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### ENFORCEMENT

## Recent Developments in CFTC Enforcement



BY ZACH BREZ, JON DANIELS, JOHN IVEY EAGLES,  
AND KATHRYN ROULETT

**A**lthough it is less well-known than some of its regulatory counterparts, the Commodity Futures Trading Commission (the “CFTC” or the “Commission”) plays a vital role in the financial markets by overseeing the \$31 trillion futures and options market and the \$400 trillion U.S. swaps market.<sup>1</sup> Despite this broad

<sup>1</sup> *Commodity Futures Trading Commission (CFTC) Budget and Performance Estimate for Fiscal Year 2015*, at 1 (2014), <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcbudget2015.pdf>.

*Zachary Brez is co-head of Ropes & Gray’s securities & futures enforcement and business & securities litigation practices.*

*Jon Daniels is a government enforcement associate at Ropes & Gray. His practice is focused on regulatory investigations involving the Foreign Corrupt Practices Act, insider trading, financial fraud and related litigation matters.*

*John Ivey Eagles is an associate in the litigation department of Ropes & Gray.*

*Kathryn Roulett is an associate in the litigation department at Ropes & Gray.*

oversight role, the CFTC has traditionally lacked both the resources and the authority to aggressively pursue fraudulent activities in these markets, and its reputation was as the “regulatory agency with a small bark and even less bite.”<sup>2</sup> This changed with passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) in 2010. Dodd-Frank greatly enhanced the Commission’s oversight and enforcement powers, and Congress has responded to this increased authority by enlarging the Commission’s budget from \$146 million in 2009 to \$250 million in 2015 and 2016.<sup>3</sup>

The impact of these new resources and expanded powers is just starting to be seen. For fiscal years 2014 and 2015, the CFTC obtained monetary sanctions in excess of \$3 billion.<sup>4</sup> These figures are more than 11 times

<sup>2</sup> Peter Henning, *CFTC Is Set to Get Tougher on Fraud*, *NEW YORK TIMES DEALBOOK* (Nov. 1, 2010), <http://dealbook.nytimes.com/2010/11/01/c-f-t-c-is-set-to-get-tougheron-fraud/>;

Zach Brez and Jon A. Daniels, *The New Financial Sheriff: CFTC Anti-Fraud Authority After Dodd-Frank*, *Bloomberg BNA Securities Regulation & Law Report*, 44 SRLR 1209, June 18, 2012.

<sup>3</sup> Press Release, CFTC, Statement of Chairman Timothy Massad on the Fiscal Year 2016 Budget Agreement (Dec. 21, 2015) (noting that the Commission’s request to increase their budget to \$322 million for 2016 was rebuffed by Congress.), <http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement122115>.

<sup>4</sup> Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal Year 2014 (Nov. 6, 2014), <http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement110614>.

the \$280 million collected in 2009, the last year before Dodd-Frank.<sup>5</sup> These figures include several high-profile settlements and recent judgments for very large sums. In April 2015, for example, Deutsche Bank agreed to pay an \$800 million penalty for false reporting and manipulation of certain benchmark interest rates – the largest fine in CFTC history.<sup>6</sup> Later, in December 2015, JP Morgan agreed to pay \$100 million to the CFTC for failing to disclose conflicts of interests to clients.<sup>7</sup> This trend of large enforcement penalties has continued in 2016. Charges of fraudulent misrepresentations and omissions against Nikolai Battoo, an alternative asset manager, and his three companies,<sup>8</sup> resulted in sanctions reaching approximately \$500 million in January 2016.<sup>9</sup>

These large penalties and fines reflect the CFTC's pursuit of high-profile targets, and involvement in larger, more complex investigations. This article discusses these recent cases and other attempts by the CFTC to utilize its new powers, and details specific types of conduct that have been targeted by the Commission as part of its invigorated enforcement efforts.

## Manipulation

The Dodd-Frank Act significantly expanded the CFTC's authority to regulate manipulative behavior. Before Dodd-Frank, a manipulation charge required the Commission to demonstrate both that the trader had acted with scienter – meaning that the trader *intended* to manipulate the market – and that the trader had actually affected the market price of the relevant contract. In 2009, former Commissioner Bart Chilton summa-

riarized the difficulties imposed by this standard when he noted that “in the CFTC's 35-year history we have only successfully prosecuted and won a single case of manipulation in the futures markets . . . . Proving manipulation under current law is so onerous as to be almost impossible.”<sup>10</sup> The CFTC's rule implementing the Act's anti-manipulation provisions, Rule 180.1, went into effect on July 14, 2011.<sup>11</sup> As a result, the CFTC's Division of Enforcement can now bring a civil action against any person who “intentionally or recklessly” engages in, or attempts to engage in, certain described manipulative practices – a significantly less onerous standard.<sup>12</sup> The rule expands the Commission's authority in three important ways. In contrast to the previous regulation relating to manipulative actions, the new rule: (1) is not limited to transactions but applies to *all* activities that have a relationship to swap or futures contracts, (2) includes attempted manipulation, and (3) lowers the scienter requirement from intent to recklessness.<sup>13</sup> In addition to the new rule, the CFTC continues to maintain its traditional manipulation authority arising under Section 6(c)(3) and Rule 180.2 – with the scienter requirement – and will be guided by existing case law that has emerged.<sup>14</sup> While the full impact of this more accommodating anti-manipulation authority remains to be seen, recent cases have shown that the Commission intends to make extensive use of its new powers.

