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SECURITIES PRACTICE PORTFOLIO SERIES

COMMODITIES & FUTURES ENFORCEMENT: PRACTICE AND PROCEDURE IN CFTC AND SRO INVESTIGATIONS

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SECURITIES PRACTICE PORTFOLIO SERIES

Commodities & Futures Enforcement: Practice and Procedure in CFTC and SRO Investigations

PORTFOLIO DESCRIPTION SHEET

Securities Practice Portfolio Series No. 262, *Commodities & Futures Enforcement: Practice and Procedure in CFTC and SRO Investigations*, describes the role of the Commodity Futures Trading Commission and self-regulatory organizations in regulating and policing the U.S. commodities, futures, and swaps markets. In the wake of recent financial scandals and economic upheaval, the CFTC has begun a transformation from ''toothless regulator'' to formidable counterpart to the Securities and Exchange Commission. This evolution is largely the result of the Dodd-Frank Act's substantial expansion of the CFTC's regulatory and enforcement powers.

The Portfolio gives practitioners a detailed walk-through of the CFTC's and SROs' investigative and enforcement processes, while highlighting potential pitfalls and emphasizing best practices. Several examples of investigative correspondence are included. There is a detailed discussion of the CFTC's structure and enforcement mechanisms, as well as those of the SROs under the CFTC's purview. The Portfolio provides a history and overview of the U.S. commodity futures markets and their regulation. The Portfolio analyzes in detail recent enforcement trends and high-profile CFTC cases. The analysis focuses on key areas of regulatory scrutiny, such as position limits, market manipulation, and disruptive trading practices.

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SECURITIES PRACTICE PORTFOLIO SERIES

This portfolio is part of Bloomberg Industry Group's ***Securities Practice Portfolio Series,*** a unique library of practice-oriented analysis and tools addressing the full range of securities issues and practice areas. Authored by experienced practitioners, each Portfolio provides concise legal analysis and clear practical guidance to facilitate a quick grasp of the issues, an understanding of the nuances and risks, and the development of an actionable solution. Areas of coverage include securities enforcement, capital formation, regulation of trading and markets, investment management regulation, derivatives and commodities, and more. The ***Securities Practice Portfolio Series*** is updated regularly.

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I.
Introduction

A. The CFTC and Its Evolving Powers

The commodity futures, options, and swaps markets are primarily regulated by the Commodity Futures Trading Commission (CFTC or Commission), in conjunction with a broad array of self-regulatory organizations (SROs). Traditionally, the CFTC has been relegated to the shadows of its more powerful and well-known regulatory counterpart in the securities market, the Securities and Exchange Commission (SEC). In consequence, practitioners are often less familiar with the practices, procedures, and powers of the CFTC and the vast network of self-regulatory organizations under its purview. Such knowledge gaps are becoming more harmful to attorneys in this space, as the Commission is increasingly asserting the reach of its enforcement arm—and is establishing itself as a true sister agency to the SEC. This Portfolio is intended to prepare practitioners for a new era of heightened enforcement.

The CFTC's mission is to "promote the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation."[1] The Commission was established in 1974 through amendment of the Commodity Exchange Act (CEA),[2] which granted the CFTC exclusive jurisdiction over futures trading in all commodities.[3] At the time, the majority of futures trading took place in the agricultural sector. Over the past nearly 50 years, as the futures industry has evolved to encompass complex financial and other derivative products, the CEA has been amended several times to expand the scope of the agency's authority—most recently in 2010 by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[4]

In passing Dodd-Frank, Congress heeded the message reflected in public conversation as well as government studies following the 2008 financial crisis—the need to focus greater attention on systemic risk in the marketplace, and to extend the reach and expand the resources of regulatory agencies tasked with oversight of individual markets and institutions. As a result, in the years since, the Commission's enforcement program has been substantially strengthened.

The CFTC's enforcement activities—and its resulting recoveries—have vastly expanded since the passage of Dodd-Frank. In fiscal years 2011 and 2012, the Commission filed 201 enforcement actions—almost as many as the previous five years (2006-2010) combined—and recovered over $1.8 billion in civil monetary penalties, restitution, and disgorgement.[5] In fiscal year 2013, the CFTC filed 82 enforcement actions and collected over $1.7 billion.[6] In fiscal years 2014 and 2015, the CFTC filed 67 and 69 enforcement actions, respectively, and obtained monetary sanctions in excess of $3 billion.[7] In fiscal year 2016, the CFTC filed 68 enforcement actions and obtained

[1] COMMODITY FUTURES TRADING COMM'N (CFTC), CFTC Strategic Plan FY 2022-2026, at 4 (2022).

[2] 7 U.S.C. § § 1–27f. This amendment was affected by the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 83 Stat. 1389 (1974).

[3] The CFTC, like most government agencies, must be periodically reauthorized by Congress to update its authority and recommended spending levels. However, reauthorization is not required for the CFTC to function, and the Commission can continue to operate by relying on unauthorized appropriations from Congress, as it did from fiscal year 2006 to fiscal year 2008. John Kemp, *Reauthorization Fight Looms for CFTC 2013*, INSIDE DEBT at 7 (Oct. 16, 2012). The CFTC reauthorization process is under the control of Congressional agriculture committees. The most recent CFTC Reauthorization Act was approved in 2008 as part of the Food, Conservation and Energy Act, Pub. L. 110-246, 122 Stat. 1651 (2008), and expired on September 30, 2013. The most recent of several attempts at reauthorization came in 2019, when the House Agriculture Committee approved a bipartisan reauthorization bill. *See* Press Release, U.S. House Comm. on Agric., House Agriculture Committee Approves Bipartisan CFTC Reauthorization (Oct. 30, 2019), https://agriculture.house.gov/news/documentsingle.aspx?DocumentID=6671. The bill did not receive a vote on the House floor. *See* H.R. 4895, 116th Cong. (2019). Several bills have since been introduced in the Senate for the CFTC to regulate digital commodities (including crypto and virtual currencies). *See, e.g.*, Lummis-Gillibrand Responsible Financial Innovation Act, S. 4356, 117th Cong. (2022); Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. (2022).

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. 111-203, 124 Stat. 1376 (2010). The Commission's mandate has been renewed and/or expanded under the Futures Trading Acts of 1978, 1982, and 1986; the Futures Trading Practices Act of 1992; the CFTC Reauthorization Act of 1995; the Commodity Futures Modernization Act of 2000; and the Dodd-Frank Act.

