



DOJ's Foray into the CFTC's Enforcement World: Spoofing, Commodities Fraud, Wire Fraud and even RICO



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Presented by Jonathan Marcus & Ted Kneller

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Presenters



Jonathan Marcus

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Of Counsel, Derivatives
Washington, D.C.

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

Skadden, Arps, Slate, Meagher & Flom LLP
Counsel, Derivatives
Washington, D.C.

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 Act rulemakings.





Introduction

“The Criminal Division’s message is clear. We are watching. We are closely monitoring the markets. And we will leave no stone unturned in our efforts to combat and eradicate illegal, fraudulent, and manipulative market conduct.”

*- John P. Cronan, Acting Assistant Attorney General Announcing
“Futures Market Spoofing Takedown” (Jan. 29, 2018)*

“You should be sentenced for what you did, but I do think it is fair to say that the government has used [the defendants] ... as proxy wrongdoers.”

*- Hon. Colleen McMahon, U.S. District Judge SDNY
sentencing hearing in U.S. v. Connolly (Libor)*

“Here, the Government has pursued a criminal prosecution on the basis of conduct that violated no clear rule or regulation, was not prohibited by the agreements between the parties, and indeed was consistent with the parties’ understanding of the arms-length relationship in which they operated. The Court cannot permit this case to go to the jury on such a basis.”

*- Hon. Charles Breyer, U.S. District Judge N.D. Calif., order
U.S. v. Bogucki (FX)*



Overview

- Commodity Markets & Thirty Years of Criminal Prosecutions
- Front-Running: Prosecuting Market Makers in Principal-to-Principal Markets
- How to Charge Spoofing: An Evolution

Statutory Toolbox

Commodity Exchange Act	Section	Max. Penalty	Max. Prison Term	Statute of Limitations
Price Manipulation / Attempt	CEA § 9(a)(2)	\$1,000,000	10 years	5 years
False Reports Concerning Market Info				
Knowing Violations of CEA sections concerning Spoofing, Manipulative or Deceptive Devices, or Fraud				
Criminal Code				
Wire Fraud	18 USC § 1343	\$250,000	20 years	5 years
Wire Fraud Affecting a Financial Institution		\$1,000,000	30 years	10 years
Bank Fraud	18 USC § 1344	\$1,000,000	30 years	10 years
Commodities Fraud	18 USC § 1348	\$250,000	25 years	6 years
Conspiracy	18 USC § 371 18 USC § 1349	\$250,000	5 years	
Racketeering – RICO	18 USC § 1962	\$250,000	20 years	5 years
Racketeering & Bank Fraud				10 years
Sherman Act				
Price Fixing & Bid Rigging	15 U.S.C. § 1	\$100,000,000	10 years	5 years



COMMODITY MARKETS



30 YEARS OF CRIMINAL PROSECUTIONS

1989 - FBI Futures Market Sting

The New York Times

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NEW YORK, THURSDAY, AUGUST 3, 1989

50 cents beyond 75 miles from New York City

46 Commodities Traders Indicted After a 2-Year F.B.I. Investigation

Racketeering and Fraud Are Among Charges at Chicago Exchanges

By ERIC N. BERG
Special to The New York Times

CHICAGO, Aug. 2 — The Justice Department today announced the indictment of 46 commodities brokers and traders, accusing them of repeatedly defrauding customers by stealing and skimming investors' profits.

The indictments grew out of a two-year investigation of the nation's two largest commodities exchanges, the Chicago Board of Trade and the Chicago Mercantile Exchange. As part of the inquiry, agents of the Federal Bureau of Investigation infiltrated trading floors and secretly recorded members' conversations.

'Thousands of Trades'

"We are talking about hundreds of customers and thousands of trades," said Anton E. Valukas, the United States Attorney in Chicago, who supervised the F.B.I.'s undercover investigation. "We are not talking about technical violations. It can be fairly described as wide-ranging activity."

Mr. Valukas said a number of defendants had agreed to work with prosecutors in exchange for leniency.

"We do have substantial cooperation," Mr. Valukas said.

None of the 46 were arrested today. Mr. Valukas said they would have 10 days to surrender.

