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CFTC ENFORCEMENT

Year in Review: Recent Developments in CFTC Enforcement

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I. Introduction

Long gone are the days when the Commodity Futures Trading Commission (the ''CFTC'' or the ''Commission'') was occasionally dismissed as a ''sleepy federal backwater.'' To the contrary, since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd Frank'') in 2010, the CFTC has used its expanded authority aggressively to police the futures, options, and swaps markets – bringing record numbers of enforcement actions and collecting record amounts of fines in the process.

In the fiscal year ending September 30, 2017, the Commission brought 49 enforcement actions and collected over $412 million in sanctions. While these figures represent a decrease from recent years, the Commission's continuing pursuit of increasingly complex enforcement cases and other initiatives leave no doubt about its regulatory intentions. This article examines notable developments and enforcement themes from this past fiscal year, as well as the Commission's expected priorities going forward.

II. New Leadership, New Focus

As with most federal agencies, the election of President Trump and subsequent change in administration has had a major impact on the Commission. As a preliminary matter, the Commission's composition has changed substantially since President Trump took office. In the ordinary course, the Commission consists of five commissioners appointed by the president (and approved by the Senate) to serve staggered five year terms. However, after former CFTC Chairman Timothy Massad resigned on inauguration day and Commissioner J. Christopher Giancarlo was named Acting Chairman in his place, the Commission was left with only two members (Acting Chairman Giancarlo and Commissioner Sharon Bowen). This frustrated routine business and made important rule making almost impossible. The situation improved on August 3, when the Senate confirmed two new Commissioners (Brian Quintenz and Rostin Behnam) and Commissioner Giancarlo as permanent Chairman, although two openings remain.

Although the Commission is still recalibrating its focus to reflect the priorities of the new administration, Chairman Giancarlo's public remarks provide some insight into its direction. On March 3, he stated that, ''consistent with the goals of the Trump Administration, the CFTC must reinterpret its regulatory mission through the following three-part agenda: (i) Fostering economic growth; (ii) Enhancing U.S. financial markets; and (iii) Right-sizing its regulatory footprint.'' CFTC, Remarks of Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL (Mar. 15, 2017). First, the Commission will foster economic growth by implementing Project KISS (for ''Keep It Simple Stu-

pid'') to streamline CFTC rules and regulations, making certain organizational changes, and embracing technological change in trading markets. Second, the Commission will seek to enhance the health and effectiveness of financial markets by advocating for the recalibration of bank capital requirements, fixing the regulatory framework for swaps trading, and participating in discussions with its overseas regulatory counterparts. Third, it will ''place its own house in order and right-size its regulatory footprint'' by winding down the implementation of Dodd-Frank, focusing on ''core'' missions of encouraging healthy markets by working cooperatively with other regulators and enforcement agencies, and running a ''tighter ship'' with respect to its budget.

Importantly, Chairman Giancarlo warned that these initiatives should not be interpreted as a harbinger of decreased enforcement activity, emphasizing that wrongdoers ''will face aggressive and assertive enforcement action by the CFTC under the Trump Administration.'' Later that month, on March 30, Chairman Giancarlo appointed James McDonald as the new Director of Enforcement and reiterated that ''there will be no pause, no let up and no relaxation in the CFTC's mission to enforce the law and punish wrongdoing.'' Nonetheless, the extent to which Chairman Giancarlo's newly identified objectives and Director McDonald's leadership will influence the Commission's enforcement activities remains to be seen.

III. RETAIL FRAUD

Retail fraud was a major focus of the Commission's enforcement activity in fiscal year 2017, making up almost half of its enforcement cases (20 of 49). In line with previous years, the CFTC focused on retail fraud in a number of spheres.

A. The Usual Suspects

The majority of the Commission's retail fraud cases reflected familiar themes. For example, the CFTC maintained its robust enforcement of foreign currency fraud. In February 2017, the CFTC filed and settled charges against Forex Capital Markets LLC (FXCM). FXCM agreed to pay a $7 million dollar penalty for defrauding retail foreign exchange customers over a 5-year time period by concealing its relationship with its most important market maker and misrepresenting that its platform had no conflicts of interests with its customers. As another example, the CFTC brought numerous actions related to commodity pool operators. In July 2017, a default judgment was entered against Anthony J. Klatch II, Lindsey Heim, and their company Assurance Capital Management, LLC for defrauding participants in a commodity pool they operated and misappropriating the funds of pool participants, among other violations of the Commodity Exchange Act (''CEA'') and CFTC regulations. The order required the defendants to pay more than $2.4 million in restitution and civil monetary penalties for their violations. And on September 29, 2017, the Commission filed an action against a husband and wife for operating a Ponzi scheme that defrauded commodity pool participants and for failing to register with the CFTC as commodity pool operators.