[5] John H. Sturc & Jeffrey L. Steiner, Expanded Authority, Increasing Numbers & Record Fines: The Changing Landscape of the CFTC's Enforcement Actions, GIBSONDUNN.COM (Apr. 22, 2013), https://www.gibsondunn.com/expanded-authority-increasing-numbers-and-record-fines-the-changing-landscape-of-the-cftcs-enforcement-actions/.

[6] Press Release, CFTC, CFTC Releases Enforcement Division's Annual Results (Oct. 24, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6749-13. Of the $1.7 billion that the CFTC collected in sanctions, $1.5 billion constituted civil monetary penalties and $200 million constituted restitution and disgorgement. The civil monetary penalties alone total more than seven times the Commission's operating budget for the fiscal year. *Id*.

[7] Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal Year 2014 (Nov. 6, 2014) (noting that the CFTC obtained $3.27 billion in 2014), https://www.cftc.gov/PressRoom/PressReleases/7051-14; Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal Year 2015 (Nov. 6, 2015), http://www.cftc.gov/PressRoom/PressReleases/7274-15 (noting that the CFTC obtained $3.14 billion in 2015).

orders totaling approximately $1.29 billion.[8] The Commission did slow down slightly in 2017, filing only 49 enforcement actions and obtaining orders totaling approximately $413 million.[9] In fiscal years 2018 and 2019, however, the Commission filed 83 and 69 enforcement actions, respectively, and obtained more than $2.25 billion in monetary sanctions.[10] In 2020, the Commission filed a record 113 actions and recovered $1.3 billion.[11] In 2021, the CFTC slowed down again slightly, filing 55 actions and recovering $1 billion.[12] In 2022, however, the CFTC filed 82 actions and recovered $2.5 billion.[13] These recoveries far outstrip the $280 million collected in 2009, the last year before Dodd-Frank.[14]

There is no indication that the CFTC's enforcement momentum is slowing—particularly given that Dodd-Frank gave the CFTC authority over certain aspects of the previously unregulated swaps market. The Commission is likely to focus its enforcement efforts in the coming years on digital-asset related actions,[15] manipulative and deceptive conduct and spoofing, recordkeeping and supervision, misappropriation of material non-public information, swaps reporting and swap dealer business conduct, among other enforcement areas, such as fraud, registration, reporting, wash trading, and position limit violations.[16] Practitioners who engage in commodity futures work should expect and prepare for more aggressive enforcement in these and other areas in the years ahead.[17]

B. The CFTC's Partners in Enforcement

The vast network of SROs, which aid the CFTC in its market oversight responsibilities, is comprised of a variety of futures exchanges and the National Futures Association (NFA).[18] SROs have the power to enforce industry regulations and standards with respect to their members; these include financial and sales requirements of the SROs' own making as well as those promulgated directly by the CFTC. The enforcement priorities of SROs are informed and influenced by those articulated by the CFTC, but do not necessarily overlap. In cases where a suspected violation infringes on both the Commission's rules and an SRO's rules, the two agencies will generally coordinate their enforcement efforts to ensure that resources are used efficiently. It is possible, however, for a company or individual to be subjected to parallel investigations regarding the same conduct.

C. Investigations and Enforcement Actions

The CFTC's Division of Enforcement, as well as its counterpart within each SRO, may initiate an investigation for a variety of reasons. For example, these enforcement agencies may open an inquiry as part of their regular market surveillance activities or in response to information provided by a wide variety of sources, including internal recommendations and publicly-available information such as news sources. Entities and individuals should expect to receive inquiry letters in the ordinary course of business. While these organizations may occasionally identify and request further information regarding a specific transaction that is deemed potentially problematic, they often issue inquiry letters as a matter of routine review into a particular area of market activity. As such, the issuance of an inquiry letter is not indicative of wrongdoing and will not necessarily give rise to a formal investigation or enforcement action. An inquiry may ultimately blossom into a formal investigation if the Commission or SRO has reason to suspect that a violation of the CEA, CFTC regulations promulgated thereunder, or applicable SRO rules has taken place. At this later stage, the respondent may be required to furnish information through documents or testimony.

Investigations may be concluded without any enforcement action. Should the CFTC determine that a violation has occurred, it may bring an enforcement proceeding before an administrative law judge, file an action in federal court, or, if criminal conduct is suspected, refer the case to the Department of Justice; in the case of an SRO, such actions typically are adjudicated by the entity's Business Conduct Committee or similar body. Usually, the respondent is offered an opportunity to submit a written offer of settlement that does not require an admission of guilt. The consequences of an enforcement action can be serious and include monetary penalties; censure; disgorgement; temporary or permanent bans from certain markets; and cease-and-desist orders.

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[8] Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal Year 2016 (Nov. 21, 2016), https://www.cftc.gov/PressRoom/PressReleases/7488-16.

[9] Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal year 2017 (Nov. 22, 2017), https://www.cftc.gov/PressRoom/PressReleases/7650-17.

[10] Press Release, CFTC, CFTC Division of Enforcement Issues Report on FY 2018 Results (Nov. 15, 2018), https://www.cftc.gov/PressRoom/PressReleases/7841-18.

[11] Press Release, CFTC, CFTC Division of Enforcement Issues Annual Report (Dec. 1, 2020), https://www.cftc.gov/PressRoom/PressReleases/8323-20; Press Release, CFTC, CFTC Division of Enforcement Issues Annual Report for FY 2019 (Nov. 25, 2019), https://www.cftc.gov/PressRoom/PressReleases/8085-19.

[12] CFTC, AGENCY FINANCIAL REPORT, FISCAL YEAR 2021, at 4 (2021).

[13] Press Release, CFTC, CFTC Division of Enforcement Releases Annual Enforcement Results (Oct. 20, 2022), https://www.cftc.gov/PressRoom/PressReleases/8613-22.

[14] CFTC, COMMODITY FUTURES TRADING COMMISSION PERFORMANCE AND ACCOUNTABILITY REPORT FISCAL YEAR 2009, at 4 (2009), available at http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2009par.pdf.

[15] In fiscal year 2022, the Commission brought 18 actions involving conduct related to digital assets, representing more than 20 percent of all actions filed that year. Press Release, CFTC, CFTC Division of Enforcement Releases Annual Enforcement Results (Oct. 20, 2022), https://www.cftc.gov/PressRoom/PressReleases/8613-22.

[16] *Id.*

[17] Virtually all participants in the commodity futures market will be affected by the Commission's heightened vigilance: designated contract markets and swap execution facilities; swap data repositories; derivatives clearing organizations; swap dealers; registered futures associations; and others.