In June 2015, for example, Judge William H. Pauley of the U.S. District Court for the Southern District of New York issued a consent order against Joseph F. Welsh III to resolve CFTC charges that Welsh attempted to manipulate settlement prices on the New York Mercantile Exchange, assessing a civil monetary penalty of \$500,000 and ordering a trading ban and compliance training. Similarly, in December 2015, the Commission settled charges 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.<sup>15</sup>

In addition to these settlements, two separate manipulation cases are currently being litigated in federal courts – the first time a CFTC manipulation case has gone to trial since 2008.<sup>16</sup> In the first case, the Commission filed a complaint in the Southern District of New York in late 2013 against DRW Investments, LLC, and

[www.cftc.gov/PressRoom/PressReleases/pr7051-14](http://www.cftc.gov/PressRoom/PressReleases/pr7051-14); Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal Year 2015 (Nov. 6, 2015) (noting that the CFTC obtained \$3.27 billion in 2014 and \$3.14 billion in 2015.), <http://www.cftc.gov/PressRoom/PressReleases/pr7274-15>.

<sup>5</sup> *Commodity Futures Trading Commission Performance and Accountability Report Fiscal Year 2009*, at 4, (2009), <http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2009par.pdf>.

<sup>6</sup> Press Release, CFTC, Deutsche Bank to Pay \$800 Million Penalty to Settle CFTC Charges of Manipulation, Attempted Manipulation, and False Reporting of LIBOR and EURIBOR (Apr. 23, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7159-15>.

<sup>7</sup> JP Morgan's total settlement with both the SEC and CFTC totaled \$307 million. See Sarah Lynch, *JP Morgan to pay \$307 million to settle SEC, CFTC disclosure charges*, REUTERS (Dec. 18, 2015), <http://www.reuters.com/article/us-jpmorgan-sec-settlement-idUSKBN0U124R20151218>; Press Release, CFTC, CFTC Orders JPMorgan Chase Bank, N.A. to Pay \$100 Million for Failure to Disclose Conflicts of Interest (Dec. 18, 2015) (The CFTC order required JP Morgan to pay the CFTC a \$40 million civil monetary penalty, and an additional \$60 million in disgorgement.), <http://www.cftc.gov/PressRoom/PressReleases/pr7297-15>.

<sup>8</sup> The companies involved were BC Capital Group S.A., BC Capital Group International Limited, and BC Capital Group Holdings S.A. The three companies were operated as a common enterprise. Each entity was said to perform different functions in operating the commodity pools, though some of the corporations were mere shells with no actual offices.

<sup>9</sup> Press Release, CFTC, Federal Court in Illinois Orders Approximately \$500 Million in Sanctions against Defendant Nikolai S. Battoo and His Three Companies for Committing a Global Commodity Futures and Options Fraud (Jan. 13, 2016), <http://www.cftc.gov/PressRoom/PressReleases/pr7306-16>.

<sup>10</sup> Press Release, CFTC, Speech of Commissioner Bart Chilton before the Argus Media Summit (Oct. 21, 2009), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-28>.

<sup>11</sup> 17 CRF 180.1

<sup>12</sup> 17 CFR 180.1(a); Kenneth W. McCracken and Christine Schleepegrell, *The CFTC's Manipulative and Disruptive Trading Authority in an Algorithmic World*, Schiff Hardin (April 2015), [http://www.schiffhardin.com/Templates/media/files/publications/PDF/Mccracken-Schleepegrell\\_FutDerLaw\\_201504.pdf](http://www.schiffhardin.com/Templates/media/files/publications/PDF/Mccracken-Schleepegrell_FutDerLaw_201504.pdf).

<sup>13</sup> Zach Brez and Jon A. Daniels, *The New Financial Sheriff: CFTC Anti-Fraud Authority After Dodd-Frank*, Bloomberg BNA Securities Regulation & Law Report, 44 SRLR 1209, June 18, 2012.

<sup>14</sup> McCracken and Schleepegrell, *supra* note 12.

<sup>15</sup> Press Release, CFTC, CFTC Files and Settles Charges against Total Gas & Power North America, Inc. and Therese Tran for Attempted Manipulation of Natural Gas Monthly Index Settlement Prices (Dec. 7, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7289-15>.

<sup>16</sup> Bradley Hope, *Big Trader Strikes Back Against CFTC*, NASDAQ (Dec. 24, 2015), <http://www.nasdaq.com/article/big-trader-strikes-back-against-cftc-20151224-00055>.

its founder Donald Wilson, alleging that Wilson and DRW were involved in a “manipulative scheme” in which they placed orders for futures contracts with the intent to move prices in their favor and thereby increase the value of futures contracts in their portfolio.<sup>17</sup> According to the CFTC, DRW earned \$20 million with this illegal tactic, a practice called “banging the close.”<sup>18</sup> The case is scheduled to go to trial in the latter half of 2016.

A second manipulation case is being litigated in Chicago federal court. On April 1, 2015, the Commission, relying on the new Dodd Frank standard, charged Kraft Foods Group, Inc. and Mondelez Global LLC (“Kraft”) for manipulating the price of wheat under both the traditional manipulation approach — including Commodity Exchange Act § 6(c)(3) and Rule 180.2, as well as the new Dodd-Frank approach set forth in Rule 180.1 and new Commodity Exchange Act § 6(c)(1).<sup>19</sup> According to the CFTC, the manipulation caused shifts in price, which lowered the cost of the wheat, thereby earning Kraft over \$5.4 million in profits.<sup>20</sup>

As these cases demonstrate, the CFTC is taking a vigorous approach to enforcement of manipulation cases. Both DRW and Kraft have questioned the CFTC’s interpretation of these new standards. DRW argued that the intent element was narrower than the CFTC’s reading, while in Kraft, the defendants have argued that the factual scenario that is the basis of the charges is not sufficient to show manipulation, and could have been the result of legitimate acts. Decisions from these recent settlements and litigated proceedings should answer these questions and shed light on the interpretation of the Commission’s new manipulation rule, and will likely have a great impact on the CFTC’s future manipulation enforcement efforts.