Attorney General Dick Thornburgh said the indictment covered a wide range of charges, including racketeer-



The New York Times/Gates Kaghan
Anton E. Valukas, who supervised undercover investigation.

ing, mail fraud, commodities fraud, filing false tax returns, lying to Federal agents and conspiring to defraud the Internal Revenue Service.

If convicted, those indicted could face jail terms of up to 20 years and fines of up to \$250,000, he said. They may also face confiscation of assets under the Racketeer Influenced and Corrupt Organizations Act; loss of their exchange membership, and a temporary prohibition on their trading.

At least 16 of the exchange members were charged with racketeering under the RICO statute. Most of them were brokers accused of failing to fulfill their obligations to their customers.

Mr. Thornburgh, at a news conference here today, said the Govern-

Continued on Page D5, Column 1

- Dual Trading, Trading Ahead, Prearranged Trading
- 46 traders indicted
- Broad Range of Charges
 - RICO
 - Mail & Wire Fraud
 - CEA Violations
 - 18 U.S.C. § 1001
 - Filing False Tax Returns
 - Conspiracy to Defraud the IRS



Enron Energy Market Manipulations

- Natural Gas Markets
 - CFTC secured a district court consent order for manipulation of the natural gas spot market prices
- Power/Electricity Markets
 - DOJ secured 3 guilty pleas for conspiracy and wire fraud



THE WALL STREET JOURNAL. Enron Is Center of U.S. Probe Of Alleged Power-Price Fraud

Second Grand Jury Is Empaneled to Hear Evidence of Wrongdoing in California Crisis

By John R. Wilke and Kathryn Kranhold Staff Reporters of The Wall Street Journal

WASHINGTON -- Federal prosecutors are investigating alleged fraud by Enron Corp. in the manipulation of power prices in three Western states during the California electricity crisis two years ago.

The Justice Department is presenting evidence to a new grand jury that was convened in San Francisco this summer, lawyers close to the case said. It is the second grand jury in the Enron case; a special grand jury in Houston already had been investigating last year's collapse of the energy-trading firm.

Prosecutors are investigating whether Enron and other companies made fraudulent electricity trades between 1999 and 2001, and whether top Enron management knew what was going on at the hugely profitable trading unit, the lawyers close to the case said. They said that as part of this effort, the prosecutors are examining whether Jeffrey Skilling, Enron's former chief executive, and Greg Whalley, its former president and head of trading, were

2000s: Nat. Gas False Reporting Cases

THE NEW YORK TIMES, THURSDAY, DECEMBER 5, 2002

Ex-Executive Of El Paso Is Indicted Over Gas Data

By NEELA BANERJEE

A former vice president of the El Paso Corporation, the country's largest natural gas pipeline company, has been indicted in Houston on charges of falsely reporting 48 gas trades last year, according to a statement released yesterday by federal prosecutors.



Michael Shelby, the United States attorney in Houston, announcing the indictment of Todd Geiger, a former El Paso Corporation gas trader.

- Early 2000s begins a series of cases for false reporting natural gas prices
- By 2007, DOJ's Corporate Fraud Task Force counted energy actions resulting in:
 - Total monetary penalties of \$430 million against 24 companies
 - Criminal indictments against 39 individuals and companies

