authority, *infra*.

2. FPA Market Abuse

Under section 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." 16 U.S.C. § 824v.

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." 16 U.S.C. § 824u.

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 of business that operates or would operate as a fraud or deceit upon any entity" in connection with the purchase or sale of energy." 18 C.F.R. § 1c.2.

Example Case: *In re Barclays Bank PLC, Daniel Brin, Scott Connelly, Karen Levine, and Ryan Smith*, 144 FERC ¶ 61,041 (2013).

FERC's Office of Enforcement alleged that Barclays and its employees violated FERC Rule 1c.2 between November 2006 and December 2008 by developing substantial monthly physical positions simultaneously with swap positions in the opposite direction and that Barclays would then buy or sell 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." 144 FERC ¶ 61,041 at 2.

FERC rejected Barclays' arguments that (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.

In rejecting these contentions, FERC appears to have concluded 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.

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.

Barclays is currently contesting the fine in the U.S. District Court for the Eastern District of California, arguing that FERC lacks the authority to regulate the swap-related conduct because the CFTC has exclusive jurisdiction. In May 2015, the court rejected Barclays' motion to dismiss, holding that FERC does have authority to regulate the conduct and that Barclays' open-market conduct can violate FERC's anti-manipulation rule.

Example Case: *In re Houlian Chen and Powhatan Energy Fund, LLC*, 149 FERC ¶ 61,261 (2014).

On May 29, 2015, FERC issued an Order Assessing Civil Penalties against Dr. Houlian 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 offsetting trades in the PJM "Up to Congestion" (UTC) product. Powhatan's strategy was to place a significant number of "round-trip" trades that 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. Powhatan admitted the conduct, but argued that this was a legitimate pattern of trades, which 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. FERC explained that 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. Moreover, FERC also found that Powhatan's conduct constituted wash trades, which are *per se* fraudulent and manipulative.

A Petition for an Order Affirming FERC's Order Assessing Civil Penalties has been filed by FERC in the Eastern District of Virginia.

D. Limitaitons on FERC's Jurisdiction

As noted above, the Second Circuit Court of Appeals held in *Stoller v. Commodity Futures Trading Comm'n*, 834 F.2d 262 (2d Cir. 1987), 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. *See id.* at 267 ("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.").

The rationale underlying the *Stoller* holding appears equally applicable to FERC's interpretations of newly issued statutory or regulatory requirements. *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.

Following FERC's decision that Brian Hunter had engaged in market manipulation, Hunter appealed the decision to the D.C. Circuit. Hunter argued on appeal that FERC had exceeded its authority under the Energy Policy Act by fining him for manipulating prices in the natural-gas futures market, because the CFTC has exclusive jurisdiction over transactions involving commodity futures contracts. *Hunter v. Federal Energy Regulatory Comm'n*, 711 F.3d 155, 156 (D.C. Cir. 2013). The CFTC intervened in the appeal in support of Hunter.

The D.C. Circuit, after examining the statutory bases for both regulators' claims of jurisdiction, 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 section 2(a)(1)(A)⁹⁸ vests the CFTC with exclusive jurisdiction. *Id.* at 158. The D.C. Circuit 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." *Id.* The court agreed with the CFTC that accepting this argument would "eviscerate the CFTC's exclusive jurisdiction over commodity futures contracts and defeat Congress's very clear goal of centralizing oversight of futures contracts." *Id.*

Unlike *Hunter*, which involved alleged manipulation of a futures market to realize a gain in a futures market, *Barclays* involves alleged manipulation of a cash

⁹⁸ Codified at 7 U.S.C. § 2(a)(1)(A).

market within FERC's jurisdiction to realize a gain in an over-the-counter swap market.

Barclays argues in its brief in the district court, however, 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.

Barclays further contends that FERC lacks jurisdiction over wholesale electric-energy transactions unless they result in the physical delivery of electric energy. The positions at issue in *Barclays* did not result in physical delivery.

Barclays also argues that FERC's complaint is deficient in that it fails to allege an effect on any jurisdictional transaction.

Finally, Barclays contends that FERC may not bring manipulation claims against individual traders, because the anti-manipulation provision of the FPA refers only to "any entity." FERC has, however, interpreted the quoted language to include "any person or form of organization, regardless of its legal status, function or activities." Prohibition of Energy Mkt. Manipulation, 114 FERC ¶ 61,047 (Jan. 19, 2006).

While this case is still pending, the District Court's May 2015 decision on Barclays' motion to dismiss provides some guidance on these issues, as the court rejected all of Barclays' arguments.

Finally, the order assessing civil penalties in the *Houlian Chen and Powhatan Energy Fund* case shows 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.

E. Examples of Proceedings Against Large Traders

1. *Total Gas & Power North America, Inc., et al.*, 155 FERC ¶ 61,105 (2016).

In this natural gas case, FERC alleges that Total Gas & Power North America 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. 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 alleges that during bid weeks Total Gas attempted to manipulate monthly index settlement prices of natural gas through their physical fixed-price trading. According to the CFTC, during these periods Total 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. Total Gas 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.

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 is seeking 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.

In addition to proposing civil penalties against Total Gas and the two traders, the order to show cause also directs 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 "is 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."

2. *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 and claiming, that FERC lacks jurisdiction, as the transactions at issue were intrastate. BP

further claimed that the physical and financial data does not support a charge of manipulation.

The matter was originally heard by an ALJ. The ALJ's Initial Decision found that BP violated Section 1c.1 of the Commission's regulations and Section 4A of the Natural Gas Act. The Commission 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.

3. *Deutsche Bank Energy Trading, LLC*, 142 FERC ¶ 61,056 (2013)

In this power case, FERC determined that between January 29, 2010, and March 24, 2010, Deutsche Bank violated FERC's anti-manipulation rule, 18 C.F.R. § 1c.2, by engaging in a scheme wherein it entered 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. 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. FERC determined that these false designations violated FERC's regulation requiring the submission of accurate information to ISOs, 18 C.F.R. § 35.41(b).

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.

4. *Maxim Power Corporation, et al.*, Order Approving Stipulation and Consent Agreement, 156 FERC ¶ 61,223 (2016)

In September 2016, FERC issued an Order Assessing Civil Penalties for violations of the Commission's Anti-Manipulation Rule, which ordered Maxim Power to disgorge \$4,000,000 and pay a civil penalty of \$4,000,000. The Order was entered pursuant to a settlement. Previously, on May 1, 2015, FERC assessed civil penalties of \$5 million against Maxim Power Corporation, its affiliates and \$50,000 in civil penalties against Kyle Mitton, a Maxim employee. 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.

5. *MSO Virtual and FTR Trading*, 146 FERC ¶ 61,072 (2014)

In this 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 trades⁹⁹ 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 November 2009 to February 2010.

Dreyfus neither admitted nor denied the violations. Dreyfus 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.

6. *In re Make-Whole Payments and Related Bidding Strategies*, 144 FERC ¶ 61,068 (July 30, 2013)

In this 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. 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 generation and influencing energy and congestion prices.

As part of its settlement with FERC, JPMVEC admitted 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 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.

⁹⁹ 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, Stip. & Consent Agmt., at ¶ 8.

7. *Rumford Paper Co.*, 142 FERC ¶ 61,218 (2013)

In this power case, FERC determined that Rumford had engaged in fraud in ISO New England's ("ISO-NE") Day-Ahead Load Response Program ("DALRP"), thereby violating FERC's anti-manipulation rule, 18 C.F.R. § 1c.2, by inflating its load baseline and then repeatedly offering load reductions at the minimum offer price in order to maintain the inflated baseline. 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.

8. *Lincoln Paper and Tissue, LLC*, 144 FERC ¶ 61,162 (2013); *Competitive Energy Services, LLC*, 144 FERC ¶ 61,163 (2013); *Richard Silkman*, 144 FERC ¶ 61,164 (2013).

In this 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.

9. *Constellation Energy Commodities Group, Inc.*, 138 FERC ¶ 61,168 (2012)

In this 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, 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.

10. *Gila River Power, LLC* 141 FERC ¶ 61,136 (2012)

In this 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 so that they avoided creating congestion. As a result, Gila River received 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.

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. *Revised Policy Statement on Enforcement*, 123 FERC 61,156 ¶ 23 (May 15, 2008) (hereinafter, "Enforcement Policy Statement"). 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. 18 C.F.R. § 1b.8.

- (a) *Preliminary Investigation.* Conducted without the formal authorization of FERC. The OE may conduct such investigations as it deems appropriate to determine whether a formal investigation is warranted. 18 C.F.R. § 1b.6. The OE cannot use its subpoena power or compel testimony during a preliminary investigation. 18 C.F.R. § 1b.19. As a result, preliminary investigations rely on voluntary disclosures.
- (b) *Formal Investigation.* 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." 18 C.F.R. § 1b.13.