## Insider Trading

In addition to targeting manipulation, the CFTC has recently used its expansive new Dodd-Frank powers — in particular, Rule 180.1 — to bring its first commodities insider trading case.<sup>21</sup> Bringing an insider trading case marks a shift for the CFTC, which had a limited ability to target insider trading prior to Dodd Frank.

In its order, the CFTC asserted that Arya Motazed, a futures trader, orchestrated fraudulent transactions in futures contracts for crude oil and gasoline between September and November 2013.<sup>22</sup> The Commission found that Motazed misused the material, non-public

information he had about the prices, amounts and times at which his employer intended to trade commodities futures, to place trades between his personal accounts and the company’s accounts to generate profits for himself at the expense of his employer and to trade ahead of his company’s orders.<sup>23</sup> The charges were based upon violations of Section 6(c)(1) of the CEA, as well as CFTC Rule 180.1. In combination, these rules create a CFTC prohibition on deceptive or manipulative conduct that is modeled on the SEC’s use of Rule 10b-5 of the Securities Exchange Act of 1934.<sup>24</sup> The CFTC commented on the broad nature of these rules in its order, stating that the intent was “to interpret CEA section 6(c)(1) as a broad, catch-all provision reaching fraud in all its forms.”<sup>25</sup>

*Motazed* stated explicitly that “trading on material non-public information in breach of a pre-existing duty may constitute a violation of Rule 180.1.”<sup>26</sup> The CFTC used the misappropriation theory, from Exchange Act Rule 10b-5, of misuse of material, non-public information, stating that deception occurs “because the source of the information (principal) is entitled to ‘the exclusive use of the information.’”<sup>27</sup> Despite not using the terminology of “insider trading,” it is clear through this case that the CFTC has embraced the language of similar insider trading law.<sup>28</sup> The case concluded in a settlement on December 2, 2015. *Motazed* was required to pay a civil monetary penalty of \$100,000 and restitution in the amount of \$216,955.80 for his former employer. The CFTC also imposed a permanent ban on *Motazed* from trading and registering as a futures professional in any capacity. *Motazed* signals that the Commission intends to use its broad authority under the Dodd-Frank Act to go after fraud — such as insider trading — in addition to manipulation.<sup>29</sup>

## Spoofing

The CFTC has also devoted significant attention to a form of market manipulation generally referred to as “spoofing.” The CFTC has interpreted “spoofing” to include a variety of manipulative schemes, all of which involve placing orders to affect the price or the market without actually intending to execute the trades. A basic spoofing scheme involves entering a small order on one side of the market that the trader intends to fill, and contemporaneously entering a large order on the other side of the market. The large order will be canceled by the spoofer before execution, and merely creates the illusion of market depth so that the order generates a response from other market participants that will benefit the trader’s small position. A more sophisticated version known as “layering” involves placing an order on one side of the market and then placing successively

<sup>17</sup> Complaint, U.S. Commodity Futures Trading Commission v. Wilson et. al., No. 13 cv-7884 (S.D.N.Y. Nov. 6, 2013).

<sup>18</sup> Hope, *supra* note 16.

<sup>19</sup> Complaint, U.S. Commodity Futures Trading Commission v. Kraft Foods Group Inc. and Mondelez Global LLC, No. 15-cv-02881 (N.D. Ill. Apr. 1, 2015).

<sup>20</sup> Press Release, CFTC, CFTC Charges Kraft Foods Group, Inc. and Mondelez Global LLC with Manipulation of Wheat Futures and Cash Wheat Prices (Apr. 1, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7150-15>.

<sup>21</sup> Scott Himes, *The CFTC Turns to Insider Trading Enforcement*, JD SUPRA BUSINESS ADVISOR (Jan. 12, 2016), <http://www.jdsupra.com/legalnews/the-cftc-turns-to-insider-trading-18048/>.

<sup>22</sup> Press Release, CFTC, CFTC Orders Arya Motazed to Pay a Civil Monetary Penalty and Restitution and Bans Him from Trading and Registration for Engaging in Gas and Crude Oil Futures Transactions that Defrauded His Employer (Dec. 2,

2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7286-15>.

<sup>23</sup> Geoffrey Aronow and Michael Sackheim, *CFTC Asserts Its Broader Fraud Jurisdiction and Steps Into the World of Insider Trading*, Sidley Austin LLP (Dec. 31, 2015), <http://www.sidley.com/news/12-31-2015-investment-funds-update>.

<sup>24</sup> In the Matter of Arya Motazed, CFTC Docket No. 16-02 (Dec. 2, 2015).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> Aronow and Sackheim, *supra* note 23.

<sup>29</sup> *Id.*

more aggressive orders on the other side of the market, with no intent to have these orders filled, in order to simulate change that will affect the price of the original order in the trader's favor.<sup>30</sup> "Quote stuffing" involves a trader repeatedly placing and canceling large orders in order to overwhelm a markets' quotation system or to slow and confuse competitors' analysis of the market.<sup>31</sup>

Prior to the enactment of Dodd-Frank, the CFTC could only charge spoofers under the generic manipulation provision – the same rule that prompted Commissioner Chilton to bemoan the difficulty of bringing such claims. In addition to making it easier to bring general manipulation charges, the Dodd-Frank Act also created an entirely new rule specifically targeting spoofing.<sup>32</sup> Now, a spoofing charge only requires the intent to cancel the bid or offer before it is filled.