[18] The SEC oversees several SROs that also provide futures and options contracts to their members. These include, for example, the Chicago Board Options Exchange, the Boston Options Exchange and the International Securities Exchange. A discussion of these organizations is beyond the scope of this Portfolio.

D. Overview of Portfolio

The purpose of this Portfolio is to educate practitioners about the functions, operations, and procedures of the CFTC and the various SROs that, taken together, comprise the regulatory framework for the commodity futures markets in the United States. Chapter II provides an overview of the history of the commodity markets and the various products traded on such markets. Chapter III discusses the structure of the Commission as well as the SROs under its purview. Chapter IV provides an in-depth guide to navigating the enforcement mechanisms of the Commission. Chapter V sets forth the various enforcement regimes and priorities of prominent SROs with which practitioners can expect to interact, in the course of their market activities. Chapter VI discusses the likely enforcement priorities of the CFTC in the next several years. It is our hope that, by the end of the Portfolio, practitioners will have a comprehensive understanding of (i) regulatory exposure for their commodity futures clients; (ii) the various ways one can act to mitigate the risk of an enforcement action; and (iii) best practices in the event that an enforcement action is initiated.

II.
History and Products Overview

A. Introduction to Commodities and Futures

Before turning to commodities and futures enforcement in the U.S.—the subject of this Portfolio—practitioners should become familiar with the history of commodities and futures products and the markets in which they trade, as well as the underlying commodities and instruments themselves. Compared to their securities industry counterparts, lawyers representing clients in the commodities and futures industry may have less familiarity with the products being traded and the governing regulations, for two main reasons. First, securities have historically been more widely traded than commodities. Moreover, unlike equities, commodities are often traded and priced away from public exchanges.[1] As a result, practitioners have generally had little, if any, exposure to commodity-specific issues. Second, commodities and futures regulators, such as the CFTC and Self-Regulatory Organizations (SROs), traditionally have lacked the authority and resources of their counterparts in the securities industry. These limited enforcement powers have engendered comparatively little judicial precedent and scholarly commentary, with the result being that commodities and futures regulation and enforcement often lacks some of the clarity that has developed in the securities industry. Accordingly, this chapter provides an introductory overview of commodities and commodities markets.

B. What is a Commodity?

A commodity is a good that may be bought or sold and that is interchangeable with other goods of the same type. In other words, while a commodity may be generated in large quantities by many different producers, it is essentially fungible in that it possesses uniform qualities and has equivalent value irrespective of who brings it to market. To this end, as Karl Marx famously quipped, ''[o]ne cannot tell from the taste of wheat whether it has been raised by a Russian serf, a French peasant or an English capitalist.''[2] Examples of commodities include raw materials such as lumber or oil, as well as agricultural products such as coffee or corn.[3]

This is not to say that all commodities are created equal. Within a particular category of commodity, there may exist different ''grades,'' or levels of quality. The minimum accepted standards that a commodity must satisfy to be suitable for trading on an exchange is referred to as a ''basis grade.''[4] Basis grades promote uniformity amongst marketable goods, and thus facilitate negotiations related to their sale. Higher grades of a commodity command a premium above the price paid for the basis grade. For example, the purity of crude oil is based on its sulfur and hydrogen content, with gasoline producers preferring a more expensive but purer form of crude oil called ''West Texas Intermediate,'' because it requires less refinement and production time before going to market. Due to their (essentially) homogenous nature, commodities within a particular grade are priced by the forces of supply and demand in the aggregate market, without reference to qualitative differences. At any given time, for example, every seller of West Texas Intermediate crude oil should receive the same base price.[5]

C. History of the Commodities Market

In the U.S., the development of commodities markets can be traced to the booming agricultural trade in Chicago during the 1840s.[6] Due to its central location in the Midwest, Chicago informally served as the annual meeting point for farmers seeking buyers for their crops and grain mills seeking raw materials for their operations. The trading occurred during the harvest season, because farmers needed to sell their crops immediately, given the shortage of adequate facilities to store the grain, as well as the difficulty of travelling to Chicago in the icy winter and muddy spring months.[7] Consequently, the price for grain was very low during the harvest but rose dramatically as the grain supply dwindled over the remainder of the year. These price fluctuations affected both farmers and grain processors, resulting in a cycle in which farmers were forced to sell their grain at a huge discount in the peak of the harvest season, and grain mills were forced to pay a steep premium in times of scarcity.

1. CBOT establishes cash market

In an effort to remedy these imbalances, the Chicago Board of Trade (CBOT) was organized in 1848 to serve as a central

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[1] Peter Gardett, Regulators to Energy Traders: HELP (or else), Breaking Energy (May 29, 2013), https://breakingenergy.com/2013/05/29/regulators-to-energy-traders-help-or-else.

[2] Karl Marx, A Contribution to the Critique of Political Economy 20 (N.I. Stone trans., Charles H. Kerr & Co. ed. 1911). Accordingly, it would make little difference to a bakery that needs 50 pounds of wheat whether it received the wheat from seller A or seller B. In contrast to wheat or other commodities, products like blue jeans are differentiated by branding and quality.

[3] *See* 7 U.S.C. § 1a(9) (defining the term ''commodity'' by reference to a specified list of assets, as well as ''all services, rights, and interests . . . in which contracts for future delivery are present or in the future dealt in''). In extending the CFTC's authority to the swaps market, the Dodd-Frank Act may also bring onions within the Commission's purview for the first time. Due to a historical political eccentricity, onions are excluded from the definition of ''agricultural commodities'' regulated by the CFTC. 7 U.S.C. § 1a(9). However, the CFTC takes the view that, under the Commodities Exchange Act, as amended by Dodd-Frank, swaps in onions ''would seem to be permissible''—and thus subject to regulation—because a swap may be based upon an item that is not defined as a commodity. 76 Fed. Reg. 41,048 (July 13, 2011).

[4] Basis grades are alternatively referred to as ''par grades'' or ''contract grades.''

[5] The ultimate price paid for the commodity will be the base price plus any additional shipping costs or currency conversion costs.

[6] Formalized trading of commodities can be traced back to the ancient Greek and Roman markets. The famed Agora (literally, ''marketplace'') in Athens and the Forum in Rome were distribution centers for commodities within their respective empires. The concept of a central marketplace outlasted its origins, and endured through the middle ages in the form of medieval fairs, which eventually evolved into specialized commercial centers reminiscent of those in existence today. CBOT, Commodity Trading Manual 2–3 (1998).