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) 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) 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"). 18 C.F.R. § 1b.9.

2. FERC's Compulsion Powers

A formal order of FERC is required to authorize the use of subpoenas. 18 C.F.R. § 1b.13. 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." 18 C.F.R. § 1b.16(a).

3. Testimony and Document Production

- (a) During the investigation stage, the target is free to contact the OE staff to provide information and explanations. *See* Enforcement Policy Statement ¶ 28. OE staff also frequently communicate with the target and its representatives to discuss relevant factual and legal issues. *See id.*
- (b) Targets 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. *See id.* ¶ 27.
- (c) 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." 18 C.F.R. § 1b.12.
- (d) Witnesses may be accompanied, represented, and advised by counsel. 18 C.F.R. § 1b.16. 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. *Id.* Counsel for a witness also has the right to question the witness during the interview. *Id.*
- (e) Counsel can represent more than one party, including serving as counsel to a witness and the witness's employer. However, when this occurs "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." 18 C.F.R. § 1b.16.
- (f) 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. 18 C.F.R. § 1b.9. Parties must submit a written request that FERC afford

confidential treatment under FOIA to any information submitted.
18 C.F.R. § 1b.9.

4. How FERC Actions are Resolved

(a) Wells Submissions and Settlement Efforts

- (1) 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. 18 C.F.R. § 1b.19.
- (2) 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

- (1) FERC considers the following factors in determining whether an entity has an effective compliance program and, thus, whether a penalty is warranted for an instance of noncompliance:
 - (i) 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;
 - (ii) Effective preventive measures, including hiring, training, accountability, and supervision policies;
 - (iii) Prompt detection, cessation, and reporting of an offense, with an emphasis on internal detection through strong compliance measures; and
 - (iv) Remediation, with an emphasis on the particular steps taken by the entity to remedy misconduct, including discipline of employees involved.

(2) These factors, applied on a fact-specific, case-by-case basis, may lead FERC to reduce or even eliminate the civil penalty assessed for a violation.

(i) 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."

(ii) 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.

Policy Statement on Compliance, 125 FERC ¶ 61,058 (Oct. 16, 2008).

(c) Determining Penalty: Settlements and Cooperation

(1) 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.

(2) 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. FERC Penalty Guidelines § 1C2.2.

- (3) 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. FERC Penalty Guidelines § 1C2.3. 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. *Id.*

5. Orders to Show Cause and Contested Actions

- (a) If the parties are unable to settle, the OE staff may recommend enforcement proceedings. However, before the OE staff makes the recommendation, it shall, except in exigent circumstances, allow the target entity to make a Wells Submission. The OE staff will then submit its report and the target entity's submissions to FERC for consideration. *See id.* ¶ 35.
- (b) 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. 18 C.F.R. § 385.
- (c) 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

- (a) The target entity may request a rehearing within 30 days after FERC issues an order assessing a penalty. FERC may grant or deny rehearing and may abrogate or modify its order without further hearing. 16 U.S.C. § 825l(a) (2012).
- (b) Following a decision on a request for rehearing, the target entity can appeal FERC's judgment to a federal Court of Appeals within sixty days after FERC's order. *See* 16 U.S.C. § 825l(b).

IV. 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. 42 U.S.C. § 17301.

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 (15 U.S.C. § 41 *et seq.*) 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 section 18(a)(1)(B) of the Federal Trade Commission Act (15 U.S.C. § 57a(a)(1)(B)). 42 U.S.C. § 17303.

B. Manipulation

1. Petroleum Market Manipulation Rule ("Anti-Manipulation Rule")

The FTC adopted its Anti-Manipulation Rule in 2009. 74 Fed. Reg. 40686 (Nov. 4, 2009). The rule 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.

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 U.S. Security and Exchange Commission's ("SEC") Rule 10b-5, which prohibited conduct made unlawful by Section 10b of the Securities Exchange Act of 1934 ("Section 10b"), including manipulating the U.S. securities markets. However, the FTC rule was "tailored to account for significant differences between wholesale petroleum markets and securities markets."¹⁰⁰ The rule 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.

The FTC, in deviating from the Rule 10b-5 template, "sought to achieve the appropriate balance between the flexibility needed to prohibit fraud-based market manipulation without burdening legitimate business activity."¹⁰¹ The FTC recognized that players in the petroleum marketplace

¹⁰⁰ Prohibitions on Market Manipulation, Final Rule, 74 Fed. Reg. at 40,690; *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).

¹⁰¹ Prohibitions on Market Manipulation, Final Rule, 74 Fed. Reg. at 40,690.

are "sophisticated and experienced commercial actors," which require markedly less protection than "individual retail securities investors."¹⁰²

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, as for omissions, 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.

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. *See* 16 C.F.R. § 317.2(c) (2014).
- 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."

¹⁰² *Id.*

- 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

- (a) The FTC can bring suit in federal court under the EISA or the Anti-Manipulation Rule. 42 U.S.C. § 17304(b) (2012).
- (b) The court can impose civil penalties of up to \$1 million per day per violation. 42 U.S.C. §§ 17304(a), (c)(1).
- (c) In assessing civil penalties, a court must take into account factors including (1) the seriousness of the violation and (2) any efforts by the violator to remedy the harm. 42 U.S.C. § 17304(c)(2)(A)-(B).
- (d) The court can also impose other remedies such as injunctive relief to stop illegal conduct. 42 U.S.C. § 17304(a).

2. Example Case: *Federal Trade Comm'n 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 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"). *Id.* at 583. 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. *Id.* When Ken Roberts resisted compliance with the CIDs, arguing that they were beyond the FTC's regulatory power, the FTC petitioned the U.S. District Court for 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. *Id.* at 584. 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. *Id.* at 585-87. 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. *Id.* at 590-92. Nor does the IAA manifestly preclude all agencies but the SEC from regulating the activities of investment advisers in advertising courses concerning investment. *Id.* at 592-93. 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." *Id.* at 593 (internal quotation marks omitted).

V. 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, 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.¹⁰³ 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.¹⁰⁴ In addition, the CEA imposes criminal liability for knowingly false statements. 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 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,¹⁰⁵ manipulation of propane prices,¹⁰⁶ spoofing and other prohibited trading practices,¹⁰⁷ and embezzlement.¹⁰⁸

2. Energy Policy Act of 2005

Under the Energy Policy Act of 2005, willful violations of the FPA, NGA, and Natural Gas Policy Act are punishable by penalties of up to \$1 million and up to five years' imprisonment.¹⁰⁹ While FERC is limited to civil enforcement of its statutes, orders, rules, and regulations, it may also 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

¹⁰³ 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).

¹⁰⁴ 7 U.S.C. § 13(a)(5).

¹⁰⁵ See, e.g., *United States v. Deutsche Bank AG*, 15-cr-61 (D. Conn. filed April 23, 2015); *United States v. Paul Robson, et al.*, 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).

¹⁰⁶ See, e.g., *United States v. BP America 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).

¹⁰⁷ 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).

¹⁰⁸ See, e.g., *United States v. Wasendorf*, No. 12-cr-2021 (N.D. Iowa filed Oct. 9, 2012).

¹⁰⁹ Energy Policy Act of 2005 §§ 314; 1284.

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.¹¹⁰

3. FTC Act

The FTC has similar authority to refer criminal violations to the DOJ for prosecution.¹¹¹ In addition, the DOJ may appoint FTC attorneys as special U.S. Attorneys to represent the U.S. 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.¹¹²

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 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.¹¹³ 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.¹¹⁴ 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

¹¹⁰ *United States v. Berkshire Power Company LLC et al.*, No. 3:16-cr-30021 (D. Mass. filed Mar. 30, 2016).

¹¹¹ FTC Act § 16(b).

¹¹² 15 U.S.C. § 6107(b).

¹¹³ 18 U.S.C. § 1341; *see also* U.S. Dep't of Justice, *Crim. Resource Manual* § 940; *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).").

¹¹⁴ U.S. Dep't of Justice, *Crim. Resource Manual* § 941; *see also United States v. Briscoe*, 65 F.3d 576, 583 (7th Cir. 1995); *United States v. Brooks*, 2009 WL 3644122, at *3 (E.D.N.Y. Oct. 27, 2009).

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."¹¹⁵

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.¹¹⁶

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 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 the circumstances of the case the restrictive practice imposes an unreasonable restraint on competition."¹¹⁷

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 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 10 years in

¹¹⁵ 18 U.S.C. § 1343.