U.S. v. Radley – TET Propane

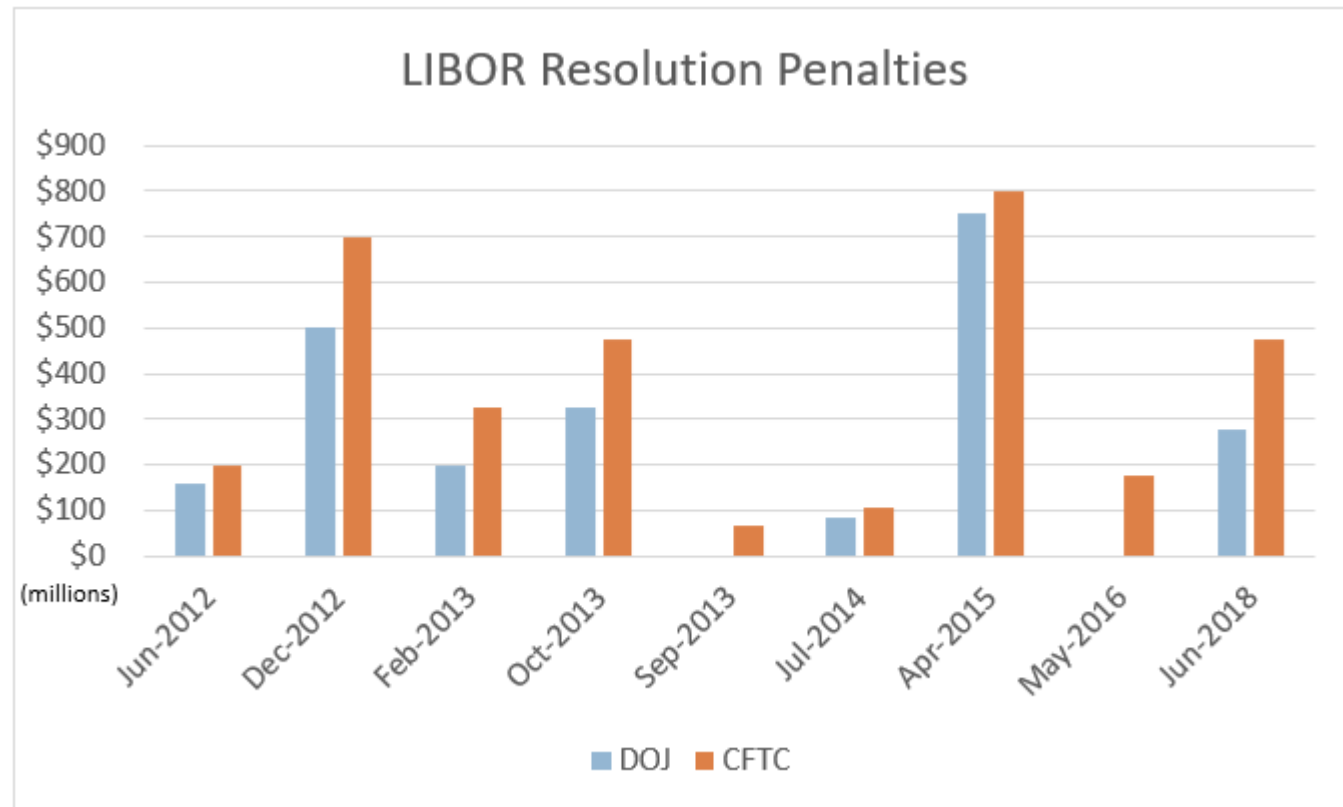
- The Company Settlements
 - DOJ
 - DPA for conspiracy, wire fraud & price manipulation
 - \$100 million penalty and \$75 million restitution
 - CFTC
 - \$125 million penalty pursuant to a district court consent order
- DOJ Prosecutions of Individuals
 - 4 traders charged with manipulation and cornering the market under the CEA and wire fraud
 - District court dismissed all charges
 - CEA manipulation provision is unconstitutionally vague as applied
 - CEA Sec. 2(g) [since repealed by the Dodd-Frank Act] excluded the conduct from CEA jurisdiction
 - 5th Circuit affirmed on CEA Sec. 2(g) grounds