[7] Indeed, during and immediately following harvest, farmers frequently dumped their unsold grain into Lake Michigan or left it to rot in the streets for lack of means to transport or store it. *See* Carley Garner, Trading Commodities, Commodity Options and Currencies 2 (2012).

trading location for market participants. The creation of a formal ''cash market'' allowed buyers to pay cash and secure immediate delivery of goods whenever the need arose, with price determined on the spot by current market prices.[8] This system facilitated price stability, as wealthy investors were galvanized to build silos for storing grain throughout the year. Accordingly, the cash market enabled a better balance between the farmer's incentive to produce and the processor's need for an assured and steady grain supply.

2. Emergence of a centralized forwards exchange and commodities futures contracts

Yet the cash market was not without its downside. The unpredictability of the weather—and its ensuing effect on the harvest—meant that neither farmers nor processors knew what the prevailing price for a commodity would be at any given time of year. The uncertainty of cash market prices caused participants to enter into private negotiated agreements to buy or sell a quantity of grain at some future date. Under these so-called ''forward contracts,'' the price for a given commodity was set in advance, which allowed both parties to the transaction to more reliably project their cash flows, and minimized the possibility that either side would get a windfall to the detriment of the other.[9]

In recognition of the conveniences afforded by forward contracts, the CBOT developed a centralized exchange where parties could trade such agreements. This exchange originally complemented, then later eclipsed, the CBOT's function as a cash market. In taking steps to further formalize grain trading, the CBOT sought not only to institutionalize forward contracts, but also to remedy some of their perceived deficiencies: namely, their lack of structure and the ease with which they were broken. First, the CBOT standardized key contract terms, and thus took them out of the realm of private negotiation. The only remaining variable, and sole distinguishing feature between different contracts for the same commodity, was the delivery price. Second, the CBOT also published all bids, offers, and negotiated prices, thus bringing wide-scale transparency to commodity trading for the first time. Third, the CBOT implemented a margin requirement, whereby both parties were required to post good faith deposits that guaranteed their intent to honor the contract.

As such, the CBOT created fungible instruments that allowed the contracts to be offset before delivery; through these futures contracts, buyers could relieve themselves of the obligation to take physical delivery by selling the contract to someone else before the maturation date, while sellers could avoid making deliveries by purchasing back the same contract they had previously sold. Traders could speculate more easily in the price of commodities and hedge against price changes. The transaction costs associated with the delivery process, such as transportation, storage, and insurance, could be avoided entirely. Without any need for protracted negotiations, the transactions could be consummated quickly and with minimal hassle. Most critically, however, commodities could now be bought or sold by parties who neither owned nor needed the physical products. Thus, it did not take long for speculators—i.e., individuals or firms engaged in trading activity primarily to derive profits from asset price fluctuations, and who lack any affiliation with the grain market—to enter the picture.[10]

3. Financial futures develop

The late 19th and early 20th centuries saw continued growth in futures trading, as new exchanges formed in the U.S. and commodities trading expanded beyond agricultural products to precious metals, manufactured or processed products, and non-storable commodities.[11] Yet it was the advent of futures in financial products that most dramatically—and enduringly—transformed the industry.

Financial futures arose in the 1970s from a climate of interest and exchange rate uncertainty. First, the collapse of the Bretton Woods system of fixed exchange rates undermined global financial stability, as major currencies began to float against each other and nations faced the prospect of insolvency. Second, the U.S. reoriented its monetary policy to target money supply rather than interest rates, thus allowing interest rates to fluctuate wildly. To account for the new risks posed by interest and exchange rate exposure, Chicago's futures exchanges sought to assist struggling businesses in much the same way that they had helped farmers and processors—by trading in futures. This time, the futures were based on financial instruments like foreign currencies,[12] mortgage-backed certificates,[13] and U.S. Treasury bonds.[14] In 1982, CBOT launched its first options on Treasury bond futures; it extended these options offerings to soybean and corn futures in 1984 and 1985, respec-

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[8] Cash markets are also known as physical markets, spot markets, or actual markets.

[9] Forward contracts are commonly traced back to the Japanese rice markets in the 1600s. *See* DAVID A. MOSS & EUGENE KINTGEN, THE DOJIMA RICE MARKET AND THE ORIGINS OF FUTURES TRADING (Harv. Bus. Sch. 2009).

[10] *See* CBOT, COMMODITY TRADING MANUAL 7 (1998) (''By purchasing and selling grain that would not otherwise have traders, speculators made the markets more liquid and helped minimize price fluctuations.'').

[11] CBOT, COMMODITY TRADING MANUAL 7 (1998).

[12] The Chicago Mercantile Exchange, another Chicago-based entity, began trading futures on the Canadian dollar, Deutsche mark, Japanese yen, and Swiss franc in 1972. CBOT, COMMODITY TRADING MANUAL 11 (1998).

[13] CBOT began trading in futures based on Government National Mortgage Association mortgage-backed certificates in 1975.

[14] The CBOT tackled interest rate risk with futures contracts on U.S. treasury bonds beginning in 1977. As the CBOT has explained:

> In the absence of the Federal Reserve's pursuit of interest rate stability, financial institutions became reluctant to make long-term fixed-rate loans. Instead, they shifted the interest rate risk to the borrower. This helped the lenders, but stuck the borrower with the risk. With U.S. Treasury futures, companies and investors exposed to interest rate risk—practically everyone—could lock in lending or financing rates, protect portfolios against interest rate shocks, even create low-cost synthetic debt instruments. Not many years passed before Treasury bond futures became the most actively traded futures contract in the world.

CBOT, COMMODITY TRADING MANUAL 10 (1998).

tively.[15] Eventually, the CBOT also added swap contracts to its offerings.

The growth of financial futures has been remarkable. Simply put, ''the floodgates opened'' as soon as the CBOT engaged in its first financial futures transactions.[16] Today, trading based on financial instruments far surpasses the agricultural market and the stock exchange. Indeed, while the entire U.S. Gross Domestic Product is just over $26 trillion a year, the gross notional value of all over-the-counter (OTC) derivatives issued was more than $632 trillion in 2022.[17] Correspondingly, noncommercial (i.e., speculative) market activity has increased at a much higher rate than commercial (i.e., hedging) market activity. For example, commercial interests in the oil futures market grew by 63 percent between 2000 and 2008, whereas speculative interests grew by a staggering 600 percent in the same period.[18]

4. Types of financial instruments/derivatives

The commodities market is primarily supported by four types of financial instruments to help manage and price risk in connection with the purchase and sale of commodities,[19] namely, (1) forward contracts; (2) futures contracts; (3) options contracts; and (4) swaps. These financial instruments are referred to as ''derivatives,'' a generic term used to describe a contract whose value is based primarily on the price of an underlying asset. The underlying assets can be either physical commodities, such as precious stones, or other financial instruments, such as securities.