The Commission also continued to bring enforcement actions related to precious metals fraud. For example, in September 2017, the CFTC charged Monex Deposit Company, its affiliates, and their principals, in a multi-million dollar fraudulent precious metals scheme. The CFTC alleged that Monex defrauded thousands of retail customers across the country -- many of whom are elderly -- out of hundreds of millions of dollars while executing tens of thousands of illegal, off-exchange leveraged commodity transactions. Enforcement Director James McDonald described this as ''one of the largest precious metals fraud cases in the history of the Commission.''

IV. VIRTUAL CURRENCY

In addition to maintaining its focus on traditional areas of enforcement, the Commission expanded its focus to include fraud in virtual currency. In September 2017, the CFTC brought its first anti-fraud enforcement action in the cryptocurrency space when it charged Gelfman Blueprint, Inc. and its Chief Executive Officer and Head Trader Nicholas Gelfman with fraud, misappropriation, and issuing false account statements in connection with solicited investments in bitcoin. According to the complaint, the defendants operated a bitcoin Ponzi scheme in which they convinced at least eighty customers to invest approximately $600,000 in a fund that purportedly employed a high-frequency algorithmic trading strategy to trade bitcoin when, ''in fact, the strategy was fake, the purported performance profits were false, and —as in all Ponzi schemes—payouts of supposed profits . . . in actuality consisted of other customers' misappropriated funds.'' The CFTC alleges that Gelfman staged a computer hack in order to conceal the plot and explain the loss of nearly all the customer funds. Among other things, the CFTC is seeking restitution to defrauded pool participants, disgorgement, civil monetary penalties, trading bans, and a permanent injunction against certain trading activity.

Based on the CFTC's public statements and the increasing prevalence of virtual currency in the marketplace, this case is likely to be the first of many enforcement actions in this space. In October 2017, the CFTC released ''A Primer on Virtual Currencies,'' the first of a series of publications by a newly launched CFTC initiative known as LabCFTC ''to help market participants and innovators navigate the FinTech landscape.'' The primer reiterates the CFTC's view that virtual currency is a commodity and that the ''CFTC's jurisdiction is implicated when a virtual currency is used in a derivatives contract, or if there is fraud or manipulation involving a virtual currency traded in interstate commerce.'' That the LabCFTC focused on virtual currency for its inaugural publication is a testament to the growing importance of virtual currency to the marketplace and to the CFTC's regulatory agenda.

V. MARKET MANIPULATION

Market manipulation has been a major focus of the Commission in recent years, and fiscal year 2017 was no exception: enforcement cases based on manipulation, attempted manipulation, false reporting, and disruptive trading represented almost a quarter of the total enforcement actions brought by the Commission.

A. Benchmark Manipulation

The CFTC has continued to work with domestic and foreign regulators to target manipulation of global benchmark rates. In December 2016, the Commission settled with Goldman Sachs for $120 million for attempted manipulation of ISDAFIX, a leading global

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benchmark for interest rate swaps and related derivatives. In February 2017, the Commission settled with RBS for $85 million for similar conduct. These settlements bring the total amount of penalties that the Commission has imposed in connection with benchmark manipulation to $5.29 billion, of which $3.4 billion relate to interest rate benchmarks such as ISDAFIX, LIBOR, and Euribor and $1.8 billion relate to foreign exchange rate benchmarks. Benchmark manipulation is likely to remain a Commission priority given how lucrative (and high profile) these types of cases have proven to be since the Commission brought its first benchmark manipulation action in December 2012.

B. Testing the Commission's Authority

In addition to the market manipulation cases it brought in fiscal year 2017, two closely watched legal challenges against major market players are testing the scope of the Commission's anti-manipulation authority as they continue to slog their way through federal court. Notwithstanding the Commission's specific mandate to protect market participants from manipulative activity, its efforts to police such practices before Dodd-Frank were hindered by the high level of proof required to demonstrate actionable manipulation. Pursuant to its traditional anti-manipulation authority under Rule 180.2, the CFTC had to prove that a defendant specifically intended to cause an ''artificial'' price that did not reflect the legitimate forces of supply and demand. Dodd-Frank expanded the Commission's authority with respect to fraud-based manipulation and led to the promulgation of Rule 180.1, which applies to mere attempts at manipulation and lowers the scienter standard to recklessness.