LIBOR Settlements

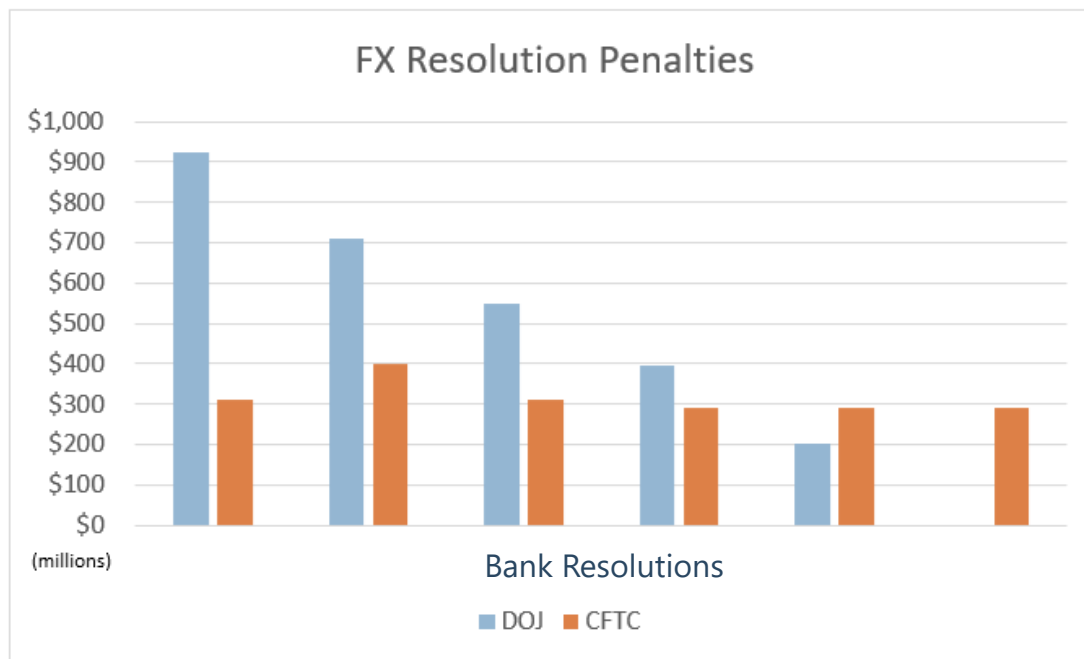
- LIBOR Statistics

- DOJ/CFTC penalties exceed \$5 billion
- 3 institutions plead guilty to wire fraud
- 5 DPAs / 3 NPAs
- CFTC charged 10 institutions with attempted manipulation



WM/Reuters Spot FX Settlements

- DOJ
 - 4 institutions pleaded guilty to conspiracy to fix prices and engage in bid rigging
 - 1 institution entered an NPA and pleaded guilty to wire fraud in violation of its LIBOR NPA
- CFTC charges 6 institutions with attempted manipulation





FRONT-RUNNING



Prosecuting Market Makers in Principal-to-Principal Markets



U.S. v. Johnson (E.D.N.Y. 2016), *affirmed* (2d Cir. 2019)

- The Trade: A 2011 Spot FX Transaction – USD \$4 Billion to GBP
- Case History
 - Indicted in 2016 (EDNY) – Conspiracy & Wire Fraud
 - Convicted by Jury in 2017
 - Second Circuit Affirmed in 2019
 - Supreme Court Cert. Petition Pending
- Second Circuit Appeal
 - Right-to-Control Theory: Depriving the victim of information necessary to allow it to make discretionary economic decisions
 - **Standard:** “A defendant who executes a fixing transaction engages in criminal fraud if he intentionally misrepresents to the victim how he will trade ahead of the fix, thereby deceiving the victim as to how the price of the transaction will be determined.”



U.S. v. Bogucki (N.D. Calif. 2019)

- The Trade: A 2011 FX Option – USD/GBP £6 Billion
- Case History
 - Indicted in 2018 – Conspiracy & Wire Fraud Affecting a FI
 - “Hammer the market down”
 - “We need to sell aggressively ... we call out and sell shedloads”
 - Court Entered Judgment of Acquittal 2019
- District Court’s Opinion
 - Two Theories of Fraud Liability
 - Misappropriating confidential information in violation of a duty of trust
 - Depriving the Victim of its property through material misrepresentations
 - ISDA Non-Reliance Provision – no duty owed
 - Both parties agreed that they were “bluffing” and “posturing”
 - The misleading statements were not material because they would not have influenced the counterparty’s decisions



SPOOFING



How to Charge Spoofing: An Evolution



Pre-Dodd-Frank “Spoofing”

- CFTC v. Eric Moncada & BES Capital (SDNY 2009)
 - Moncada allegedly “electronically enter[ed] and immediately cancel[ed] numerous large-lot orders for wheat futures that he did not intend to fill, but that he intended to use to create a misleading impression of increasing liquidity in the marketplace”
 - 9 counts of attempted manipulation
 - Default Judgment

Post-Dodd-Frank Spoofing

- U.S. v. Coscia
 - Relevant period: Aug. – Oct. 2011

CFTC	DOJ
July 22, 2013	Oct. 1, 2014
Admin. Consent Order	Indictment
CEA Sec. 4c(a)(5)(C) - Spoofing	3 Counts Spoofing (CEA Sec. 4c(a)(5)(C) & 9(a)(2)) 3 Counts Commodities Fraud (18 USC 1348)