¹¹⁶ See *United States v. Motz*, 652 F.Supp.2d 284, 295 (E.D.N.Y.2009) (citing *United States v. Mahaffy*, 2006 WL 2224518, at *11-12 (E.D.N.Y. Aug. 2, 2006).

¹¹⁷ *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 *Board of Trade of Chicago v. United States*, 246 U.S. 231, 238 (1918), which provided that "[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.").

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, 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 from at least June 2005 through October 2008, in a scheme by Deutsche Bank traders to coordinate their EURIBOR requests with traders at other banks to benefit their trading positions.

Other Sherman Act charges are found in several of the cases described in section G below.

(b) CEA Restraining Trade Provision

CEA section 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."¹¹⁸ Furthermore, swap dealers, among others, are prohibited from adopting "any rules or taking any action that results in any unreasonable restraint of trade" 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 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 section 1 of the Sherman Act. It is therefore likely that Sherman Act cases and its "rule of reason" doctrine (see (a) above) will act as precedent for the CFTC in this area. Restraint of trade in the Sherman Act context means restraint of competition. In order to establish liability it must be proven that the defendants engaged in a conspiracy to restrain or eliminate competition in the relevant market.

Antitrust law continues to have a major impact on CEA market manipulation jurisprudence. For example, the definitions of terms such as

¹¹⁸ Codified at 7 U.S.C. § 9(1)(A).

"corner" are derived primarily from antitrust litigation.¹¹⁹ Furthermore, DOJ has pursued Sherman Act charges in recent commodities cases.

¹¹⁹ See *Peto v. Howell*, 101 F.2d 353, 357-58 (7th Cir. 1938) (antitrust case defining corners in the commodities market).

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),¹²⁰ it is unlikely that the "conduct and effects" tests,¹²¹ which was traditionally used to determine whether the CEA applied, would be used to determine whether a criminal prosecution was improperly extraterritorial.

1. Extraterritorial Application of the CEA

There have been no post-*Morrison* criminal cases where defendants claimed that a prosecution was barred as an extraterritorial application of the CEA. However, courts hearing CEA claims brought by private litigants have begun to apply *Morrison*. The Second Circuit Court of Appeals endorsed the application of *Morrison*'s transaction-based test to the CEA in *Loginovskaya v. Batratchenko*.¹²² 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."¹²³ 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."¹²⁴ 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."¹²⁵ 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,

¹²⁰ 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.

¹²¹ 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., Commodity Futures Trading Comm'n v. Lake Shore Asset Mgmt. Ltd.*, 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.

¹²² 764 F.3d 266 (2d Cir. 2014).

¹²³ *Id.* at 266.

¹²⁴ *Id.* at 273.

¹²⁵ *Id.*

the complaint failed to allege that either title had passed or irrevocable liability was incurred within the United States.¹²⁶

In another case, *In re LIBOR-Based Financial Instruments Antitrust Litigation*, the court applied *Morrison* to a claim for manipulation under the CEA.¹²⁷ The *LIBOR* court first found that because section 9(a) of the CEA gives no indication of extraterritorial application, it has none.¹²⁸ After concluding that section 9(a) of the CEA 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."¹²⁹ 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."¹³⁰ The court therefore held that although the CEA does not apply extraterritorially, the manipulation alleged in this complaint fell within the CEA's reach.¹³¹

2. Extraterritorial Application of Wire Fraud Statute

The DOJ is often able to establish jurisdiction despite the fact that the conduct at issue occurred largely, if not entirely, overseas based on its Title 18 authority to prosecute mail or wire fraud. Pursuant to this authority, the DOJ would only need to show that a scheme to defraud that affects "interstate or foreign commerce," relied on the use of U.S. wires, sent either interstate or in foreign commerce. Consequently, an *intrastate* transmission would not satisfy this element, nor would a transmission sent between two foreign countries that does not pass through the United States.¹³² But so long as there was a U.S. communication, the DOJ would likely take the position that there was jurisdiction to prosecute wire fraud.

In this situation, several courts have ruled that it is not necessary for defendant to have sent the wire transmission himself, provided that use of the wires was a reasonably foreseeable result of his acts.¹³³ Further, case law holds that the transmission need not be essential to the scheme,

¹²⁶ *Id.* at 275.

¹²⁷ *In re LIBOR-Based Financial Instruments Antitrust Litigation*, 935 F. Supp. 2d 666 (S.D.N.Y. 2013), *vacated on other grounds*, *Gelboim v. Bank of America Corp.*, 823 F.3d 759 (2d Cir. 2016).

¹²⁸ *Id.* at 696.

¹²⁹ *Id.* (internal quotation marks omitted).

¹³⁰ *Id.* at 697.

¹³¹ *Id.*

¹³² *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 III.B.3.

¹³³ *United States v. Gill*, 909 F.2d 274, 278 (7th Cir. 1990).

provided it was incident to the accomplishment of an essential part of the scheme.¹³⁴ 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.¹³⁵

Therefore, on its face, the wire fraud statute appears to allow for a broad extraterritorial application for 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.¹³⁶ Despite the varied approaches, where a scheme involves the use of U.S. wires and additional U.S. contacts, a court will likely find that application of the wire fraud statute to this conduct does not raise extraterritorial concerns.

¹³⁴ *United States v. Mann*, 884 F.2d 532, 536 (10th Cir. 1989).

¹³⁵ *United States v. Castillo*, 829 F.2d 1194, 1199 (1st Cir. 1987).

¹³⁶ 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 *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).

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 often play a leading role, particularly in matters involving corporate liability of large financial institutions.¹³⁷ In recent years, the Fraud Section has become 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 Sherman Act violations.¹³⁸ In cases involving commodities or derivatives manipulation, the Antitrust Division often operates in tandem with the Criminal Division. The Antitrust Division maintains staff in Washington, as well as in several regional field offices in major U.S. cities. These field offices operate independently and are generally physically separate from the U.S. Attorney's Offices in those same cities.

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.¹³⁹ Each office is led by a United States Attorney, who is a Presidential appointee. While the United States 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 will often

¹³⁷ See U.S. Dep't. of Justice, Fraud Section Year in Review 2015 (<https://www.justice.gov/criminal-fraud/file/833301/download>).

¹³⁸ See U.S. Dep't of Justice, Antitrust Division Manual (April 2015) (<https://www.justice.gov/atr/file/761126/download>).

¹³⁹ See U.S. Dep't of Justice, Mission (September 22, 2016) (<https://www.justice.gov/usao/mission>).

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 have established dedicated securities and commodities fraud units, are particularly known for bringing sophisticated and aggressive commodities and derivatives prosecutions.¹⁴⁰

¹⁴⁰ 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>).

E. Cooperation, Investigation and Procedure

1. Cooperation with the DOJ Generally

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 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."¹⁴¹ 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."¹⁴² These relevant facts include: "[H]ow and when did the alleged misconduct occur? Who promoted or approved it? Who was responsible for committing it?"¹⁴³

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.¹⁴⁴

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 cooperation credit."¹⁴⁵ Thus, any attempt to cooperate and seek credit should be taken on diligently and with the full commitment of all involved.

¹⁴¹ U.S. Dep't of Justice, United States Attorneys' Manual § 9-28.700.

¹⁴² *Id.*

¹⁴³ *Id.* at § 9-28.720.

¹⁴⁴ U.S. Dep't of Justice, United States Attorneys' Manual § 9-28.710.

¹⁴⁵ Marshall L. Miller, Principal Deputy Ass't Att'y Gen., U.S. Dep't of Justice, Remarks before the Global Investigation Review Program (17 Sept. 2014) (<https://www.justice.gov/opa/speech/remarks-principal-deputy-assistant-attorney-general-criminal-division-marshall-l-miller>).

2. Individual Accountability

DOJ's focus on individual accountability is a relatively new development. In 2015, DAG Sally Yates announced a "substantial shift" from the DOJ's prior practice through the issuance of a DOJ-wide memorandum regarding "Individual Accountability for Corporate Wrongdoing."¹⁴⁶ Now popularly referred to as the "Yates Memo," the directive states that "[i]n order for a company to receive any consideration for cooperation," it is necessary for the company to "completely disclose to the Department all relevant facts about individual misconduct."¹⁴⁷ In other words, "[c]ompanies cannot pick and choose what facts to disclose," but "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" to be eligible for any cooperation credit.¹⁴⁸

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. And now, to achieve cooperation under the Yates Memo, 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.

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. 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.

¹⁴⁶ Sally Quillian Yates, Deputy Att'y Gen., U.S. Dep't of Justice, Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015) (<http://www.justice.gov/dag/file/769036/download/>) (Appendix B).

¹⁴⁷ *Id.* (emphasis in original).