1. The Scope of Rule 180.1

In *CFTC v. Kraft Foods Group Inc. and Mondelez Global LLC* (Kraft), the Commission sought to advance a broader application of Rule 180.1 beyond fraud-based manipulation to *any* manipulative conduct. The Commission alleged that Kraft engaged in price manipulation in violation of both Rule 180.1 and Rule 180.2 by establishing an ''enormous'' position in wheat futures for which it had no ''bona fide commercial need'' in order to prompt the market to react and depress the spot price to benefit its own trading positions. Kraft responded that the trades in question were a legitimate trading strategy for securing the cheapest wheat and moved to dismiss the complaint, arguing in part that the CFTC could not rely on Rule 180.1 because it did not ''allege conduct by which Kraft purportedly misled, deceived or tricked the market.'' According to Kraft, a straightforward price manipulation claim could not give rise to a Rule 180.1 violation because it did not include fraud.

In December 2015, the court agreed with Kraft that Rule 180.1 ''prohibit[s] only fraudulent conduct.'' However, the court took an expansive view of such conduct, finding that fraud-based manipulation could include actions intended to affect market prices – even if such actions were limited to open-market transactions, such as taking a large futures position, without any other false communications to the market. Based on this reasoning, the court found that the CFTC had sufficiently pled fraud to withstand a motion to dismiss. Thus, although the court's ruling ostensibly limited the scope of Rule 180.1, for all practical purposes, it has left open the possibility that ''a whole swath of perfectly legitimate and legal conduct in the commodities markets would come under cloud based on nothing but price fluctuations and a trader's pursuit of its legitimate business interest.'' A jury trial is set for March 2019 and the outcome will inform the Commission's ability to circumvent the artificial price and specific intent requirements that have proved so challenging to its previous market manipulation enforcement efforts. In the interim, the CFTC is likely to continue to test and stretch the scope of Rule 180.1 to reach conduct beyond the scope of traditional fraud through misrepresentation or omission.

2. The Scope of Attempted Manipulation Cases Under Rule 180.2

In *CFTC v. Wilson and DRW Investments* (Wilson), the Commission sought to lower the burden of proof for attempted manipulation under Rule 180.2. The case arose out of charges that a trading firm and its founder were involved in a manipulative scheme in which they used artificial bidding near the end of the trading session to boost the prices of certain futures contracts in their favor. The defendants admitted that they intended to affect the settlement price of the futures contracts, but explained that they were undervalued and that they were posting bids to correct a fundamental mispricing, not create an artificial price. The CFTC argued that having the mere intent to affect market price was sufficient to give rise to an attempted manipulation claim. The defendants countered that the CFTC must prove the same intent standard for both attempted and completed manipulation, i.e., that a defendant ''specifically intended to create an artificial price,'' and that attempting to trade at the best available price with the intent to reflect fair value could not therefore give rise to a manipulation claim. Interestingly, numerous regulatory and industry organizations – including CME Group, Commodities Markets Council, Futures Industry Association, Intercontinental Exchange, and the Managed Funds Association – filed an amicus brief in favor of the defendants and rejecting the CFTC's position. The Amici argued that many legitimate trading strategies are specifically intended to affect market prices, noting that ''[e]ach time a market maker submits a higher bid or lower offer to provide more competitive pricing, it does so with the intent to affect price.''

Both the defendants and the CFTC moved for summary judgment on the attempted manipulation claim. On September 30, 2016, the court agreed with the defendants that an attempted manipulation claim requires the ''specific intent to affect market prices that did not reflect the legitimate forces of supply and demand'' – i.e., the ''intent to cause artificial prices.'' However, the court denied both summary judgment motions on the ground that there were sufficient facts for a reasonable factfinder to conclude that the defendants did intend to create an artificial price. A bench trial took place in December 2016. The decision, which is still pending, will have industry-wide implications regarding the type of conduct that could give rise to attempted manipulation. It will also be particularly critical for the defendants, who face a permanent trading ban if found liable.