- U.S. v. Sarao
 - Relevant Period: April 2010 – March 2014

CFTC	DOJ
April 17, 2015	Feb. 11, 2015
District Court Complaint	Indictment
Price Manipulation / Attempted Spoofing 180.1 Manipulative or Deceptive Device	Wire Fraud Commodities Fraud (11 counts) Price Manipulation / Attempted (10 counts) Spoofing (1 count)

Post-Dodd-Frank Spoofing

- U.S. v. Liew
 - Relevant Period: Dec. 2009 – Feb. 2012

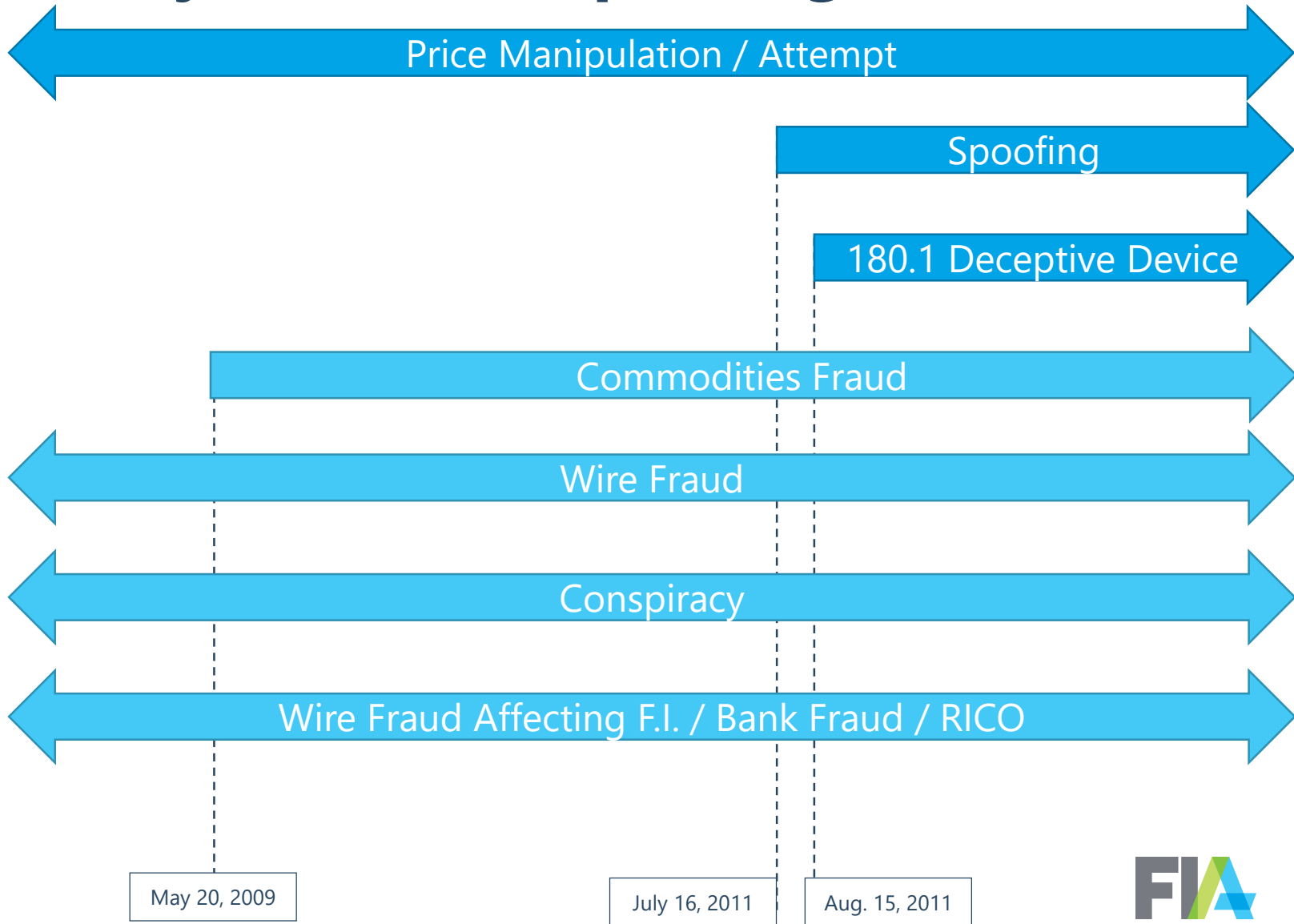
CFTC	DOJ
June 2, 2017	May 24, 2017
Admin. Consent Order	Criminal Information
Spoofing Price Manipulation / Attempt 180.1 Deceptive Device	Conspiracy <ul style="list-style-type: none"> • Wire Fraud Affecting a Financial Institution • Spoofing