¹⁴⁸ *Id.*; see also Marshall L. Miller, Principal Deputy Ass't Att'y Gen., U.S. Dep't of Justice, 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>) ("Voluntary disclosure of corporate misconduct does not constitute true cooperation, if the company avoids identifying the individuals who are criminally responsible. Even the identification of culpable individuals is not true cooperation, if the company fails to locate and provide facts and evidence at their disposal that implicate those individuals.").

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.¹⁴⁹

The benefits of leniency are significant and include:

- (1) the company will not be charged criminally if certain conditions are met;
- (2) cooperating employees will also not be criminally charged; and
- (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 effects on US domestic commerce. The applicant must also take prompt action to halt the offending conduct and, as a corporate act, confess its wrongdoing.

An application for leniency is initiated by counsel for the company calling the Division to secure a "marker," which generally requires

¹⁴⁹ Further information, including the full leniency policy, can be found at <http://www.justice.gov/atr/public/criminal/leniency.html>.

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 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-lenieny 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 U.S. Department of Justice 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, recent caselaw (albeit addressing the use of a search warrant as opposed to a subpoena) has restricted the government's ability to compel the production of records held overseas.¹⁵⁰

Productions made pursuant to grand jury subpoenas are governed by rules mandating grand jury secrecy. Moreover, grand jurors, federal prosecutors, and others aware of the grand jury's deliberations are generally forbidden from disclosing matters that occur before a grand jury. This requirement often restricts the ability of the DOJ to disseminate documents obtained by grand jury subpoena to other regulatory agencies. Witnesses that appear before a grand jury are not covered by this secrecy obligation. The DOJ 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

¹⁵⁰ See *Matter of Warrant to Search a Certain E-Mail Account Controlled & Maintained by Microsoft Corp.*, 829 F.3d 197 (2d Cir. 2016).

before a grand jury do not have a right to be accompanied by counsel during the testimony, but do have a right to consult with counsel outside of the presence of the grand jury during their testimony. Often, the DOJ will seek a voluntary interview before, or in lieu of, issuing a subpoena. Individuals that are considered "targets"¹⁵¹ of the investigation, i.e. 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" have certain additional rights.¹⁵² Targets must be informed that they are considered such before a prosecutor may compel them to testify before a grand jury. The DOJ cannot rely on its grand jury subpoena power to compel testimony from foreign witnesses.¹⁵³

(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.¹⁵⁴

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 representatives of the CFTC. In July 2002, the Corporate Fraud Task Force was

¹⁵¹ U.S. Attorney's Manual § 9-11.150.

¹⁵² *Id.* at § 9-11.151.

¹⁵³ *See U.S. v. Johnpoll*, 739 F.2d 702, 709 (2d Cir. 1984) (witness' presence in Switzerland precluded service of process); *U.S. 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'r's death*, 389 U.S. 329 (1967).

¹⁵⁴ CFTC, Futures Industry Registrants by Location (Oct. 1, 2010) (<http://www.cftc.gov/ucm/groups/public/@educationcenter/documents/file/registrantsbylocation.pdf>).

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 York, the Assistant Attorney General for the Criminal Division, the Director of Enforcement for the SEC, and the Director of Enforcement for the CFTC.

The CFTC's willingness to cooperate with other enforcement authorities is not absolute however. Notably, the CFTC has taken actions to protect its exclusive jurisdiction to regulate transactions involving or conducted on regulated markets, such as the NYMEX.¹⁵⁵

¹⁵⁵ See *Hunter v. Federal Energy Regulatory Comm'n*, 711 F.3d 155 (D.C. Cir. 2013).

F. DOJ Charging Decisions

1. General Principles for Charging

Although civil regulators such as CFTC, FERC, and the FTC do not themselves bring criminal charges against entities or individuals, they can refer criminal violations of U.S. law DOJ for prosecution. Charges for the offenses described in this chapter are often brought by grand jury indictment.¹⁵⁶

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."¹⁵⁷

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 typically must 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, companies and individuals can refuse to cooperate with a DOJ investigation and instead try to contest the charges on the merits.

¹⁵⁶ An indictment may be obtained when a prosecutor presents evidence to a federal grand jury that allows the grand jury to conclude that there is probable cause to believe that a person or entity committed a crime. An information can be filed in place of an indictment when a defendant waives indictment by a grand jury.

¹⁵⁷ See U.S. Dep't of Justice, Coordination of Parallel Criminal, Civil, Regulatory, and Administrative Proceedings (January 30, 2012) (<https://www.justice.gov/usam/organization-and-functions-manual-27-parallel-proceedings>) (Appendix D).

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.¹⁵⁸ Cooperation is emphasized particularly. 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

DOJ has recently reemphasized its focus on individual accountability. DOJ considers individual accountability to be important for several reasons, including deterrence of future illegal activity, incentivizing changes in corporate behavior, ensuring that proper parties are held responsible for their actions, and promoting public confidence in the U.S. justice system.¹⁵⁹ Pursuant to this policy, DOJ requires a company seeking cooperation credit to completely disclose to the Department all relevant facts about individual misconduct.¹⁶⁰ These relevant facts include the identification of all individuals involved in or responsible for the misconduct at issue, regardless of any individual's position, status or seniority, and details pertaining to how and when the misconduct occurred and who promoted or approved it.¹⁶¹ Notably, 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.¹⁶²

¹⁵⁸ U.S. Dep't of Justice, United States Attorneys' Manual § 9-28.300; Mark Filip, Deputy Att'y Gen, U.S. Dep't of Justice, Principles of Federal Prosecution of Business Organizations (Aug. 28, 2008) (<https://www.justice.gov/sites/default/files/dag/legacy/2008/11/03/dag-memo-08282008.pdf>) (Appendix A).

¹⁵⁹ Sally Quillian Yates, Deputy Att'y Gen., U.S. Dep't of Justice, Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015) (<http://www.justice.gov/dag/file/769036/download/>) (Appendix B).

¹⁶⁰ *Id.*

¹⁶¹ *Id.*; see also Marshall L. Miller, Principal Deputy Ass't Att'y Gen., U.S. Dep't of Justice, Remarks before the Global Investigation Review Program (17 Sept. 2014) (<https://www.justice.gov/opa/speech/remarks-principal-deputy-assistant-attorney-general-criminal-division-marshall-l-miller>) ("Voluntary disclosure of corporate misconduct does not constitute true cooperation, if the company avoids identifying the individuals who are criminally responsible. Even the identification of culpable individuals is not true cooperation, if the company fails to locate and provide facts and evidence at their disposal that implicate those individuals.").

¹⁶² Sally Quillian Yates, Deputy Att'y Gen., U.S. Dep't of Justice, Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015) (<http://www.justice.gov/dag/file/769036/download/>) (Appendix B).

(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.¹⁶³ 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 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).¹⁶⁴ 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.¹⁶⁵

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.¹⁶⁶ 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.

¹⁶³ 18 U.S.C. § 3181 note (listing countries with which the U.S. has an extradition treaty).

¹⁶⁴ *See, e.g., United States v. Wright*, 343 F.3d 849, 857 (6th Cir. 2003); *United States v. Sruulowitz*, 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).

¹⁶⁵ 18 U.S.C. § 3292(a) (1984).

¹⁶⁶ *See* INTERPOL, Red Notices (<https://www.interpol.int/INTERPOL-expertise/Notices/Red-Notices>).

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.¹⁶⁷ 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."¹⁶⁸ While most of the trading activity occurred in London, related trading activity and wires used to settle accounts were routed through New York.¹⁶⁹

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.¹⁷⁰ Notably, in October 2013, two years before Thompson was arrested, Rabobank resolved its own LIBOR liability by entering into a deferred prosecution agreement with the DOJ and paying a \$325 million penalty.¹⁷¹

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

¹⁶⁷ 18 U.S.C. § 1343.

¹⁶⁸ *United States v. Mark Johnson and Stuart Scott*, No. 16M0674 (E.D.N.Y. July 19, 2016) (Complaint and Affidavit in Support of Application for Arrest Warrants).

¹⁶⁹ *Id.*

¹⁷⁰ *United States v. Anthony Allen et al.*, No. 1:14-cr-00272 (S.D.N.Y. Oct. 16, 2014) (Indictment).

¹⁷¹ *United States v. Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. ("Rabobank")*, No. 3:13-cr-00200 (D. Conn. Oct. 29, 2013) (Deferred Prosecution Agreement).

individuals are located outside the subpoena power of the prosecutor.

G. Recent DOJ Derivative and Commodity Market Prosecutions

1. *United States v. Mark Johnson & Stuart Scott*, No 16-cr-00457 (E.D.N.Y. filed July 19, 2016) (wire fraud-based charges for front-running a client's foreign exchange trade).