The CFTC has made no secret of its efforts to exert this new authority and crack down on spoofing. Indeed, Chairman Timothy Massad has repeatedly singled out spoofing in public remarks as a particular area of focus for the Commission.<sup>33</sup> At the CME Global Financial Leadership Conference in 2014, Massad emphasized that the CFTC "will focus on enforcement at all levels," including "new challenges like spoofing that come with our increasingly electronic markets."<sup>34</sup> More recently, Massad stated that the CFTC has "brought enforcement actions against those who engage in spoofing," and "will continue to be aggressive on this front."<sup>35</sup> The CFTC's focus on spoofing is also clear from the directives that the Commission has given to the Self-Regulatory Organizations that it oversees.<sup>36</sup>

The first high profile example of spoofing enforcement was a July 2013 settlement with Panther Energy Trading LLC and Michael J. Coscia (collectively, "Panther").<sup>37</sup> The CFTC investigation revealed that Panther used a layering algorithm to quickly place and cancel

series of bids or offers designed to simulate changes in demand and price in order to benefit orders they wanted to execute.

In the civil case, Panther paid a \$1.4 million penalty, disgorged an additional \$1.4 million in trading profits, and was ordered to serve a one-year suspension from trading.<sup>38</sup> Significantly, the CFTC's cooperation with the Department of Justice on this case also led to criminal charges being filed and ultimately a conviction against Coscia for spoofing and commodities fraud. Significantly, this criminal charge appears to be a signal of future enforcement efforts and the ongoing cooperation between the Commission and the DOJ.<sup>39</sup> Indeed, Aitan Goelman, the Director of the CFTC's Division of Enforcement, has stated that he wants the Commission to continue its close cooperation with criminal authorities, because as a deterrent there is "no substitute for putting actual human beings in jail."<sup>40</sup> True to his word, Goelman and the CFTC assisted the DOJ in bringing a second indictment for spoofing violations against Navinder Singh Sarao for manipulation alleged to have caused the so-called "flash crash" in 2010<sup>41</sup> by using an algorithm to implement a repetitive layering scheme, similar to that used by Panther.<sup>42</sup>

The CFTC crackdown on spoofing has only continued in recent years. In October 2014, the Commission settled spoofing charges against trader Eric Moncada, ordering him to pay \$1.56 million, and obtaining a default judgment for \$32.24 million against the companies for which he traded.<sup>43</sup> The CFTC filed another spoofing action against Heet Khara and Nasim Salim, two traders based in the United Arab Emirates in May 2015.<sup>44</sup> Furthermore, after a multi-year spoofing investigation,<sup>45</sup> the CFTC brought a case against trading company 3Red and trader Igor Oystacher on October 19,

<sup>38</sup> *Id.*

<sup>39</sup> Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal Year 2015, (Nov. 6, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7274-15>.

<sup>40</sup> Jean Eaglesham, *CFTC Turns Toward Administrative Judges*, WALL STREET JOURNAL (Nov. 9, 2014), <http://www.wsj.com/articles/cftc-turns-toward-administrative-judges-1415573398>.

<sup>41</sup> Ben Rooney, *UK Trader Arrested for Causing 2010 Stock Market 'Flash Crash'*, CNN MONEY (Apr. 21, 2015), <http://money.cnn.com/2015/04/21/investing/flash-crash-uk-trader-arrested/>; Sarah Lynch, *U.S. federal grand jury indicts 'flash crash' trader*, REUTERS (Sep. 4, 2015), <http://in.reuters.com/article/usa-indictment-flashcrash-idINKCN0R32AO20150903>.

<sup>42</sup> Press Release, CFTC, CFTC Charges U.A.K. Resident Navinder Singh Sarao and His Company Nav Sarao Futures Limited PLC with Price Manipulation and Spoofing (Apr. 21, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7156-15>.

<sup>43</sup> Press Release, CFTC, Federal Court Orders Eric Moncada to Pay \$1.56 Million Penalty for Attempting to Manipulate the Wheat Futures Market (Oct. 1, 2014), <http://www.cftc.gov/PressRoom/PressReleases/pr7026-14>.

<sup>44</sup> Press Release, CFTC, CFTC Charges United Arab Emirates Residents Heet Khara and Nasim Salim with Spoofing in the Gold and Silver Futures Markets (May 5, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7171-15>.

<sup>45</sup> Matthew Leising, *Market Manipulation Probe Entangles Chicago Trading Firm*, BLOOMBERG (Nov. 19, 2014), <http://www.bloomberg.com/news/2014-11-19/market-manipulation-probe-entangles-chicago-trading-firm.html>. See also Bradley Hope, *As "Spoof" Trading Persists, Regulators Clamp Down*, WALL STREET JOURNAL (Feb. 22, 2015), <http://www.wsj.com/articles/how-spoofing-traders-dupe-markets-1424662202>.

<sup>30</sup> *Indictment Highlights Increased Scrutiny of Futures and Derivative Market Participants' Trading Practices*, Sidley Austin LLP (Dec. 2, 2014), <http://www.sidley.com/news/08-07-14-securities-and-derivatives-enforcement-and-regulatory-update>.

<sup>31</sup> Roberta Rampton, *"Quote Stuffing" a Focus in Flash Crash Probe*, REUTERS (Sep. 2, 2010), <http://www.reuters.com/article/2010/09/02/us-sec-trades-idUSTRE6812ZS20100902>.

<sup>32</sup> 7 U.S.C. § 6c(a)(5).

<sup>33</sup> E.g., Press Release, CFTC, Remarks of Chairman Timothy G. Massad before the Futures Industry Association Expo 2014 (Nov. 5, 2014), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-3>.

<sup>34</sup> Press Release, CFTC, Remarks of Timothy G. Massad at the CME Global Financial Leadership Conference (Nov. 18, 2014), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-5>.