- U.S. v. Smith et al
 - Relevant Period: March 2008 – August 2016

CFTC	DOJ
September 16, 2019	August 22, 2019
District Court Complaint	Indictment
Spoofing 180.1 Deceptive Device Attempted Price Manipulation	Conspiracy <ul style="list-style-type: none"> • Racketeering • Price Manipulation • Bank Fraud • Wire Fraud Affecting an FI • Commodities Fraud • Spoofing



Statutory Toolbox - Spoofing



January 29, 2018 – Futures Market Spoofing Takedown

Case	Relevant Period	Market	Charges	Status
US v. Vorley et al.	2008 – 2013	Metals	<ul style="list-style-type: none"> Conspiracy / WF Affecting an FI Wire Fraud Affecting an FI 	MTD Denied/ 2 nd MTD Pending
US v. Thakkar	2013 – 2015	E-minis	<ul style="list-style-type: none"> Conspiracy / Spoofing Spoofing 	<i>Mistrial / Dismissed</i>
US v. Zhao	2012 – 2016	E-minis	<ul style="list-style-type: none"> Spoofing Commodities Fraud Wire Fraud 	Pleaded Guilty
US v. Bases et al.	2009 – 2014	Metals	<ul style="list-style-type: none"> Conspiracy / WF Affecting an FI Spoofing Commodities Fraud 	Pending / MTD Denied
US v. Flotron	2012 – 2013	Metals	<ul style="list-style-type: none"> Conspiracy / Commodities Fraud Commodities Fraud Spoofing 	<i>Acquitted</i>
US v. Mohan	2013	E-minis	<ul style="list-style-type: none"> Conspiracy / Spoofing, Commodities Fraud, Wire Fraud 	Pleaded Guilty

Spoofing Prosecutions

Case	Market	Relevant Period	Charges	Status
US v. Edmonds	Metals	2009 – 2015	<ul style="list-style-type: none"> Conspiracy / Wire Fraud, Commodities Fraud, Price Manipulation, Spoofing Commodities Fraud 	Pleaded Guilty
US v. Mao	E-minis	2012 – 2014	<ul style="list-style-type: none"> Conspiracy / Commodities Fraud Commodities Fraud Spoofing 	Bench Warrant
US v. Gandhi	E-minis	2012 – 2014	<ul style="list-style-type: none"> Conspiracy / Wire Fraud, Commodities Fraud, Spoofing 	Pleaded Guilty
US v. Flaum	Metals	2007 – 2016	<ul style="list-style-type: none"> Attempted Price Manipulation 	Pleaded Guilty
US v. Trunz	Metals	2007 – 2016	<ul style="list-style-type: none"> Conspiracy / Spoofing Spoofing 	Pleaded Guilty
US v. Smith et al.	Metals	2008 – 2016	<ul style="list-style-type: none"> Conspiracy / Racketeering, Price Manipulation, Bank Fraud, Wire Fraud Affecting an FI, Commodities Fraud, Spoofing Attempted Price Manipulation Bank Fraud Wire Fraud Affecting an FI Commodities Fraud Spoofing 	Pending



Spooing Score Card

DOJ spoofing charges brought since 2014

- Conduct Spans 2007 – 2016
- Charging:
 - price manipulation / attempted
 - commodities fraud
 - spoofing
 - wire fraud affecting a financial institution
 - bank fraud
 - RICO
 - conspiracy

2014 - 2019	
Guilty Pleas	8
Convictions	1
Acquittals	1
Mistrial/Dismissal	1
Individuals' cases pending	9

FIA

The image features the letters 'FIA' in a bold, sans-serif font. The 'F' is dark grey. The 'I' is a solid green vertical bar. The 'A' is composed of two overlapping blue shapes: a larger, semi-transparent blue 'A' and a smaller, solid blue 'A' positioned in front of it. The background consists of several overlapping, semi-transparent geometric shapes in shades of light green, light blue, and white, creating a layered, abstract effect.