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.

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 allegedly 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 its conduct.

2. *United States v. Barclays PLC*, No. 15-cr-00077 (D. Conn. filed May 20, 2015); *United States v. Citicorp*, No. 15-cr-00078 (D. Conn. filed May 19, 2015); *United States v. The Royal Bank of Scotland plc*, No. 15-cr-00080 (D. Conn. filed May 20, 2015); *United States v. JP Morgan Chase & Co.*, No. 15-cr-00079 (D. Conn. filed May 19, 2015) (conspiracy to manipulate currency values).

In May 2015, Citicorp, JPMorgan Chase & Co., Barclays PLC, and The Royal Bank of Scotland plc agreed to plead guilty to conspiring to manipulate the price of U.S. dollars and euros exchanged in the foreign currency exchange ("FX") spot market and to pay criminal fines totaling more than \$2.5 billion. 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 alleges 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.

3. *United States v. UBS AG.*, No. 15-cr-00076 (D. Conn. filed May 20, 2015) (wire fraud in connection with a scheme to manipulate benchmark interest rates; violation of previous non-prosecution agreement).

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 also agreed to pay a criminal penalty of \$203 million.

4. *United States v. Deutsche Bank AG*, 15-cr-61 (D. Conn. filed on April 23, 2015) (deferred prosecution of wire fraud and antitrust charges in benchmark interest rate manipulation scheme).

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 from at least June 2005 through October 2008, in a scheme by Deutsche Bank traders to coordinate their EURIBOR requests with traders at other banks to benefit their trading positions.

5. *United States v. Sarao*, No. 15-cr-75 (N.D. Ill. unsealed Apr. 21, 2015) (prosecution of London-based trader for criminally spoofing U.S. futures markets in connection with 2010 "flash crash").

In February 2015, the DOJ filed under seal a complaint charging Navinder Singh Sarao with 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 in 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.

6. *United States v. Coscia*, No. 14-0551 (N.D. Ill. filed Oct. 1, 2014) (commodities fraud and spoofing for deceptive high-frequency trading).

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 and six counts of "spoofing" under the CEA. The indictment marked 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.

7. *United States v. Paul Robson, et al.*, No. 1:14-cr-00272 (S.D.N.Y. filed April 28, 2014) (wire fraud and bank fraud charges for LIBOR manipulation).

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.

8. *United States v. Martin-Artajo*, No. 13-cr-707 (S.D.N.Y. filed Aug. 14, 2013) (wire fraud in connection with scheme to mis-value certain derivatives).

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 of 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. The case is still pending.

9. *United States v. Taylor*, No. 13-cr-00251 (S.D.N.Y. filed Apr. 4, 2013) (wire fraud in connection with a futures trading scheme to defraud employer).

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.

10. *United States v. Wasendorf*, No. 12-cr-2021 (N.D. Iowa filed Oct. 9, 2012) (mail fraud in connection with embezzlement of commodities futures customer funds).

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.

11. *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) (false reporting and manipulation of natural gas prices).

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.

12. *United States v. Dooley*, No. 10-cr-0335 (N.D. Ill. 2010) (willful violation of the CFTC's position limits for wheat futures).

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.

13. *United States v. BP America Inc.*, No. 07-cr-00683 (N.D. Ill. filed Oct. 25, 2007) (deceptive trading, wire fraud, and manipulation of propane prices).

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.

14. *United States v. Radley*, 659 F. Supp. 2d 803 (S.D. Tex. 2009), *aff'd*, 632 F.3d 177 (5th Cir. 2011) (acquittal for propane price manipulation).

In a criminal case against four former BP traders, the DOJ alleged that the defendants committed a criminal manipulation offense under the CEA 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 alleges specific instances of defendants attempting to conceal their actions, it never alleges that defendants lied about their activity. Mere concealment is not sufficient to show that their actions were not legitimate forces of supply and demand."

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.¹⁷²

The criminal market abuse regime is contained in section 397 of the Financial Services and Markets Act 2000 ("FSMA") (in respect of conduct occurring prior to April 1, 2013), Sections 89 and 90 of the Financial Services Act 2012 ("FSA 2012") (in respect of conduct occurring after on or April 1, 2013) and Part 5 of the Criminal Justice Act 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 as 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.

¹⁷² 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.

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 remain to be released and the date for some provisions to come into force has been delayed 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 ("MiFID"), this brings many commodity derivatives not previously covered by the market-abuse regime within its ambit.

MAR 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 UK civil market abuse regime both as in force previously under Part 8 of FSMA (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". FSMA § 118(1)(a).

Pursuant to this standard, "behavior" can consist of action or inaction. *Id.* § 130A(3). A failure to act constitutes a "behavior" either:

- (1) when it "involves failing to discharge a legal or regulatory obligation," (1.2.6E(1) of the Code); or
- (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," (*id.* 1.2.6E(2)).

Behaviors proscribed by the market-abuse regime were:

- (1) Insider dealing, defined as "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." (FSMA § 118(2)).

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. *See* FSMA § 118C. However, in all cases, the information in question had to have been:

- (i) "precise";¹⁷³
- (ii) not "generally available";¹⁷⁴ and
- (iii) 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.¹⁷⁵

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. *See* FSMA § 118B.

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.¹⁷⁶ 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.

¹⁷³ 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, 28 June 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 and *Lafonta v AMF* (Case C628/13, 11 March 2015)).

¹⁷⁴ 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.

¹⁷⁵ 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).

¹⁷⁶ 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.

- (3) Improper disclosure of inside information, defined as "where an insider discloses inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties." FSMA § 118(3).
 - (i) Improper disclosure differs from insider dealing in that no dealing is required in order for market abuse to occur. The mere fact of "improper disclosure" suffices.
 - (ii) 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. (1.4.5E(2) of the Code).
- (4) Misuse of information, which 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." FSMA § 118(4).
 - (i) 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 take action 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).
 - (ii) 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.

- (5) Manipulating transactions, which occurred "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." FSMA § 118(5).
- (i) The statutory definition of this behavior is 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." (1.6.2E).
 - (ii) 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 (1.6.5E of the Code). 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.
 - (iii) 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 (1.6.7G of the Code). 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.
- (6) Manipulating devices, which occur "where the behavior consists of effecting transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance." FSMA § 118(6).
- (i) 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."

- (ii) 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.(1.7.2E of the Code).
- (7) Dissemination of false or misleading information, which 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." FSMA § 118(7).
 - (i) This provision covered both dissemination of information through the media (although FSMA recognizes elsewhere that journalists are in a special position¹⁷⁷) and undertaking a course of conduct in order to give a false or misleading impression.
 - (ii) 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 (1.8.6E(1) of the Code).
- (8) Misleading behavior or distortion, which occurs "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." FSMA § 118(8).

¹⁷⁷ See FSMA § 118A(4).

- (i) 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 "... the European Directive preceding MAR, the Market Abuse Directive ("MAD") provisions.
 - (ii) 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.
 - (iii) This provision lapsed on July 3, 2016.
- (a) "In relation to":
- (1) Neither FSMA nor MAD expressly delineated the circumstances under which conduct will be deemed to be "in relation to" qualifying investments.
 - (2) 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. *See* the Code at 1.2.5E.
 - (3) 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. *See, e.g., FSA Final Notices issued to Welcome Financial Services Limited and Cattles Limited in March 2012* (<http://www.fsa.gov.uk/static/pubs/final/cattles-ltd.pdf> and <http://www.fsa.gov.uk/static/pubs/final/welcome-financial-service.pdf>).
- (b) "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. Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001 (SI 2001/996) ("PMQI Order"). This list included a wide range of securities, instruments, and commodities.

(c) "Related investment":

- (1) 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."
- (2) A "related investment" was "an investment whose price or value depends on the price of [a] qualifying investment." FSMA § 130A(3). This definition was broad and included, for example, OTC and exchange-traded derivatives.

(d) "Prescribed market": The "prescribed markets" were set out in the PMQI Order and include 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." (1.2.3G of the Code).

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 of associated individuals, that there is no need for a person to have an "actuating purpose" in order to commit market abuse. *Winterflood Securities Limited v FSA*, Financial Services and Markets Tribunal, Mar. 11, 2009.¹⁷⁸

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

¹⁷⁸ Available at http://www.tribunals.gov.uk/financeandtax/Documents/decisions/FSMTribunal/066_WinterfloodSecuritiesLimitedStephenSotiriouJasonRobins.pdf.

transaction or order to trade that gives a false or misleading impression or secured the price of investments at an abnormal or artificial level.

The 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. *See, e.g.*, 1.6.2E of the Code.