<sup>35</sup> Press Release, CFTC, Remarks of Chairman Timothy Massad before the Conference on the Evolving Structure of the U.S. Treasury Market (Oct. 21, 2015), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-30>.

<sup>36</sup> E.g., "Trade Practice Rule Enforcement Review: The New York Mercantile Exchange and the Commodity Exchange" CFTC Division of Market Oversight (Nov. 21, 2014), <http://www.cftc.gov/ucm/groups/public/@iodcms/documents/file/rertradepractice112114.pdf>.

<sup>37</sup> Press Release, CFTC, CFTC Orders Panther Energy Trading LLC and its Principal Michael J. Coscia to Pay \$2.8 Million and Bans Them from Trading for One Year, for Spoofing in Numerous Commodity Futures Contracts (July 22, 2013), <http://www.cftc.gov/PressRoom/PressReleases/pr6649-13>.

2015.<sup>46</sup> These public statements, high-profile enforcement actions, and continuing investigations indicate that spoofing will remain a point of emphasis for the Commission.

The CFTC's spoofing efforts have been met with significant criticism from industry participants and practitioners who have commented that the Commission's guidance on the issue is vague and fails to take into account valid reasons for the type of trading activity being targeted. During the comment phase on the proposed spoofing rule, for example, two industry organizations noted that there are many legitimate reasons to cancel orders – even after very short periods of time – and the language of the regulation is so broad that it encompasses some of these entirely appropriate trades.<sup>47</sup> Some market participants have argued that even deceptive spoofing is “beneficial” because it acts as a check on other destabilizing high-frequency trading strategies without actually harming legitimate traders.<sup>48</sup>

Traders and defense counsel have also complained that CFTC guidance on spoofing is vague.<sup>49</sup> The CFTC's Guidance provided four “non-exclusive” examples of spoofing, but beyond that, the Commission adopted an ambiguous standard suggesting that they “know it when they see it” when it comes to spoofing: “[a]s with other intent-based violations, the Commission intends to distinguish between legitimate trading and ‘spoofing’ by evaluating all of the facts and circumstances of each particular case.”<sup>50</sup> Despite criticisms, the only legal challenge to these new rules has thus far been unsuccessful. In a pretrial motion, Coscia moved to dismiss the criminal charges against him as void for vagueness, but the motion was denied.<sup>51</sup>

As a result of these recent successes, the Commission will likely continue its crackdown on spoofing in upcoming years. The conviction of Coscia, in particular, illustrates the consequences that might befall individuals or companies as a result of a CFTC investigation into spoofing behavior and has emboldened the Commission and the DOJ to bring additional spoofing cases.

<sup>46</sup> Press Release, CFTC, CFTC Charges Chicago Trader Igor B. Oystacher and His Proprietary Trading, 3 Red Trading LLC, with Spoofing and Employment of Manipulative and Deceptive Device while Trading E-Mini S&P 500, Copper, Crude Oil, Natural Gas, and VIX Futures Contracts (Oct. 19, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7264-15>.

<sup>47</sup> Futures Industry Association and Securities Industry and Financial Markets Association Letter Re: Antidistruptive Practices Authority Proposed Interpretive Order, May 17, 2011 (“Traders engage in legitimate trading practices that are unintentionally captured by Section 747’s definition of ‘spoofing.’ For example, traders may enter larger than necessary orders to ensure their hedging or delivery needs are met and, once met, they may then cancel part of the original order.”).

<sup>48</sup> John D. Arnold, *Spoofers Keep Markets Honest*, BLOOMBERG VIEW (Jan. 23, 2015), <http://www.bloomberglaw.com/articles/2015-01-23/high-frequency-trading-spoofers-and-front-running>.

<sup>49</sup> Press Release, CFTC, Q&A – Interpretive Guidance and Policy Statement on Disruptive Practices (May 16, 2013), [http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dtpinterpretiveorder\\_qa.pdf](http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dtpinterpretiveorder_qa.pdf).

<sup>50</sup> 78 FR 31896.

<sup>51</sup> Mem. Order and Opinion, United States of America v. Coscia, No. 14-CR-551 (N.D. Ill. Apr. 16, 2015), <https://www.bloomberglaw.com/document/X1Q6N747J2O2>.

## False Statements

One example of the CFTC's historical weakness was its inability to effectively pursue a range of false statements made during the Commission's investigations and enforcement proceedings. A key new area of enforcement authority authorized by Dodd-Frank is the CFTC's ability to pursue such false statements.

Prior to Dodd Frank, the CFTC had the ability to address only certain kinds of false statements. This authority included the power to target false statements made in certain formal documents or materials required to be submitted to the Commission or regulated entities.<sup>52</sup>

The Commission's authority to pursue charges for false statements has been expanded in two important ways. First, it now includes 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,<sup>53</sup> the new Dodd-Frank rule 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.”<sup>54</sup>

This new authority has been cited as a point of emphasis several times by Enforcement officials. For example, then-Acting Director of the Division of Enforcement Gretchen L. Lowe stated that “[w]itnesses in CFTC investigations must tell the truth. If they do not, the CFTC will not hesitate to take action to enforce the Dodd-Frank's prohibition against providing false or misleading information and impose sanctions.”<sup>55</sup> Director Goelman, at a December 2014 conference hosted by Thompson Reuters, similarly made clear that “[w]here it's possible to prove false statements, you have to bring those cases.”<sup>56</sup> The Commission has backed up these words by bringing a number of enforcement actions under its new false statements powers. In one case, the president of a Russian bank and co-owner of a Cypriot investment fund, Artem Obolensky, agreed to pay \$250,000 to settle charges that he made false and misleading statements to investigators regarding crossed trades. Notably, no charges were brought regarding the crossed trades; the false statement charge stood on its

<sup>52</sup> See 7 U.S.C. § 13(a)(3)-(4).