Derivatives contracts can be settled in one of three ways: physical delivery, cash settlement, or offsets. Physical delivery requires the seller to deliver the underlying goods to a specific location at a predetermined date or date range.[20] The obligation to make or take delivery is the foundation of virtually every derivatives contract: by tying the derivatives contract to a tangible, physically deliverable product, the parties to a transaction are assured that the price will necessarily converge with the market upon expiry and thus reflect a sum that is universally agreed to be fair.[21] Nonetheless, due to the transaction costs incurred by the delivery process—including transportation, storage, and insurance costs and the corresponding rise of speculative activity in the derivatives industry—physical delivery has become quite rare.[22]

Although the potential for nearly every derivative contract to result in physical delivery is extant—thus preserving the integrity of the contract—the vast majority of derivative contracts are now offset or settled by cash. In a cash settlement, only the associated cash position, i.e., the difference between the price of the asset as set forth in the agreement versus the price commanded on the open market for immediate delivery, is transferred on the contract maturity date.[23] The economic function of cash-settled transactions is to transfer risk from one party to another, rather than to procure specific goods. In an offset transaction, the investor takes another futures position opposite and equal to the initial trade in order to return his net position to zero. For example, a contract for the sale of a particular commodity is offset by entering into a contract for the purchase of the same commodity.

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[15] While CBOT was the first exchange to list options on futures contracts, the first U.S. marketplace for trading listed options was founded in 1973 by the Chicago Board Options Exchange (CBOE). Although option contracts had been traded previously, the trading did not take place within the context of an organized exchange with structured contracts. *See, e.g.*, *Bigelow v. Benedict*, 70 N.Y. 202 (1877) (put option for gold coins); *Harris v. Tumbrige*, 83 N.Y. 92 (1880) (option for stock). The CBOE launched trading with futures in 2004 through the CBOE Futures Exchange (CFE).

[16] CBOT, COMMODITY TRADING MANUAL 11 (1998).

[17] *See Gross Domestic Product*, FRED ECON. DATA, https://fred.stlouisfed.org/series/GDP (last accessed Feb. 22, 2023); *Statistical release: OTC derivatives statistics at end-June 2022*, BANK INT'L SETTLEMENTS (Nov. 30, 2022), https://www.bis.org/publ/otc_hy2211.htm. Notional value refers to the total value of a leveraged position's assets. Thus, if a futures contract requires the purchase of 200 units of the S&P 500 Index, and that index is trading at $1,000, the futures contract has a notional value of $200,000.

[18] John E. Parsons, *Black Gold and Fool's Gold: Speculation in the Oil Futures Market*, 10 ECONOMIA (No. 2) 81, 88 (2010). Although the vast majority of trading activity in the derivatives market is executed by speculators (and, to a lesser extent, hedgers), there is also a place for arbitrageurs—experienced investors who exploit price inefficiencies in the market, or across multiple markets, by making trades that offset each other to generate quick profit. ''Riskless'' or ''true'' arbitrage occurs when the same asset is simultaneously selling for different prices, such that the asset is purchased at the lower price and resold at the higher price. Risk arbitrage seeks to profit from the difference between two or more securities, such as by buying the stock of a company being acquired and selling the stock of the acquiring company.

[19] *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1157-58 (8th Cir. 1971) (noting that ''futures trading in commodities performs several economic functions[,]'' such as ''eliminat[ing] the fluctuation of crop prices which results from the imbalance of supply over demand at the end of a harvesting period'' and ''offer[ing] a form of 'price insurance' which guarantees the futures price agreed to even if market prices subsequently rise or fall prior to the date of delivery'').

[20] *See* Craig Pirrong, *Manipulation of Cash-Settled Futures Contracts*, 74 J. BUS. 221, 224 (2001).

[21] Chris McMahon, *Financial Settlement vs. Physical Delivery*, FUTURES MAG. (Aug. 1, 2006).

[22] *See* Robert S. Pindyck, *The Dynamics of Commodity Spot and Futures Markets: A Primer*, 22 ENERGY J. 1, 15–16 (2001). Less than five percent of derivatives contracts in the U.S. are now settled by actual physical delivery. As explained by the court in the landmark case of *Cargill, Inc. v. Hardin*,

> ″[w]hile the obligation to make or take delivery is a bona fide feature of the futures contract, in reality . . . [m]ost parties who engage in futures transactions are in no position to either make or take delivery, and if they were required to always make preparations to fulfill their obligations to make or take delivery, the number of persons who could effectively participate in the futures market would be substantially restricted, thus reducing the liquidity and volume of that market.″

452 F.2d 1154, 1172-73 (8th Cir. 1971).

[23] *See* Craig Pirrong, *Manipulation of Cash-Settled Futures Contracts*, 74 J. BUS. 221, 224 (2001). The determination of the market value of the asset is based on a pre-agreed formula (such as the cash price for immediate delivery of the asset on the last day of the contract) or index (such as the average price of the asset from several geographic locations).

a. Forward contracts

A forward contract refers to a customized, binding, private bilateral agreement for deferred delivery of an underlying asset. One party agrees to buy—and the other agrees to deliver—a predetermined quantity of the asset at a fixed price on a specific date in the future. The contract is settled by actual delivery of the asset. Because they are privately negotiated, forward contracts carry an inherent risk of default: both parties are exposed to the risk that one side is negotiating in bad faith or without sufficient funds, as well as the possibility that future events could prevent one or both sides from fulfilling the contract.

