

Manipulation Law Under the Commodity Exchange Act

FIA - CEA Manipulation Law Webinar

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Presenters



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Jonathan Marcus represents clients in financial markets litigation and government enforcement matters before the CFTC, NFA and SEC and advises on a range of issues related to commodity and derivatives regulatory compliance. Prior to joining Skadden's Derivatives Group, Mr. Marcus served as the general counsel of the CFTC. He served in that role from April 2013 to February 2017, advising the Commission on a wide range of issues, including rulemakings and other actions to implement the Dodd-Frank Act amendments to the Commodity Exchange Act.

Before his appointment as general counsel, Mr. Marcus was the deputy general counsel for litigation for two years. In that position, he defended the CFTC's Dodd-Frank rules against industry challenge. Before joining the CFTC, Mr. Marcus was of counsel at another major law firm, where he was a member of its Supreme Court & Appellate practice from 2007 to 2011.

He previously served at the U.S. Department of Justice as an assistant to the solicitor general from 2004 to 2007, arguing five cases before the U.S. Supreme Court.



Ted Kneller

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Ted Kneller's practice focuses on government investigations, Dodd-Frank Act regulatory compliance and private litigation related to the swaps and futures markets.

Mr. Kneller represents clients in enforcement matters before the CFTC, the Department of Justice, FINRA, the NFA and other self-regulatory organizations.

Representations have included parallel CFTC and DOJ investigations into alleged price manipulation, fraud and anti-competitive conduct related to various financial benchmarks and commodity markets. Mr. Kneller also represents clients in related class action lawsuits alleging Commodity Exchange Act claims and antitrust injury.

Mr. Kneller also has extensive experience in CFTC regulatory compliance, and he represents a broad range of commodity and derivatives market participants.

He previously worked in the CFTC Division of Enforcement and participated in the development of various Dodd-Frank rulemakings.



“The methods and techniques of manipulation are limited only by the ingenuity of man.”

- *Cargill v. Sec’y of Agric. Hardin* (8th Cir. 1971)

“The word ‘manipulation’ . . . in its use is so broad as to include any operation of the . . . market that does not suit the gentleman who is speaking at the moment.”

- William Clayton, Cotton Trader, Senate Testimony 1928



Overview

- What is Manipulation?
 - Types of Manipulation Schemes
 - ‘Open Market’ Manipulation
 - Statutory Authority & CFTC Rules
 - Price Manipulation & Corners
 - Manipulative or Deceptive Devices or Contrivances
- Recent Developments
 - *CFTC v. Wilson & DRW* (S.D.N.Y. 2018)
 - *CFTC v. Kraft* (N.D. ILL. 2015)
 - *CFTC v. Monex* (C.D. Cal. 2018)
- Potential legal developments on the horizon?



Common Manipulation Schemes

- **Market Misconduct**
 - Wash Sales, Accommodation Trades, Fictitious Sales, Matched Orders
 - Violating Bids/Offers
 - Spoofing
 - Rigged Prices
 - False Reporting
 - Misappropriated Information
- **Corners & Squeezes**
- **Open Market Manipulation**
 - Banging the Close / Marking the Close
 - Naked Market Manipulation
- **What can we learn from securities law cases?**



Statutes & Rules

	Traditional CEA Prohibitions on Manipulation		New Dodd-Frank Prohibitions
Statute	<p>CEA Section 9(a)(2)</p> <p>7 USC § 13(a)(2)</p> <p>It shall be a felony punishable by a fine of not more than \$1,000,000 or imprisonment for not more than 10 years, or both ... for: ... (2) Any person <i>to manipulate or attempt to manipulate the price</i> of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or of any swap, <i>or to corner or attempt to corner any such commodity</i></p>	<p>CEA Section 6(c)(3)</p> <p>7 USC § 9(3)</p> <p>It shall be unlawful for any person, directly or indirectly, <i>to manipulate or attempt to manipulate the price</i> of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.</p>	<p>CEA Section 6(c)(1)</p> <p>7 USC § 9(1)</p> <p>It shall be unlawful for any person, directly or indirectly, <i>to use or employ, or attempt to use or employ</i>, in connection with any swap, or contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, <i>any manipulative or deceptive device or contrivance</i>, in contravention of [CFTC] rules.</p>
Rule		<p>Rule 180.2</p> <p>It shall be unlawful for any person, directly or indirectly, <i>to manipulate or attempt to manipulate the price</i> of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.</p>	<p>Rule 180.1(a)</p> <p>It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, <i>to intentionally or recklessly: (1) Use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud</i></p>



Application – Traditional Price Manipulation

Traditional CEA Prohibitions on Price Manipulation

CEA Sections 6(c)(3), 9(a)(2) and Rule 180.2

Elements of a Violation	Completed Price Manipulation:	Attempted Price Manipulation:
	<ul style="list-style-type: none">(1) Manipulative Intent(2) Ability to influence price(3) Artificial price existed(4) Caused the artificial price	<ul style="list-style-type: none">(1) Manipulative intent(2) An overt act in furtherance of that intent

In re Indiana Farm Bureau (CFTC 1982)

“[I]n order to prove the intent element of a manipulation or attempted manipulation ... it must be proven that the accused acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand”

In re Amaranth Natural Gas Commodities Litig. (2nd Cir. 2013)

“There is thus no manipulation without intent to cause artificial prices.”