<sup>53</sup> *Id.*

<sup>54</sup> Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 747, 124 Stat. 1376, 1739 (2010) (emphasis added).

<sup>55</sup> Press Release, CFTC, CFTC Orders President of a Russian Bank, Artem Obolensky, to Pay \$250,000 Penalty to Settle Charges of Making False Statements to the CFTC During an Investigation, (Jan. 2, 2014), <http://www.cftc.gov/PressRoom/PressReleases/pr6815-14>. She reiterated that sentiment in remarks to the Industry Association at their Annual Legal and Compliance Conference in May. Vincent P. (Trace) Schmeltz III, *CFTC Enforcement Update: Straight from the Acting-Chief's Mouth*, Lexology (May 21, 2014), <http://www.lexology.com/library/detail.aspx?g=aa57a195-2fb6-44db-b4a4-0cd9767729f1>.

<sup>56</sup> Peter Rawlings, *CFTC, Prosecutors Eye Obstruction Cases*, Compliance Reporter, Vol. XXI, No. 26 December 29, 2014.

own.<sup>57</sup> In another case, *In the Matter of Sean R. Stropp*, the owner of a precious metals investment company agreed to pay \$250,000 to settle charges that he falsely represented his assets and omitted material facts in a financial disclosure statement.<sup>58</sup> False statement claims have also been brought alongside other charges and have likely increased the size of settlements. In the proceeding *In the Matter of Scott A. Beatty, et al.*, defendants paid restitution of more than \$600,000 and a civil penalty of \$1 million for foreign exchange fraud and making false statements.<sup>59</sup> In *CFTC v. Arista LLC, et al.*, defendants agreed to pay restitution of more than \$8 million and combined civil penalties of nearly \$14 million for commodity pool fraud and making false statements to the CFTC.<sup>60</sup> The aggressive enforcement of false statement cases continued throughout the latter half of 2015.<sup>61</sup>

## Benchmark Manipulation

Like many regulators around the world, the CFTC has also focused increasingly on the area of benchmark manipulation. Financial benchmarks are designed to provide information about average or fair rates or prices in the market and serve as the foundation for many important financial and business decisions. In 2012, it was revealed that manipulation might have occurred in connection with the London Interbank Offered Rate (“LIBOR”), one of the most important financial benchmarks in the world. The institutions who were supposed to report their rates for inter-bank lend-

ing conspired in secret chat rooms to report false rates in order to move the benchmark in ways that would benefit their other trades. The CFTC entered a number of substantial settlements with financial institutions related to LIBOR manipulation.<sup>62</sup>

Since the LIBOR settlement, the CFTC has taken a close interest in potential manipulation of other benchmarks. In November 2014, the CFTC ordered five large banks to pay a total of \$1.4 billion in civil monetary penalties for manipulating and attempting to manipulate foreign exchange benchmark rates for their own benefit.<sup>63</sup> The foreign exchange manipulation settlements were some of the largest in CFTC history and were reached after a multi-agency investigation in which the banks settled with several other regulators, paying fines totaling \$4.3 billion.

The size and scope of the investigation and settlement highlighted the CFTC’s aggressive new strategy as well as its increasingly sophisticated enforcement capabilities. Moreover, the CFTC has made clear that these settlements represent just the beginning of its efforts in this area. To that end, the largest fine in CFTC’s history – \$800 million – was imposed on Deutsche Bank in April 2015, as part of a settlement for charges that the bank “succeeded in manipulating” LIBOR and the Euro Interbank Offered Rate.<sup>64</sup> In May 2015, Barclays agreed to pay \$115 million to settle charges of manipulation of the ISDAFix swaps and derivatives benchmark as part of a larger settlement (totaling \$750 million in penalties) involving foreign exchange and LIBOR manipulation.<sup>65</sup> It was reported in February 2015 that the Commission and the Justice Department are investigat-

<sup>57</sup> In the matter of Artem Obolensky, CFTC Docket No. 14-05, Order Instituting Proceedings Pursuant To Sections 6(c) And 6(d) Of The Commodity Exchange Act, As Amended, Making Findings And Imposing Remedial Sanctions (Jan. 2, 2014), <https://www.bloomberglaw.com/document/X958AP7>.

<sup>58</sup> Press Release, CFTC, CFTC Orders Sean R. Stropp to Pay \$250,000 Penalty to Settle Charges of Making False and Misleading Statements During a CFTC Investigation (Mar. 18, 2014), <http://www.cftc.gov/PressRoom/PressReleases/pr6880-14>.

<sup>59</sup> Press Release, CFTC, CFTC Orders Utah Resident Scott A. Beatty and his Company, Peak Capital Management Group, Inc., to Pay over \$1.6 Million for Forex Fraud and Making False Statements to the CFTC During an Investigation (Sept. 30, 2014), <http://www.cftc.gov/PressRoom/PressReleases/pr7022-14>.

<sup>60</sup> Press Release, CFTC, Federal Court Orders Defendants Arista LLC, Abdul Sultan Walji, and Reniero Francisco, All of Southern California, to Pay over \$22 Million in Restitution and Fines for Commodity Pool Fraud and Making False Statements to the CFTC (Dec. 4, 2013), <http://www.cftc.gov/PressRoom/PressReleases/pr6786-13>.