Regardless of the outcome, the CFTC is likely to bring more attempted manipulation cases in the future. First, the requirement to show that a defendant had specific intent to cause artificial price is still far less onerous than the requirement to show that a defendant actually caused an artificial price (as required for traditional manipulation claims). Second, notwithstanding this lower bar, the penalties for attempted manipulation

claims can be just as steep as for a traditional manipulation claim. A recent case demonstrates that the CFTC's post-Dodd-Frank authority to bring attempted manipulation claims may have some upside for market participants, however. In April 2017, the Southern District of New York dismissed a class action lawsuit tracking allegations in a December 2015 CFTC settlement against Total Gas & Power North America, Inc. and one of its gas traders, Therese Tran (together, TGPNA), for attempted manipulation of natural gas monthly index settlement prices. Among other things, TGNPA agreed to pay a $3.6 million civil monetary penalty to the Commission and to be subject to a two year trading suspension. Relatedly, TGNPA settled with the Federal Energy Regulatory Commission for $225 million. In dismissing the subsequent class action, the court held that plaintiffs failed to plead actual damages and thus lacked standing to bring its case. This holding highlights the benefits of CFTC settlements that contain terms limited to attempted market manipulation—as opposed to a actual manipulation—and demonstrates that stipulating to a significant monetary penalty may not necessarily give rise to subsequent liability in the context of private litigation.

C. Spoofing

The CFTC continues to devote significant efforts to a form of market manipulation generally referred to as ''spoofing,'' which involves placing bids or offers with the intent to cancel them before they are filled. The CFTC has long pursued spoofing cases under its general anti-manipulation authority, but the practice was not specifically prohibited until the passage of Dodd-Frank. The Commission has pursued a number of notable spoofing cases in fiscal year 2017.

For example, in November 2016, the CFTC entered into a consent order with Navinder Singh Sarao and Nav Sarao Futures Limited PLC to settle allegations related to the 2010 flash crash for $25.7 million in monetary sanctions, $12.9 million in disgorgement, and permanent trading and registration ban. According to the CFTC, Sarao used computer algorithms to place fake orders from his modest home office in the United Kingdom and reap unlawful profits of $40 million between 2010 and 2014. This enforcement action followed a successful year-long, multi-appeal battle by the DOJ to extradite Sarao to face criminal proceedings in federal court in Illinois, pursuant to which he pled guilty to one count of spoofing and one count of wire fraud. Sarao's case is only the second criminal prosecution for spoofing and follows the conviction of trader Michael Coscia by a federal jury in Chicago. Sarao faces thirty years' imprisonment when he is sentenced.

Shortly after settling with Sarao, the CFTC settled with trading company 3Red and trader Igor Oystacher (together, 3Red) in December 2016, imposing a $2.5 million penalty, a monitor for three years, and requiring the use of certain trading compliance tools. According to the complaint, 3Red ''intentionally and repeatedly engaged in a manipulative and deceptive spoofing scheme while placing orders for and trading futures contracts on multiple registered entities.'' .Unlike in Sarao's and Coscia's case, 3Red's orders were placed and cancelled manually and without using high-speed algorithms. In April 2016, the court held an eight-day preliminary injunction hearing on the CFTC's motion to bar Oystacher from trading in certain commodity futures. In a 99-page order, U.S. District Court Judge Amy J. St. Eve denied the CFTC's motion, finding that 3Red's voluntarily imposed trading limitations – including size and speed restrictions on Oystacher's trades – were enough to prevent the risk of market manipulation through artificial orders. Later in 2016, 3Red's constitutional challenge against the anti-spoofing provisions of the CEA for vagueness was denied. The court disagreed with 3Red's argument, holding that the statute was not unconstitutionally vague because it included an intent element. The court found that the intent element was met, because the CFTC was not required to allege direct evidence of intent – rather, circumstantial evidence, including Oystacher's trading patterns and relevant market data, was sufficient. Although media reports suggested that the DOJ held a federal grand jury regarding 3Red's trading practices, 3Red has not been charged criminally.

It is likely that the Commission will continue to cooperate with criminal authorities in connection with spoofing investigations, albeit with potentially different results. On the one hand, former Director of Enforcement Goelman pursued criminal prosecution as a penalty for spoofing activity. In contrast, current Enforcement Director James McDonald seems to favor a different approach, emphasizing that reduced penalties might be possible based on self-reporting and cooperation. For example, in June 2017, he settled spoofing, manipulation, and related manipulation charges against former trader David Liew in exchange for an agreement that Liew would not trade commodity interests under the CFTC's jurisdiction in the future. Director McDonald explained that the Liew settlement demonstrates that ''the Commission will give meaningful cooperation credit to those who acknowledge their own wrongdoing, enter into a Cooperation Agreement and provide substantial assistance to the Division in its investigations and enforcement actions against others who have engaged in illegal conduct.''