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. *See* 1.6.3G of the Code. 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 on 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.¹⁷⁹

The FSA and the FCA have, however, demonstrated that its 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 markets) from and/or on markets located in, for example, the US,¹⁸⁰ Japan,¹⁸¹ Canada,¹⁸² Switzerland,¹⁸³ Lithuania,¹⁸⁴ and Dubai,¹⁸⁵ or who have subsequently located themselves in those jurisdictions.

¹⁷⁹ As explained above, the scope of the regime is wider for insider dealing and improper disclosure, which take account of behavior in relation to "related investments."

¹⁸⁰ *See* FCA Final Notice, *Michael Coscia*, July 3, 2013 (<http://www.fca.org.uk/your-fca/documents/final-notice/2013/michael-coscia>).

¹⁸¹ *See* FSA Final Notice, *Philippe Jabre & GLG Partners LP*, Aug. 1, 2006 (<http://www.fsa.gov.uk/static/pubs/final/jabre.pdf>).

¹⁸² *See* 7722656 *Canada Inc (formerly carrying on business as Swift Trade) v. FSA*, Upper Tribunal (Tax and Chancery Chamber), Jan. 23, 2013

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.¹⁸⁶

4. Defenses

The "defenses" under the civil market abuse regime applicable prior to July 3, 2016 are described below.

(http://www.tribunals.gov.uk/financeandtax/Documents/Canada_Inc_Swift_Trade_Inc_and_Peter_Beck_v_FSA.pdf).

¹⁸³ See *Chaligne, Sejean, and Diallo v. FSA*, Upper Tribunal (Tax and Chancery Chamber), Apr. 15, 2012 (http://www.tribunals.gov.uk/financeandtax/Documents/decisions/C_S_D_v_FSA.pdf).

¹⁸⁴ See *Michiel Visser and Oluwole Fagbulu v. FSA*, Upper Tribunal (Tax and Chancery Chamber), (FS/2010/0001 and FS/2010/0006), Aug. 9, 2011 (http://www.tribunals.gov.uk/financeandtax/Documents/decisions/VisserandFagbulu_v_FSA.pdf).

¹⁸⁵ See FSA Final Notice, *Rameshkumar Goenka*, Oct. 17, 2011 (http://www.fsa.gov.uk/static/pubs/final/rameshkumar_goenka.pdf).

¹⁸⁶ 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.

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.¹⁸⁷

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 are 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 "possesses¹⁸⁸ inside information and uses¹⁸⁹ that information by acquiring or disposing of (for his own account or for that of a third

¹⁸⁷ 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.

¹⁸⁸ 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.

¹⁸⁹ 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.

party), directly or indirectly, financial instruments to which that information relates."¹⁹⁰

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.¹⁹¹

"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,"¹⁹² 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

¹⁹⁰ 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.

¹⁹¹ 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.

¹⁹² 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.". Recital 17 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.

concerned or on the prices of certain related instruments or contracts.¹⁹³ (article 7(1), MAR)

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 (articles 7(1)(a), (b), (c) and (d), MAR respectively). In October 2016, ESMA published its final guidelines in relation to the meaning of "inside information" under MAR for the purposes of commodity derivatives.¹⁹⁴

- (1) 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 (article 7(1)(b), MAR). 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 Organisations Database Initiative for oil.
- (2) 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.

¹⁹³ 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.

¹⁹⁴ 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

- (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.¹⁹⁵

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 a 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 behaviour 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

¹⁹⁵ 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

conformity with an "accepted market practice"¹⁹⁶ (Article 12(1)(a), MAR)

- (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" (Article 12(1)(b), MAR)
- (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 rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading" (Article 12(1)(c) MAR)
- (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" (Article 12(1)(d), MAR)¹⁹⁷
- (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

¹⁹⁶ "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.

¹⁹⁷ 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.

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" (Article 12(2)(a), MAR)

- (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" (Article 12(2)(b), MAR)
- (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 the one of the effects set out in articles 12(1)(a) or (b) by:
 - (i) disrupting or delaying the functioning of the trading system of the trading venue or being likely to do so;
 - (ii) 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
 - (1) 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" (Article 12(2)(c), MAR)
- (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 having simultaneously disclosed that conflict of interest to the public in a proper and efficient way" (Article 12(2)(d), MAR)
 - (i) "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" (Article 12(2)(e), MAR).

- (9) Attempted market manipulation is a separate behavior. It takes in circumstances including where activities which would amount to manipulation as described above are commenced but not completed.¹⁹⁸

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

- (a) Behavior which, provided certain conditions are complied with, will not amount to particular types of market abuse is described above.
- (b) 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.¹⁹⁹

5. Defenses

Before MAR, FSMA § 123(2), provided a defense to the imposition of a penalty for market abuse (although not a defense to liability) if the relevant person could show that he believed on reasonable grounds that his behavior was not market abuse, or if he could show that he took all reasonable precautions and exercised all due diligence to avoid committing market abuse. The threshold for this defense was very high

¹⁹⁸ Article 15 and recital 46, MAR

¹⁹⁹ Article 9, MAR

because it was almost impossible for individuals in particular to show that they have taken "**all** reasonable precautions" and exercised "**all** due diligence" (emphases added).

Following MAR, these defenses have been removed from FSMA. There are no equivalent defenses in the operative provisions of MAR.

Recital 30 to MAR provides "*where legal persons have taken all reasonable measures to prevent market abuse from occurring but nevertheless natural persons within their employment commit market abuse on behalf of the legal person, this should not be deemed to constitute market abuse by the legal person.*"

This recital appears to provide a company with an equivalent to the "reasonable precautions" defense previously found in FSMA § 123(2), but the recital is not reflected in the operative provisions of the Regulation and is silent as to whether an equivalent defense is available to individuals.

It remains the case that the FCA is entitled to impose a penalty of such amount as it deems appropriate. Thus it will remain open to the FCA to reduce or remove a penalty where the conditions previously found in FSMA § 123(2) are satisfied if the FCA deems that appropriate in all the circumstances.

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. *Id.* The trader may be able to avoid a penalty on the same basis, or if he establishes that he reasonably believed that he was not committing 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 offenses where the conduct amounting to the commission of the offense falls within the scope of specific criminal offenses.²⁰⁰

1. Application to the Commodities Markets

Like its civil counterpart described above, the criminal market-abuse regime in the UK encompasses the commodities markets. Of the offenses 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:

- (a) The addition of a new specific offense in relation to benchmarks; and
- (b) 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 offense for a person to:
 - (1) "make a statement that he/she knows to be false or misleading in a material respect;" or
 - (2) "make a statement which is false or misleading in a material respect, being reckless as to whether it is;" or

²⁰⁰ 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 offenses 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 offenses and has taken action for fraud and forgery offenses 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 31 convictions in criminal market abuse cases. All of these have involved the prosecution of individuals for insider dealing offenses.

- (3) "dishonestly conceal any material facts whether in connection with a statement made by that person or otherwise;"²⁰¹
- (4) "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:
 - (5) enter into or offer to enter into, or to refrain from entering into or offering to enter into, a relevant agreement;
 - (6) to exercise, or refrain from exercising, any rights conferred by a relevant investment."²⁰²

Trading in commodities falls within one or both of the definitions of "relevant agreement"²⁰³ and/or "relevant investment,"²⁰⁴ 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"²⁰⁵ if the person:

- (1) "intends to create the impression;"²⁰⁶ 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;"²⁰⁷ 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

²⁰¹ Financial Services Act 2012 § 89(1).

²⁰² *Id.* § 89(2).

²⁰³ *Id.* § 93(3).

²⁰⁴ *Id.* § 93(5).

²⁰⁵ *Id.* § 90(1).

²⁰⁶ *Id.* § 90(1)(a).

²⁰⁷ *Id.* § 90(2).

himself or herself or another or to cause a loss for another person or expose another person to a loss.²⁰⁸

(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 offense covering false and misleading statements made in connection with the setting of benchmark rates.²⁰⁹

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.²¹⁰

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 of prosecuting these offenses (and has received some dedicated additional funding and resources from the UK government to enable it to do so).²¹¹

3. Territorial Application

(a) 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;

²⁰⁸ *Id.* §§ 90 (3)-(4).

²⁰⁹ *Id.* § 91.

²¹⁰ Financial Services Act 2012 (Misleading Statements and Impressions) Order 2013/637, Article 3

²¹¹ 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 offenses 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 US Dollar 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.

- (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.²¹²
- (b) 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.²¹³

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).²¹⁴

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.²¹⁵

²¹² *Id.* § 89(4).

²¹³ *Id.* § 90(10).