<sup>61</sup> Press Release, CFTC, CFTC Charges New York Resident Gary Creagh and his Company, Wall Street Pirate Management, LLC, with Making False Statements to the National Futures Association (Aug. 7 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7210-15>; Press Release, CFTC, CFTC Orders Florida Resident Barbara Cohen and Her Company, Pure Reason, LLC, to Pay a \$140,000 Penalty for Cohen’s False Statements to the CFTC and for Not Disclosing that Profitable Trading Results were Based on Hypothetical Trading (Sept. 29, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7253-15>; Press Release, CFTC, CFTC Imposes a Monetary Penalty and Permanently Bars California Resident Garen Ovspeyan and Forex trading Advisors Share Signa, LLC and Haeres Capital, LLC from the Commodities Industry (Dec. 7, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7288-15>.

<sup>62</sup> Among others, the CFTC settled charges against UBS for \$700 million, Press Release, CFTC, CFTC Orders UBS to Pay \$700 Million Penalty to Settle Charges of Manipulation, Attempted Manipulation and False Reporting of LIBOR and Other Benchmark Interest Rates (Dec. 19, 2012), <http://www.cftc.gov/PressRoom/PressReleases/pr6472-12>; Rabobank for \$475 million, Press Release, CFTC, Rabobank to Pay \$475 Million Penalty to Settle Manipulation and False Reporting Charges Related to LIBOR and Euribor (Oct. 29, 2013), <http://www.cftc.gov/PressRoom/PressReleases/pr6752-13>; Lloyds Banking group for \$105 million, Press Release, CFTC, CFTC Charges Lloyds Banking Group and Lloyds Bank with Manipulation, Attempted Manipulation, and False Reporting of LIBOR (July 28, 2014), <http://www.cftc.gov/PressRoom/PressReleases/pr6966-14>; and Barclays for \$200 million, Press Release, CFTC, CFTC Orders Barclays to pay \$200 Million Penalty for Attempted Manipulation of and False Reporting concerning LIBOR and Euribor Benchmark Interest Rates (June 27, 2012), <http://www.cftc.gov/PressRoom/PressReleases/pr6289-12>.

<sup>63</sup> Press Release, CFTC, CFTC Orders Five Banks to Pay over \$1.4 Billion in Penalties for Attempted Manipulation of Foreign Exchange Benchmark Rates (Nov. 12, 2014), <http://www.cftc.gov/PressRoom/PressReleases/pr7056-14>.

<sup>64</sup> Press Release, CFTC, Deutsche Bank to Pay \$800 Million Penalty to Settle CFTC Charges of Manipulation, Attempted Manipulation, and False Reporting of LIBOR and EURIBOR (Apr. 23, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7159-15>.

<sup>65</sup> Press Release, CFTC, CFTC Orders Barclays to Pay \$115 Million Penalty for Attempted Manipulation of and False Reporting of U.S. Dollar ISDAFIX Benchmark Swap Rates (May 20, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7180-15>; Press Release, CFTC, CFTC Orders Barclays to Pay \$400 Million Penalty for Attempted Manipulation of and False Reporting of Foreign Exchange Benchmark Rates (May 20, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7181-15>.

ing at least ten large banks for fraud related to benchmark prices of precious metals including gold and silver. Enforcement Director Goelman has stated that benchmark manipulation will remain a focus of enforcement and that “there is no reason to be sanguine or confident that there aren’t a host of other benchmarks that haven’t been corrupted.”<sup>66</sup> The Commission is expected to continue to pursue large, high-profile cases and to continue its cooperation with various domestic and foreign regulators in the area of benchmark manipulation.

## Automated and Algorithmic Trading

Technological advances have led to an increase in automated trading, with nearly all trading on CFTC markets now done electronically. The CFTC has been responsive to these changes. In November 2015, the CFTC proposed “Regulation Automated Trading” or “Regulation AT.” The new regulation is designed to reduce the risk associated with automated and algorithmic trading on U.S.-designated markets.<sup>67</sup>

Once operative, these new rules can be expected to have a significant impact on the algorithmic and automated trading industry – as well as CFTC enforcement in these areas – because the proposed regulation creates a new and independent basis for charges to be brought. Regulation AT, if adopted in its current state, would give the CFTC the authority to bring enforcement actions against automated traders if the CFTC determines that the traders did not comply with Regulation AT requirements.<sup>68</sup> Enforcement actions brought on this basis would not require evidence of fraud, manipulation or other similar misconduct; instead, a violation of the Regulation alone would be sufficient.<sup>69</sup> In short, this represents another tool in the enforcement division’s ever-expanding arsenal.

## Cyber Security

The CFTC has recently taken steps to increase its focus on the regulation of cybersecurity. On December 16, 2015, the Commission unanimously approved proposals designed to enhance cybersecurity protection in the markets that it regulates.<sup>70</sup> Chairman Timothy Massad was a strong supporter of these proposals, stating “[t]he risk of cyberattacks is perhaps the most important single issue we face in terms of financial mar-

<sup>66</sup> Rawlings, *supra* note 56.

<sup>67</sup> The proposed regulation “represent[s] a series of risk controls, transparency measures, and other safeguards to enhance the U.S. regulatory regime for automated trading.” Press Release, CFTC, CFTC Unanimously Approves Proposed Rule on Automated Trading, (Nov. 24, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7283-15>.

<sup>68</sup> *CFTC Proposes Rulemaking Regarding Automated Trading*, Sullivan & Cromwell (Dec. 2, 2015), [https://www.sullcrom.com/siteFiles/Publications/SC\\_Publication\\_CFTC\\_Proposes\\_Rulemaking\\_Regarding\\_Automated\\_Trading.pdf](https://www.sullcrom.com/siteFiles/Publications/SC_Publication_CFTC_Proposes_Rulemaking_Regarding_Automated_Trading.pdf).