Forward contracts are ''over-the-counter'' or ''OTC'' derivatives—i.e., derivative contracts that are negotiated outside of an exchange. Markets for OTC derivatives are generally arranged in accord with one of the following formats: (1) ''traditional'' dealer markets, whereby dealers negotiate directly with each other to execute a transaction on behalf of market participants; (2) electronically brokered markets, whereby offers and bids are matched on an electronic platform operated by an outside firm that is not a counter-party to any trades; or (3) proprietary trading platform markets, whereby individual dealers post bids and offers on their own trading platforms and act as counterparties to every trade.[24] OTC markets lack the standardization and security afforded by traditional exchanges, but they offer market participants more flexibility in negotiation and facilitate the creation of customized financial instruments.

b. Futures contracts

Like a forward contract, a futures contract also contemplates delivery of the underlying asset at a specific date in the future for a predetermined price. However, there are fundamental differences between a futures contracts and a forward contract. First, a futures contract is standardized with respect to delivery specifications—quantity, quality, time, and location—such that the parties need only agree on the price terms. Second, a futures contract is generally traded on a regulated exchange. The exchange is able to guarantee both sides of the transaction, in part because the exchange requires each party to post payments, held by the exchange, as evidence of good faith. These ''margin payments'' allow the exchange to act as counterparty to both sides of a transaction, thereby essentially obviating the risk of default by either side. Third, every transaction involving futures contracts is made public by the exchange to foster transparency. Lastly, a futures contract is typically settled in cash.

c. Options

An option contract gives the holder (i.e., the buyer) the right to buy or sell an underlying asset at a fixed price—called the ''strike'' or ''exercise'' price—before or on some specified date in the future, in exchange for a premium paid to the writer (i.e., the seller) of the contract. In turn, the writer is bound to perform if an option is exercised by either delivering the underlying security to the holder or by paying the holder the difference between the strike price and the prevailing futures price. By paying a premium, the holder of the contract ensures that its loss is limited to the price of the option, in the event that it is not financially advantageous to buy or sell at the agreed upon price over the life of the option. A ''call option'' gives the holder the right, but not the obligation, to *buy* the asset, while a ''put option'' gives the holder the right, but not the obligation, to *sell* the asset.[25]

Option contracts can be negotiated privately over-the-counter, or through organized exchanges. While options generally are standardized, certain exchanges allow for their customization.

d. Swaps

A swap is a privately-negotiated agreement to exchange one set of cash flows for another. The parties to a swap transaction do not exchange the underlying loan or payment obligation, but rather, the difference between the payments that each is obliged to make. In other words, swaps are not intended to result in the transfer of actual legal ownership of a property or commodity. Swaps are most frequently used to manage risks associated with fluctuations in interest rates, currency exchange rates, commodity prices, and share prices. For example, a common swap transaction involves an exchange of interest rate obligations, whereby the cash flows of a fixed-rate asset are exchanged for those of a floating asset.

Swap contracts were all OTC derivatives before the passage of Dodd-Frank, meaning market participants could arrange trades that were outside the parameters of the rules and regulations set forth by the CFTC and the Commodities Exchange Act (CEA).[26] However, § 723(a)(8) of Dodd-Frank amended the CEA by adding § 2(h)(8), which requires that the execution of certain swap transactions occur on an exchange.[27]

D. The Current State of the Commodities Market

Most commodity prices began to rise in the second half of 2021, fueled by pent-up demand as Covid-19 lockdowns were

[24] Randall Dodd, *The Structure of OTC Derivatives Markets*, 9 FINANCIER (Nos. 1–4) 1, 1–2 (2002).

[25] While American-style options may be exercised at the strike price any time before or on the date of expiration, European-style options may only be exercised at maturity.

[26] The CFTC has investigated whether large traders and other market participants used the unregulated OTC swaps markets to illegally trade futures off an exchange, through the guise of derivatives transactions known as exchanges of futures for swaps, or EFSs, and has brought enforcement actions relating to this activity. *See, e.g.*, Press Release, CFTC, In CFTC Enforcement Action, Federal Court Orders Florida Resident Martin Sommers and His Company International Monetary Metals, Inc. to Pay over $9.8 Million for Engaging in Illegal, Off-Exchange Precious Metals Transactions and Registration Violations (Aug. 12, 2016), https://www.cftc.gov/PressRoom/PressReleases/7425-16.

[27] *See Fact Sheet: Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade under Section 2(h)(8) of the Commodity Exchange Act*, CFTC (2013), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sat_factsheet.pdf; *see also* 7 U.S.C. § 2; *Process for Designated Contract Market or Swap Execution Facility to make a Swap Available to Trade*, CFTC, https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_DCM/index.htm (last accessed Feb. 22, 2023) (cataloging the Commission's proposed and final rules implementing this provision of Dodd-Frank).

gradually lifted amid a slow return of supply.[28] Russia's invasion of Ukraine in February 2022 further bolstered the increase in prices, with Western sanctions imposed on Russia impacting several key markets, particularly energy markets such as oil and gas and agricultural commodities such as wheat.[29] This was initially felt through growing supply concerns, with Russia responding to Western sanctions by cutting off supplies to the European Union and other countries.[30]

Most commodity prices have since retreated from their peaks in the aftermath of the post-pandemic demand surge and war in Ukraine as global growth slows and concerns about a global recession intensify.[31] As inflation accelerated throughout 2022, central banks throughout the world hiked interest rates to contain runaway prices.[32] The prolonged implementation of China's strict zero-Covid policy to contain a major outbreak of the virus has also played a key role in curtailing consumer confidence throughout the second half of 2022.[33]

In many economies, however, commodity prices remain elevated in domestic-currency terms because of currency depreciations.[34] As the global growth slowdown intensifies, commodity prices are expected to recede in the next two years, but they will remain significantly above their average over the past five years.[35] Energy prices are expected to fall by 11 percent in 2023 and 12 percent in 2024.[36] Agricultural and metal prices are projected to decline 5 and 15 percent, respectively, in 2023 before stabilizing in 2024.[37] This outlook, however, is subject to numerous risks in the short- and medium-term. Energy markets face an array of supply concerns as worries about the availability of energy during the upcoming winter mount in Europe.[38] Higher-than-expected energy prices could pass through to non-energy prices, especially food, exacerbating challenges associated with food insecurity.[39] A sharper slowdown in global growth presents a key downside risk, especially for crude oil and metal prices.[40] Concerns about a possible global recession have already contributed to a decline in copper prices from their peak in March 2022, and a shift in demand from aluminum has contributed to lower aluminum prices.[41] Prices will likely remain volatile as the energy transition unfolds and global demand moves from fossil fuels to renewables, which are metals intensive.[42]

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[28] F. Wulandari, *Commodities forecast: Which markets will surge in 2023?*, CAPITAL.COM (Jan. 9, 2023), https://capital.com/commodities-forecast-outlook-trend.

[29] J. Moss, *Commodities Outlook for 2023*, INT'L BANKER (Jan. 18, 2023), https://internationalbanker.com/finance/commodities-outlook-for-2023.

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.*

[34] *Commodity Markets Outlook*, WORLD BANK (Oct. 2022), https://openknowledge.worldbank.org/bitstream/handle/10986/38160/CMO-October-2022.pdf.

[35] *Id.*

[36] *Id.* at 2.

[37] *Id.* at 1, 29, 36

[38] *Id.* at 3, 25-26

[39] *Id.* at 32.