²¹⁴ *Id.* §§ 89(3), 90(9)(b)-(d), & 91(3)-(4).

²¹⁵ *Id.* § 90(9)(a).

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 take action 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 taking action against them under the civil or criminal market-abuse regimes.

Similarly, there is no bar to the FCA's taking action 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. FSMA § 19.

In practice, however, they prohibit a much wider range of behavior. They are not limited to conduct relating to "qualifying investments" or "related investments" or "prescribed markets," and apply to all conduct, whether or not it falls within one of the seven types of behavior proscribed under the market abuse regime.

The FCA can take action 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 take action under the Principles.²¹⁶

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." FSMA § 59.²¹⁷

²¹⁶ 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-notice/wh-ireland.pdf>

²¹⁷ 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>)

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 March 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 take action 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.^{218 219}

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's and the other regulator(s) investigating and enforcing their own rules.²²⁰

²¹⁸ 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.

²¹⁹ 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 purchase coffee futures. *See Financial Conduct Authority v David John Hobbs* [2013] EWCA Civ 918 at <http://www.bailii.org/ew/cases/EWCA/Civ/2013/918.html>

²²⁰ 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-notice/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.

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).²²¹

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 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.²²²

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.²²³

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

²²¹ 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.

²²² FSMA § 174(2).

²²³ Enforcement Guide, Chapter 12.

from the financial services industry²²⁴ or to require the disgorgement of profits.²²⁵

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,²²⁶ 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. FSMA § 126.

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.

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. FSMA § 123(1). 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 rules²²⁷ 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.

²²⁴ See, e.g., FSA Final Notice issued to Christian Littlewood, May 31, 2012 (<http://www.fsa.gov.uk/static/pubs/final/christian-littlewood.pdf>).

²²⁵ See, e.g., FSA Final Notice issued to Anjam Ahmad, June 22, 2010 (<http://www.fsa.gov.uk/static/pubs/final/ahmad.pdf>).

²²⁶ Decision Procedure and Penalties Manual ("DEPP") Chapter 5.1.

²²⁷ Regulation 26B and Schedule 3, Tribunal Procedure (Upper Tribunal) Rules 2008 (SI 2008/2698).

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 defence 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.²²⁸

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 2007.²²⁹

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 too action under section 118(5) of FSMA in connection with his actions, on the instructions of a client, to place large numbers of orders with a view to raising the price of coffee futures to a particular level.²³⁰

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.²³¹

²²⁸ *Chaligné, Sejean and Diallo v. FSA*, Upper Tribunal (Tax and Chancery Chamber), Apr. 15, 2012 (http://www.tribunals.gov.uk/financeandtax/Documents/decisions/C_S_D_v_FSA.pdf).

²²⁹ *Michiel Visser and Oluwale Fagbulu v. FSA*, Upper Tribunal (Tax and Chancery Chamber), (FS/2010/0001 and FS/2010/0006), Aug. 9, 2011 (http://www.tribunals.gov.uk/financeandtax/Documents/decisions/VisserandFagbulu_v_FSA.pdf).

²³⁰ FSA Final Notice, *Andrew Charles Kerr*, June 2, 2010 (http://www.fsa.gov.uk/pubs/final/andrew_kerr.pdf).

²³¹ *Geddis v. FSA*, Aug. 26, 2011 (http://www.tribunals.gov.uk/financeandtax/Documents/decisions/JasonGeddis_v_FSA.pdf).

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.²³²

3. Layering

In July 2013, the FCA imposed a financial penalty of US \$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 US \$2.1 million.²³³

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 2008.²³⁴

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.²³⁵

²³² FCA Final Notice, *Mark Stevenson*, March 20 2014 (<https://www.fca.org.uk/publication/final-notices/mark-stevenson.pdf>)

²³³ FCA Final Notice, *Michael Coscia*, July 3, 2013 (<http://www.fca.org.uk/your-fca/documents/final-notices/2013/michael-coscia>).

²³⁴ *Swift Trade Inc and Beck v FSA*, Upper Tribunal (Tax and Chancery Chamber) (FS/2011/0017; FS/2011/0018), January 23 2013.

²³⁵ 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 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).

I. 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 June 29, 2013. *See* Electricity & Gas (Market Integrity and Transparency) (Enforcement etc.) Regulations 2013.

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, REMIT Articles 3(1) & 3(5);
2. requires the disclosure of "inside information" before trades can take place, *id.* Articles 4(1)-4(3);
3. prohibits "market manipulation" or the dissemination of incorrect information giving false or misleading signals in relation to supply, demand or prices, *id.* at Article 5; and
4. imposes transaction reporting obligations on energy traders, *id.* at Article 15.

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 guidelines²³⁶ setting out the process for enforcement, a penalties statement²³⁷ setting out how it will decide whether to impose a penalty or take other action, when action will be taken and the process

²³⁶ <https://www.ofgem.gov.uk/publications-and-updates/consultation-decision-remit-procedural-guidelines-and-penalties-statement-consultation>

²³⁷ https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/remit_penalties_statement_23_june_2015_1.pdf

for determining the appropriate level of penalties and a prosecution policy statement²³⁸ stipulating the circumstances in which it will prosecute insider dealing or market manipulation offenses.

²³⁸ 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 offenses in relation to insider dealing under the Gas Act 1986 and the Electricity Act 1989 -
https://www.ofgem.gov.uk/system/files/docs/2016/02/criminal_prosecution_policy_statement_29_february_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 (DOJ), the U.S. Commodity Futures Trading Commission (CFTC), the Federal Energy Regulatory Commission (FERC), as well as the New York State Department of Financial Services (NYDFS) 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 based on 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) 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 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.
 - (1) 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 home in the forum state."²³⁹ 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.²⁴⁰
 - (2) Notably, courts obtain personal jurisdiction over individuals when they are physically present in the forum, even if only transiently.

²³⁹ *Daimler AG v. Bauman*, 134 S. Ct. 746, 754 (2014).

²⁴⁰ *Id.* at 761 n.19; *see also Gucci America, Inc. v. Weixing Li*, 768 F.3d 122 (2d Cir. 2014).

- (3) 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?"
- (4) In the criminal context, courts exercising personal jurisdiction must do so in a manner consistent with federal due process.²⁴¹ 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."²⁴²
- (5) *Gucci America, Inc. v. Weixing Li*, 768 F.3d 122 (2d Cir. 2014)
 - (i) 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.²⁴³
 - (ii) The question of whether the bank is subject to specific jurisdiction was remanded to the lower court.

2. Extraterritoriality Principles

- (a) Extraterritoriality refers to the ability of U.S. courts to adjudicate matters that involve conduct and actors that are beyond U.S. geographical borders. While courts may find that specific U.S. laws apply extraterritorially in certain circumstances, there is a strong presumption against doing so.
- (b) 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.

²⁴¹ See U.S. CONST. amend. V.

²⁴² *United States v. Yousef*, 327 F.3d 56, 58 (2d Cir. 2003).

²⁴³ 768 F.3d 122, 135 (2d Cir. 2014).

- (c) In *Morrison v. National Australia Bank*, 130 U.S. 2869 (2010), the Supreme Court found that the Securities Exchange Act of 1934 was intended to protect transactions on national securities exchanges and other domestic securities transactions. Because there was no indication that the Exchange Act was intended to apply abroad, the Court held that section 10(b) of the Exchange Act did not apply to non-U.S. securities.²⁴⁴
- (d) Courts hearing claims brought by private litigants have applied *Morrison*. The Second Circuit Court of Appeals endorsed the application of *Morrison's* transaction-based test to the Commodity Exchange Act in *Loginovskaya v. Batratchenko*, 764 F.3d 266 (2d Cir. 2014). 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."²⁴⁵
- (e) Courts have yet to determine whether the CFTC is similarly restricted in its ability to bring extraterritorial claims. The Dodd-Frank Act contains no provision enabling the CFTC to use the expansive "conduct and effects" jurisdictional test currently employed by the SEC.²⁴⁶ CEA section 2(i)(1) provides that the portions of Dodd-Frank pertaining to swaps shall only apply to those extraterritorial activities that "have a direct and significant connection with activities in, or effect on, commerce of the United States."²⁴⁷ To determine whether extraterritorial application of the swaps provisions is warranted, 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.²⁴⁸ The CFTC believes that Congress has specified that the CEA *does apply overseas* to swaps activity with a "sufficient nexus" to U.S. commerce, but this theory has not yet been confirmed or refuted by a U.S. court.²⁴⁹
- (f) 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

²⁴⁴ See *Morrison v. National Australia Bank*, 561 U.S. 247 (2010).

²⁴⁵ *Loginovskaya v. Batratchenko*, 764 F.3d 266, 268 (2d Cir. 2014).