CFTC v. Wilson & DRW (S.D.N.Y. 2018)

“[T]he mere intent to affect *prices* is not enough; rather, the CFTC must show that Defendants intended to cause *artificial* prices – *i.e.*, prices that [Defendants] understood to be unreflective of the forces of supply and demand.”



Application: Dodd-Frank Prohibitions – Rule 180.1

Dodd-Frank Prohibitions Manipulative & Deceptive Devices & Contrivances CEA Section 6(c)(1) and Rule 180.1

Violations
Consist Of:

- (1) Reckless or Intentional Conduct
- (2) Fraud-based Manipulative Schemes

CFTC Part 180 Adopting Release (2011)

Artificial Price Not Required

Rule 180.1 prohibits “among other things, manipulative and deceptive devices, *i.e.*, fraud and fraud-based manipulative devices and contrivances employed intentionally or recklessly, **regardless of whether the conduct in question was intended to create or did create an artificial price.**”

CFTC v. Kraft (N.D. ILL. 2015)

A claim under Section 6(c)(1) and Rule 180.1 must **sound in fraud.**

Recklessness is sufficient: “[A]n extreme departure from the standards of ordinary care’ which ‘presents a danger of misleading buyers or sellers that is ... so obvious that the actor must have been aware of it.’”

CFTC v. Monex (C.D. Cal. 2018)

Section 6(c)(1) and Rule 180.1 do not apply “in the absence of actual or potential market manipulation.”



'Open Market' Manipulation

- Common Characteristics of Open Market Manipulation
 - Otherwise Bona Fide Transactions in the Open Market
 - Assuming Real Market Risk
 - Exerting Market Power
 - Holding Positions in Related Markets
 - Trading Designed to Affect Price
 - Timed to Impact a Settlement or Benchmark Price
 - Intended to Maintain Current Price Levels (Price Support)

Commodity Exchange Act Open Market Cases

Traditional Price Manipulation	Manipulative or Deceptive Devices
<ul style="list-style-type: none">▪ <i>Gen. Food Corp. v. Brennan</i> (7th Cir. 1948)▪ <i>In re Henner</i> (U.S. Dep't Agric. 1971)▪ <i>CFTC v. Amaranth</i> (S.D.N.Y. 2008)▪ <i>CFTC v. Optiver</i> (S.D.N.Y. 2012)▪ <i>In re Moore Capital</i> (CFTC 2010)▪ <i>ISDAFIX Settlements</i> (CFTC 2015-2018)▪ <i>CFTC v. Wilson & DRW</i> (S.D.N.Y. 2018)	<ul style="list-style-type: none">▪ <i>In re JP Morgan</i> (CFTC 2013)▪ <i>ISDAFIX Settlements</i> (CFTC 2015-2018)▪ <i>In re Total Gas</i> (CFTC 2015)▪ <i>CFTC v. Kraft</i> (N.D. ILL. 2015)▪ <i>In re Lansing Trade Group</i> (CFTC 2018)



Fact Finder's Dilemma: Assessing Intent Manipulation or Legitimate Conduct?

In re Indiana Farm Bureau Co-op. (CFTC 1982)

“It is the intent of the parties which separates otherwise lawful business conduct from unlawful manipulative activity. This being so, 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.”

GFL Advantage Fund v. Colkitt (3rd Cir. 2001)

“[C]ourts must distinguish between legitimate trading strategies intended to anticipate and respond to prevailing market forces and those designed to manipulate prices and deceive purchasers and sellers.”

SEC v. Masri (S.D.N.Y. 2007)

“[G]iven the inherent ambiguity in determining intent, the concerns about imposing liability for otherwise legal activity based solely on intent, and the potential for chilling such legal activity, the Court finds it wise to err on the side of caution.”

CFTC v. Wilson & DRW (S.D.N.Y. 2018) (quoting *In re Amaranth Nat. Gas Litig.* (S.D.N.Y. 2008))

“Proving the existence of an artificial price is difficult – and with good reason. As Judge Scheindlin noted in *Amaranth*, ‘[t]he laws that forbid market manipulation should not encroach on legitimate economic decisions lest they discourage the very activity that underlies the integrity of the markets they seek to protect.’”