A month later, Director McDonald issued the agency's first non-prosecution agreements (NPAs) to three former Citigroup traders (Jeremy Lao, Daniel Liao, and Shlomi Salant) who admitted to spoofing the U.S. Treasury Markets in 2011 and 2012 while employed at Citigroup. The NPAs emphasize the traders' timely and substantial cooperation, immediate willingness to accept responsibility for their misconduct, material assistance provided to the CFTC's investigation of Citigroup, and the absence of a history of prior misconduct. Earlier in 2017, the CFTC had fined Citigroup itself $25 million for failing to diligently supervise the activities of its employees and agents in conjunction with spoofing orders in the same markets. Purportedly, Lao, Liao, and Salant had learned spoofing techniques from senior traders at Citi and profited from placing large orders to fill smaller ones at favorable prices. Notably, the CFTC pursued sanctions against two other former Citigroup traders, Stephen Gola and Jonathan Brims, in connection with related conduct, imposing fines of $350,000 and $200,000, respectively, along with six-month trading bans. The CFTC's disparate treatment of Gola and Brims, on the one hand, and Lao, Liao, and Salant, on the other, makes clear that the CFTC is willing to use both carrots and sticks in its enforcement efforts.

Indeed, in a speech on September 25, 2017, Director McDonald reiterated the Commission's willingness to extend a ''substantial benefit, in the form of a significantly reduced penalty . . . for companies and individu-

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als that self-report'' and otherwise cooperate. Director McDonald outlined several specific eligibility requirements. First, the disclosure of wrongdoing must be made voluntarily – i.e., it must specifically identify the misconduct ''before an imminent threat of disclosure or of a Government investigation, and it must be made independent of any other legal obligation.'' In addition, a company must promptly disclose the misconduct shortly after becoming aware of it. Second, a company must fully and proactively cooperate by making ''an active effort to find all related wrongdoing, and not taking a squinty-eyed view of the facts to minimize the misconduct or avoid disclosures.'' Third, a company must timely and appropriate implement remedial measures. Director McDonald stressed that, despite the available benefits of the Commission's self-reporting and cooperation program, it ''should not be interpreted as giving a pass to companies or individuals.'' To the contrary, he explained that the CFTC is ''committed to aggressively prosecuting, not just the company ultimately responsible for the misconduct, but also the individuals involved'' and that the ''program is about gaining an insider perspective so we can more effectively prosecute all the bad actors.''

VI. FALSE STATEMENTS

The Commission has brought numerous false statement cases in recent years. Dodd-Frank made it easier for the Commission to bring these cases in two important ways. First, the Commission now has authority to pursue false statements made in almost any context related to matters regulated by the Commission, from oral answers in an informal interview to attorney-drafted responses to a subpoena. Second, while the earlier law only targeted ''knowing'' misstatements or ''willful'' falsification, Dodd-Frank requires only recklessness with regard to the falsity of the statements – in other words, that the speaker ''knew, or reasonably should have known, the statement to be false or misleading.'' *See* 7 U.S.C. § § 13(a)(3)-(4).

In a September 2016 enforcement action filed against eFloorTrade, LLC and its principal John Moore, the Commission demonstrated its willingness to employ the Dodd-Frank standard requiring only recklessness, rather than willfulness or knowledge, as to the statements' falsity. The Commission charged both parties with recordkeeping and supervision failures, and later added an additional charge against Moore for making false and misleading statements of material fact in sworn testimony about eFloorTrade's supervision and recordkeeping violations before the CFTC. In its Complaint, the Commission alleged that Moore knew or reasonably should have known that certain of his sworn statements were false and misleading.

At an industry conference in November 2016, Manal Sultan, Deputy Director of the Division of Enforcement, indicated that the provision of false information to the CFTC will continue to be a key enforcement priority in the years ahead. For example, in May 2017, a New York federal court in New York imposed sanctions – including permanent registration and trading bans and a $125,000 fine – against Wall Street Pirate Management and owner Gary Creagh for (i) making false statements to the National Futures Association (NFA) in required reports and during an NFA audit and (ii) concealing material information, including with respect to whether his commodity pool was active. This case demonstrates the CFTC's willingness to pursue charges against companies that make false statements to self-regulatory organizations, such as the NFA, in addition to the Commission itself. Later, in September 2017, Merrill Lynch settled with the CFTC, agreeing to pay $2.5 million in penalties for its failure to supervise employees' misleading and false responses to a CME Group investigation into swaps desk trading ahead of futures block trades (and for related recordkeeping).

VII. CONCLUSION

The CFTC's enforcement efforts over the past seven years clearly show that Dodd-Frank has enabled the Commission to aggressively investigate and successfully prosecute cases that were impossible both legally and practically less than a decade ago. Though the new administration in Washington may shift the Commission's focus, it is unlikely that the CFTC will soften their commitment to bringing complex enforcement actions.

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