<sup>69</sup> *Id.*

<sup>70</sup> Press Release, CFTC, CFTC Unanimously Approves Proposed Enhanced Rules on Cybersecurity for Derivatives Clearing Organizations, Trading Platforms, and Swap Data Repositories, (Dec. 16, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7293-15>.

ket stability and integrity.”<sup>71</sup> The proposed rules were created to ensure that the automated systems used by critical infrastructures regulated by the CFTC are “doing adequate evaluation of cybersecurity risks and testing of their own cybersecurity and operational risk protections.”<sup>72</sup> The CFTC’s proposals set principles-based testing guidelines to ensure that companies are following the industry’s best practices.

It remains to be seen how the CFTC will handle violations of the new cybersecurity rules. CFTC Commissioner J. Christopher Giancarlo recently suggested that those who comply with the requirements of these new cybersecurity rules “should not be afraid of a ‘double whammy’ of a destructive cyber-attack followed shortly thereafter by a CFTC enforcement action.”<sup>73</sup> It appears from these statements that compliance with obligations under the new CFTC cybersecurity rules might protect market participants from additional enforcement actions in the event of a cyberattack. The CFTC hopes to finalize these proposals by the end of 2016, at which time the interplay between the cybersecurity rules and CFTC enforcement may become more clear.

## Administrative Proceedings

For much of the last decade, the Commission has only brought contested cases in federal courts.<sup>74</sup> In a November 2014 speech, Director Goelman announced that the Commission was planning to start bringing cases through administrative proceedings, which are widely-perceived as friendlier to regulators than federal district courts.<sup>75</sup> Goelman said the move was necessary for the Commission to “present a credible trial threat” with its limited resources.<sup>76</sup> However, the CFTC has no administrative law judges of its own and plans to “borrow” them from other agencies.<sup>77</sup> As of yet, the CFTC has not litigated any cases in an administrative tribunal.<sup>78</sup>

The potential impact of a move to administrative proceedings can be seen in the results at the CFTC’s sister regulator, the SEC. The SEC has been increasingly willing to bring cases before administrative courts and recently added two new administrative law judges to its

<sup>71</sup> Press Release, CFTC, Statement of Support of Chairman Timothy Massad, Notice of Proposed Rulemaking DCR System Safeguards Testing, (Dec. 16, 2015), <http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement121615b>.

<sup>72</sup> Press Release, CFTC, Remarks of Chairman Timothy Massad Before the ABA Derivatives and Futures Law Committee, 2016 Winter Meeting, (Jan. 22, 2016), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-37>.

<sup>73</sup> Press Release, CFTC, Statement of Commissioner J. Christopher Giancarlo Regarding Proposed Rule on System Safeguards Testing Requirements (Dec. 16, 2015), <http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement121615a>.

<sup>74</sup> Sarah N. Lynch, *U.S. CFTC enforcement chief to revive use of in-house courts*, REUTERS (Mar.12, 2015), <http://www.reuters.com/article/2015/03/12/cftc-enforcement-court-idUSL1N0WE1LD20150312>.

<sup>75</sup> Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, NEW YORK TIMES (Oct.5, 2013), <http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html>.

<sup>76</sup> Eaglesham, *supra* note 40.

<sup>77</sup> *Id.*

<sup>78</sup> The CFTC has settled, but not fully litigated, cases, including the *Motazed* insider trading case, administratively.

staff.<sup>79</sup> The results in these “in-house” courts have been striking: the Wall Street Journal reported that in the 12 months from September 2013 to September 2014, the SEC had a 100% success rate before administrative judges and only 61% in federal court.<sup>80</sup> In March 2015, the SEC finally lost a proceeding before an administrative law judge, after winning 22 of the prior 23 cases.<sup>81</sup> In addition to this one-sided track record, prominent Federal Judge Jed Rakoff of the Southern District of New York has criticized SEC administrative proceedings because – in contrast to federal trial court rulings – administrative decisions are given greater deference on appeal, which further skews the impact of this forum.<sup>82</sup>

<sup>79</sup> Sarah N. Lynch, *U.S. SEC Beefs Up Administrative Court to Meet Rising Demand*, REUTERS (June 30, 2014), <http://www.reuters.com/article/2014/06/30/sec-court-hires-idUSL2N0PB18H20140630>.

<sup>80</sup> Eaglesham, *supra* note 40.

<sup>81</sup> Mark Curriden, *Judge Rejects Most SEC Claims Against Dallas-Area Financial Execs*, DALLAS MORNING NEWS (Mar. 20, 2015), <http://www.dallasnews.com/business/headlines/20150320-judge-rejects-most-sec-claims-against-dallas-area-financial-execs>.

<sup>82</sup> Nate Raymond, *U.S. Judge Criticizes SEC Use of In-House Court for Fraud Cases*, REUTERS (Nov. 5, 2014), <http://www.reuters.com/article/2014/11/05/us-sec-fraud-rakoff-idUSKBN0IP2EG20141105>.

While the impact of bringing cases administratively remains to be seen, the CFTC’s stated intent to increase their use of these proceedings is likely already playing a role in enforcement proceeding negotiations, and may have been a contributing factor in the recent string of settlements with the Commission.

## Conclusion

The CFTC’s enforcement efforts over the past six years clearly show that Dodd-Frank has given the Commission considerably greater bite. The Commission is aggressively investigating and successfully prosecuting cases that were impossible both legally and practically less than a decade ago. In addition to greater regulatory authority, the CFTC is trying to take advantage of new opportunities to strengthen its enforcement capabilities by, for example, using administrative courts. Industry participants accustomed to weak regulatory oversight should be prepared for the Commission’s increased activity to continue – and likely intensify – in the months and years ahead.

[www.reuters.com/article/2014/11/05/us-sec-fraud-rakoff-idUSKBN0IP2EG20141105](http://www.reuters.com/article/2014/11/05/us-sec-fraud-rakoff-idUSKBN0IP2EG20141105).