CFTC Interpretation of Rule 180.1

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in response to comments calling for a bifurcated approach to scienter under 6(c)(1) and final Rule 180.1, that is, specific intent to effect a price or price trend that does not reflect legitimate forces of supply and demand for non-fraud based manipulations, and “extreme recklessness” in fraud-based manipulations, the Commission states, as it did in the NOPR, that it will be guided, but not controlled by, judicial precedent interpreting and applying scienter under Exchange Act section 10(b) and SEC Rule 10b-5.⁸⁹ At the same time, the Commission makes clear

CFTC Part 180 Adopting Release (2011)

“[I]n response to comments calling for a bifurcated approach to scienter under 6(c)(1) and final Rule 180.1, that is,

- specific intent to effect a price or price trend that does not reflect legitimate forces of supply and demand for non-fraud based manipulations, and
- “extreme recklessness” in fraud-based manipulations,

the Commission states ... that it will be guided, but not controlled by, judicial precedent interpreting and applying scienter under Exchange Act section 10(b) and SEC Rule 10b-5.”

CFTC Order – *In re JP Morgan* (2013)

“Under Section 6(c)(1) of the Act and Commission Regulation 180.1, price-distorting and certain other behavior is barred, even if the offending party **acts recklessly** rather than intentionally.”

CFTC Order – *In re Total Gas* (2015)

“Respondents at a minimum acted recklessly or **with reckless disregard for the potential impact of their trading on natural gas prices and the integrity of the natural gas market.**”

CFTC Brief Opposing MTD in *CFTC v. Kraft* (S.D.N.Y. 2015)

“Section 6(c)(1), thus, **does not require** a showing of **a specific intent to manipulate a commodity price, nor does it require proof of an actual artificial price.** This new authority was intended to ‘augment the Commission’s existing authority to prohibit fraud and manipulation’”

CFTC Order – *In re Lansing Trade Group* (2018)

“Section 6(c)(1) of the Act and Regulation 180.1 **do not require the showing of an intent to affect prices or an actual effect on prices.**”

Artificial Price & Open Market Manipulation Under 10b-5

Sullivan & Long, Inc. v. Scattered Corp. (7th Cir. 1995)

- “The plaintiffs call what [the Defendant] did ‘market manipulation,’ a term that refers to tactics by which traders, like monopolists, **create artificially high or low prices, prices that do not reflect the underlying conditions of supply and demand.**”

GFL Advantage Fund Ltd. v. Colkitt (3rd Cir. 2001)

- Market manipulation in violation of Section 10(b) and Rule 10b-5, the plaintiff must present evidence that:
 - » (1) in connection with the purchase or sale of securities
 - » (2) the defendant engaged in deceptive or manipulative conduct by injecting inaccurate information into the marketplace or creating a false impression of supply and demand for the security
 - » (3) **for the purpose of artificially depressing or inflating the price** of the security.

SEC v. Masri (S.D.N.Y. 2007)

- “If an investor conducts an open-market transaction with the intent of **artificially affecting the price** of the security, and not for any legitimate economic reason, it can constitute market manipulation.”
- “[I]n order to impose liability for an open market transaction, the SEC must prove that *but for the manipulative intent*, the defendant would not have conducted the transaction.... if a transaction would have been conducted for investment purposes or other economic reasons, and regardless of the manipulative purpose, then it can no longer be said that it is **‘artificially’ affecting the price....**”

ATSI Communications Inc. v. Shaar Fund Ltd. (2nd Cir. 2007)

- A Section 10(b) / 10b-5 “claim for market manipulation requires a showing of scienter that the defendant intended to deceive investors by **artificially affecting the market price....**”

SEC v. Koch (D.C. Cir. 2015)

- “Marking the close is investor argot for buying or selling stock as the trading day ends to **artificially inflate the stock’s value.**”
- “The entire premise of marking the close is to **increase a share’s price to an ‘artificially high level.’**”
- “Market-manipulative behavior is ‘intentional or willful conduct designed to deceive or defraud investors by controlling or **artificially affecting the price** of securities.’”

Open Market Manipulation Questions

- Does a 10b-5 open market manipulation require ‘an intent to create an artificial price’?
- Does 10b-5 impose liability for merely “reckless” conduct in open market cases?
- How would *DRW* have been decided under 10b-5?
- What elements should courts adopt for an open market manipulation under Rule 180.1?



In Theory vs. In Practice

- How should firms manage enforcement risk for open market manipulation under the CEA?
 - Recklessly employ a manipulative device?
 - Specific intent to create an artificial price?
- Training
- Communications
- Culture



Questions?



FIA

The logo consists of three letters: 'F', 'I', and 'A'. The 'F' is a solid dark grey block. The 'I' is a solid dark grey vertical bar. The 'A' is composed of several overlapping geometric shapes: a light green triangle on the left, a darker green triangle on the right, and a light blue trapezoid at the bottom. The background features a faint, light blue grid of lines and a network of thin black lines with small black dots at their intersections in the lower right corner.