[40] *Id.* at 19-20, 36.

[41] *Id.* at 37.

[42] *Id.* at 4.

III.
Overview of Commodities & Futures Enforcement

A. Futures Enforcement in the U.S.

The regulation of the commodity futures markets is primarily overseen by the Commodity Futures Trading Commission (CFTC or the Commission), as well as by the various exchanges on which market participants trade such contracts and the industry organizations that moderate this activity. As a result, when engaging in commodity and futures work, practitioners can expect to have the most frequent interactions with these entities. This Chapter provides an overview of the structure and operations of the CFTC and the various entities under its purview.

B. The CFTC and Its Enforcement Program

1. The Commission

The Commission is an independent federal agency tasked with oversight of the commodity futures, options, and swaps markets. Congress established the CFTC in 1974 under the Commodity Exchange Act (CEA)[1] as part of an effort ''to ensure fair practice and honest dealings on commodity exchanges'' by targeting fraudulent, manipulative, or abusive trading practices.[2]

To fulfill its core responsibilities, the CFTC is granted broad authority and jurisdiction under the CEA.[3] Although the CFTC originally had regulatory purview over only the futures and options markets, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) amended the CEA to establish a comprehensive new regulatory framework for the previously unregulated swaps market.[4] Thus, in addition to oversight of the $31 trillion U.S. futures and options markets, the CFTC's authority now extends to portions of the estimated $390 trillion U.S. swaps market.[5]

The Commission's regulatory scope spans the full array of participants across the derivatives market: designated contract markets (DCMs) and swap execution facilities (SEFs); swap data repositories;[7] derivatives clearing organizations (DCOs);[8]

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[1] *See* 7 U.S.C. § 1 et seq. The Commodity Exchange Act (CEA) was enacted in 1936 to regulate trading in agricultural commodities, but its impact was limited due to its reliance on the principle of exchange self-regulation. Under the CEA, commodity futures transactions were restricted to members of a designated contract market that had been approved by the Secretary of Agriculture. The Secretary's approval was contingent upon a showing that the designated contract market had taken certain prescribed measures to curtail manipulative practices by its members; once the approval was issued, it was primarily up to the designated contract market to promulgate rules and regulations to ensure fair trading. *See* 7 U.S.C. § 7.

By 1974, it was increasingly evident that the existing system of self-regulation by the exchanges ''did not work because . . . self-interested members displaced the public interest.'' JERRY W. MARKHAM, THE HISTORY OF COMMODITY FUTURES TRADING AND ITS REGULATION 62 (1986). Moreover, the increasing variety, volume, and complexity of commodity contracts trading suggested the need for a more comprehensive regulatory framework. Consequently, Congress passed several amendments to strengthen the CEA and provide a ''strong Federal regulatory umbrella'' to oversee the self-regulatory efforts of the exchanges. *Id.* (citation omitted). These amendments were contained within the Commodity Futures Trading Commission Act of 1974, which created the CFTC to provide comprehensive oversight of commodity futures by bringing under federal regulation futures trading in all goods, articles, services, rights, and interests; commodity options trading; and leverage trading in gold and silver bullion.

The Commission's mandate has been renewed and/or expanded under the Futures Trading Acts of 1978, 1982, and 1986; the Futures Trading Practices Act of 1992; the CFTC Reauthorization Act of 1995; the Commodity Futures Modernization Act of 2000; and the Dodd-Frank Act. Most recently, as cryptocurrencies have gained popularity among investors, the Legislative and Executive branches have contemplated expanding the Commission's authority to reach digital assets. *See, e.g.*, Eliminate Barriers to Innovation Act of 2021, H.R. 1602, 117th Cong. (2021) (establishing a joint SEC-CFTC digital asset working group); Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. (2022) (granting exclusive jurisdiction to the CFTC over activity involving digital assets); *see also e.g.*, Exec. Order No. 14067, 87 Fed. Reg. 14143 (Mar. 14, 2022) (requiring various federal agencies, including the CFTC, to consider whether existing investor and market protections may be used to address the risks of digital assets).

[2] S. REP. NO. 93-1131 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5843, 5856; *see also* 7 U.S.C. § 5 (''[T]he purpose of . . . [the CEA is] to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to . . . [the CEA] and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.'').

[3] *See* 7 U.S.C. § 2(a) (setting forth the jurisdiction of the CFTC); 7 U.S.C. § 8(a)) (outlining the authority of the CFTC); *see also* CFTC, PRESIDENT'S BUDGET FOR FISCAL YEAR 2023, at 1 (Mar. 2022), https://www.cftc.gov/sites/default/files/2022-03/CFTC_FY_2023_President_Budget_Report_032122.pdf.

[4] *See* Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). The Dodd-Frank Act was signed into law by President Obama on July 21, 2010.

[5] *See* CFTC, PRESIDENT'S BUDGET FOR FISCAL YEAR 2023, at 54 (Mar. 2022), https://www.cftc.gov/sites/default/files/2022-03/CFTC_FY_2023_President_Budget_Report_032122.pdf. While the CFTC has exclusive jurisdiction over commodity futures trading, 7 U.S.C. § 2(a)(1)(A), it shares jurisdiction over swap trading with its regulatory counterpart for the securities industry, the SEC. Notwithstanding—or perhaps because of—the overlap in their regulatory responsibilities, the CFTC and SEC have historically been at odds regarding the scope of their respective authority.

[7] Swap data repositories are centralized recordkeeping facilities for the collection and maintenance of information and records with respect to swaps transaction and positions. The Dodd-Frank Act mandates that all cleared and uncleared swaps be reported to a swap data repository; in turn, swap data repositories are subject to registration, regulation, reporting, and recordkeeping obligations set forth by the CFTC.

[8] Derivative Clearing Organizations (DCOs) are associations that enable parties to a transaction to substitute the credit of the clearing organization for the credit of the parties, thus mutualizing or transferring credit risk among participants. In order to provide such services, DCOs must obtain and maintain registration with the CFTC through demonstrated compliance with certain core principles set forth in the CEA. 7 U.S.C. § 7a-1.

futures commission merchants (FCMs);[9] swap dealers; registered futures associations;[10] and a host of intermediaries.[11] Some of the CFTC's regulatory activities are:[12]

- assessing registration applications of all entities seeking to be registered as DCMs and DCOs to ensure compliance with the practice guidelines set forth in the CEA and CFTC regulations promulgated thereunder;
- reviewing new product filings and amendments to rules relating to products by registered entities, as well as issuing no-action letters related to product issues;
- setting and enforcing aggregate position limits for physical commodity derivatives; establishing block trade sizes for swaps;[13]
- determining the eligibility of a swap to be cleared;[14]
- monitoring trading and the positions of market participants on an on-going basis, as well as changes to market conditions and developments;
- conducting risk and financial surveillance of DCOs;
- maintaining an electronic platform for data analysis;
- conducting assessments of regulated entities' operations or oversight programs to assess ongoing compliance with statutory and regulatory mandates; and
- investigating violations and enforcing business conduct standards set forth in the CEA and CFTC regulations.