²⁴⁶ 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 section 929P. See *Sec. Exch. Comm'n v. A Chicago Convention Center, LLC*, 961 F. Supp.2d 905 (N.D. Ill. 2013); see also DFA § 929P; 15 U.S.C. § 78aa.

²⁴⁷ 7 U.S.C. § 2(i).

²⁴⁸ 7 U.S.C. § 2(i)(1).

²⁴⁹ See *Loginovskaya v. Batratchenko*, No. 13-1624, CFTC Letter to Clerk of Court at 2 (2d Cir. Sept. 10, 2014).

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.²⁵⁰ 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.

²⁵⁰ 18 U.S.C. § 1343.

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 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 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 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) 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.

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 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 (DOJ) criminal prosecution of companies are set out in the United States Attorneys' Manual's (USAM) "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—that 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."²⁵¹ 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 for indictment and prosecution."²⁵² 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."²⁵³ These relevant facts include: "[H]ow and when did the alleged misconduct occur? Who

²⁵¹ U.S. Dep't of Justice, United States Attorneys' Manual § 9-28.300; Memorandum from Mark Filip, Deputy Att'y Gen., to U.S. Attorneys et. al., Principles of Federal Prosecution of Business Organizations (Aug. 28, 2008) (<https://www.justice.gov/sites/default/files/dag/legacy/2008/11/03/dag-memo-08282008.pdf>) (Appendix A).

²⁵² U.S. Dep't of Justice, United States Attorneys' Manual § 9-28.700.

²⁵³ *Id.*

promoted or approved it? Who was responsible for committing it?"²⁵⁴

DOJ's focus on individual accountability is a relatively new development. In 2015, DAG Sally Yates announced a "substantial shift" from the DOJ's prior practice through the issuance of a DOJ-wide memorandum regarding "Individual Accountability for Corporate Wrongdoing."²⁵⁵ Now popularly referred to as the "Yates Memo," the directive states that "[i]n order for a company to receive any consideration for cooperation," it is necessary for the company to "completely disclose to the Department all relevant facts about individual misconduct."²⁵⁶ In other words, "[c]ompanies cannot pick and choose what facts to disclose," but "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" to be eligible for any cooperation credit.²⁵⁷

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 synthesizing of potentially voluminous evidence. And now, to achieve cooperation under the Yates Memo, 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.²⁵⁸

²⁵⁴ *Id.* at § 9-28.720.

²⁵⁵ Memorandum from Sally Quillian Yates, Deputy Att'y Gen., to All U.S. Attorneys et. al., Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015) (<http://www.justice.gov/dag/file/769036/download/>) (Appendix B).

²⁵⁶ *Id.* (emphasis in original).

²⁵⁷ *Id.*; see also Marshall L. Miller, Principal Deputy Ass't Att'y Gen., Crim. Div., U.S. Dep't of Justice, Remarks before the Global Investigation Review Program (17 Sept. 2014) (<https://www.justice.gov/opa/speech/remarks-principal-deputy-assistant-attorney-general-criminal-division-marshall-l-miller>) ("Voluntary disclosure of corporate misconduct does not constitute true cooperation, if the company avoids identifying the individuals who are criminally responsible. Even the identification of culpable individuals is not true cooperation, if the company fails to locate and provide facts and evidence at their disposal that implicate those individuals.").

²⁵⁸ U.S. Dep't of Justice, United States Attorneys' Manual § 9-28.710.

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 cooperation credit."²⁵⁹ Thus, any attempt to cooperate and seek credit should be taken on diligently and with the full commitment of all involved.

(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. 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 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's Corporate Leniency Program represents an exception to the Yates Memo policy against granting immunity to individuals as part of corporate settlements.

(b) CFTC

In 2007 the CFTC outlined three broad categories of cooperation, with a list of factors against which cooperation will be measured for each category.²⁶⁰

(1) Nature of the company's efforts to uncover and investigate violations

²⁵⁹ Marshall L. Miller, Principal Deputy Ass't Att'y Gen., Crim. Div., U.S. Dep't of Justice, Remarks before the Global Investigation Review Program (17 Sept. 2014) (<https://www.justice.gov/opa/speech/remarks-principal-deputy-assistant-attorney-general-criminal-division-marshall-l-miller>).

²⁶⁰ See Commodity Futures Trading Comm'n, Enforcement Advisory (March 2, 2007) (<http://www.cftc.gov/idc/groups/public/@cpdisciplinaryhistory/documents/file/enfcooperation-advisory.pdf>) (Appendix C).

- (i) Did the company uncover misconduct and by what means?
 - (ii) Did the company take immediate steps to address the misconduct and make appropriate disclosure?
 - (iii) Did the company use an independent entity to investigate and report the misconduct?
- (2) Quality of the company's efforts in cooperating with the Enforcement Division
 - (i) Did the company promptly notify the Division and meet with Division staff to review and explain the misconduct?
 - (ii) Did the company make information, including employee testimony, documents, and financial analysis available?
 - (iii) Did the company provide a comprehensive report?
- (3) Corporate efforts to prevent future wrongdoing
 - (i) Did the company provide credible assurances that the conduct is unlikely to recur?
 - (ii) Did the company implement additional internal controls and oversight?
 - (iii) Did the company take disciplinary action against those involved in the misconduct?

2. Anticipating Referral and Charging Decisions

(a) Referral to DOJ

Although civil regulators such as CFTC do not themselves bring criminal charges against entities or individuals, they can refer criminal violations of U.S. securities and commodities laws to 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."²⁶¹

(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, 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. 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 so-called 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.²⁶²

²⁶¹ See U.S. Dep't of Justice, Coordination of Parallel Criminal, Civil, Regulatory, and Administrative Proceedings (January 30, 2012) (<https://www.justice.gov/usam/organization-and-functions-manual-27-parallel-proceedings>) (Appendix D).

²⁶² Memorandum from Sally Quillian Yates, Deputy Att'y Gen., to All U.S. Attorneys et. al., Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015) (<http://www.justice.gov/dag/file/769036/download/>) (Appendix B).

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 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.

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:

- (a) Expectations of the relevant authority, who may take a skeptical view at management-led inquiries, rather than an investigation by outside counsel;

- (b) Who is known to be involved or potentially involved in the subject matter of the investigation and establishing reporting lines accordingly;
- (c) 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

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:

- (a) The relevant time period to be investigated;
- (b) The geographic scope of the investigation;
- (c) 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
- (d) The subject matter of the investigation.

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:

- (a) 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.

Any concerns or considerations related to data privacy should also be addressed in the investigation plan.

- (b) 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.

The plan should also provide a rationale for why it has been decided that certain individuals will not be interviewed.

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.

- (c) 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.
- (d) 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.
- (e) Anticipated time frame for completion of the investigation.
- (f) Anticipated costs of the investigation.
- (g) Anticipated potential remediation.

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;
- (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)

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.

- (c) 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 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

Attorney-client privilege: U.S. attorney-client privilege protects communications made in confidence between a person who is (or is about to become) a client and a lawyer, where those communications are made for the purpose of obtaining legal advice or assistance.

Attorney work product: Protects certain documents or materials prepared in anticipation of litigation or trial. In addition to materials drafted by an attorney, the work product doctrine can also cover materials prepared at the direction of legal counsel. The privilege is qualified, rather than absolute, but is at its strongest when the work product relates to an attorney's legal theories, strategies, or assessments, rather than factual information.

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 are 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) 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.

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 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.²⁶³

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.

(2) Former Employees

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

²⁶³ See *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

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 which 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 other communications relating to the same subject matter.²⁶⁴

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.²⁶⁵

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.

²⁶⁴ Fed. R. Evid. 502(a).

²⁶⁵ Fed. R. Evid. 502(b).

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 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.

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) resist 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 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 number of components that may be included in an investigation report, including:

- (a) Background information on the circumstances leading up to the investigation;
- (b) A description of the investigation's scope and the steps taken to collect relevant information;
- (c) 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 Desired Achievable Outcome

It is important to re-evaluate the investigation's optimal achievable outcome throughout investigation as facts develop.

Most investigations are resolved through a negotiated settlement with a U.S. authority. Nevertheless, a company can 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: Can administer civil penalties in settlement orders. Although CFTC does not itself bring criminal charges against entities or individuals, it can refer criminal violations of the Commodity Exchange Act to DOJ for prosecution. Civil penalties can include disgorgement of ill-gotten gains and restitution to victims. CFTC can also require special supervision, suspend business registrations, and can 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 settlement outcome.

3. Considering Collateral Consequences

While consequences such as the loss of ability to conduct certain business can obtain 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 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.

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