Comment: Swaps and futures contracts have much in common. Both types of instruments are variants of forward contracts; are used to mitigate or hedge future price risk; and are frequently predicated on complex financial products. Despite their substantive similarities, however, the swaps and futures markets were subject to very different regulatory regimes prior to the passage of Dodd-Frank. For example, unlike futures contracts, swaps contracts did not have to be traded on exchanges and were largely exempt from margin, reporting, registration, or centralized clearing requirements. Indeed, while Congress gave the CFTC broad authority to oversee the futures market, it effectively removed the swaps market from *any* meaningful regulatory oversight. Not surprisingly, when given the choice, market participants generally opted to trade in swaps rather than futures. Not only were they able to structure their transactions without restraint, but they needed no upfront funds to execute their transactions.

In the aftermath of the 2008 financial crisis, the public and regulators began to seriously question the lack of oversight for the swaps market. Many commentators noted that the swaps market had been allowed to build up systemic risk that ultimately contributed to, or at least exacerbated, the rapid economic decline. In response, Congress enacted Title VII of Dodd-Frank to bring comprehensive regulation and transparency to the swaps market. Although modeled on the regulatory framework already in place for the futures markets, Title VII arguably went even further by subjecting swaps transactions to more restrictive capital and compliance requirements than futures transactions.

In response, market participants sought to decrease the impact of the new swaps regulations by relying on economically equivalent futures contracts to meet their needs. Opining on this phenomenon in 2013, former CFTC Chairman Gary Gensler said, ''[n]ow that the entire derivatives marketplace, both futures and swaps, have come under comprehensive oversight . . . it's the natural order of things for some realignment to take place.''[15] Futures exchanges facilitated this realignment by creating new financial products that act like swaps: for example, the Intercontinental Exchange converted all of its swaps contracts to futures, while the Chicago Mercantile Group begun to offer a futures contract that delivers a cleared over-the-counter swap at maturity. The transitions to these products were achieved quickly because, as a general rule, where a swap contract has reached a sufficiently high level of liquidity and standardization, it is relatively simple to create a standardized futures contract that replicates the swap.

The shift toward the futures market—and away from the swaps market—has been referred to as ''futurization.'' The implications of futurization are not yet clear, and some evidence suggests that traders have not moved to futures in quite the volume that was initially expected.[16] All the same, market participants should be mindful of this trend

[9] Futures commission merchants (FCMs) are individuals or entities which may solicit or accept commodity futures contract orders, as well as extend credit to customers seeking to enter into such positions.

[10] Registered futures associations are independent self-regulatory organizations for the futures industry. *See generally* 7 U.S.C. § 21 (outlining the operational criteria for registered futures associations). Under the CEA, companies and individuals who handle customer funds, solicit or accept orders, or give trained advice on futures and options must apply for CFTC registration through a registered futures association.

[11] Intermediaries are entities that act on behalf of another person in connection with the purchase or sale of any commodity for future delivery, security futures product, swap, or commodity option. Intermediaries are required to register with the CFTC—which has in turn delegated its registration processing authority to the National Futures Association—and may be subject to various financial, disclosure, reporting, and recordkeeping requirements. *See generally* Intermediaries, CFTC.GOV, https://www.cftc.gov/IndustryOversight/Intermediaries/index.htm.

[12] *See generally* CFTC, PRESIDENT'S BUDGET FOR FISCAL YEAR 2023, at 1–3 (Mar. 2022), https://www.cftc.gov/sites/default/files/2022-03/CFTC_FY_2023_President_Budget_Report_032122.pdf.

[13] A block trade is a large transaction that is negotiated off a trading floor or facility and then executed on an exchange's trading facility, as permitted under exchange rules.

[14] Traditionally, swap transactions were not cleared at clearinghouses. Instead, the risk of counterparty default was borne directly by the parties to the transaction. Where the counterparty was a large financial institution, the consequences of default also inevitably impacted the market at large. Title VII of Dodd-Frank sought to mitigate this systemic market exposure by requiring certain over-the-counter derivatives to be submitted for clearing to central counterparties.

[15] Gary Gensler, then-Chairman, CFTC, Remarks at CFTC Public Roundtable on Futurization of Swaps (Jan. 31, 2013), http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission13_013113-trans.pdf.

[16] *US swaps market resists futures model*, FIN. TIMES (Mar. 16, 2015), https://www.ft.com/content/53c971ce-cbb9-11e4-beca-

and the possibility that the Commission will enact rules to restrict or encourage the use of swaps, or futures, as necessary to further the purpose of Title VII and Dodd-Frank, generally.

To help the CFTC fulfill its expanded mandate under Dodd-Frank, Congress approved considerable increases to the Commission's budget in the first few years after the legislation was passed in 2010.[17] For example, Congress approved a 20 percent increase in the Commission's budget—from $169 million to $202 million—in fiscal year 2011.[18] While this figure remained largely unchanged in fiscal year 2012, it jumped by over $100 million in fiscal year 2013 to an all-time high of $308 million in fiscal year 2013.[19] The budget remained steady at around $250 million through fiscal year 2018. In February 2019, the House and Senate approved a slight increase to $268 million for the fiscal year 2019.[20] The Commission's budget has since increased significantly, with Congress approving a $363 million budget in fiscal year 2022.[21]

The CFTC is composed of five Commissioners appointed by the President, with the advice and consent of the Senate, to serve staggered five-year terms.[22] The President designates the Chairman, who in turn is authorized to appoint the heads of the agency's major administrative units, subject to approval by the other Commissioners.[23] The Office of the Chairman oversees the Commission's principal divisions—including the Division of Enforcement, the Division of Market Oversight, the Division of Clearing and Risk, and the Market Participants Division—and various administrative offices.[24]

The CFTC is headquartered in Washington, D.C., with regional offices in Chicago, Kansas City, and New York City. Each regional office is responsible for oversight of a specific region (Central, Southwestern, and Eastern, respectively). The regional offices operate under the plans and policies established at the Commission's headquarters, and have little independence under the CFTC's centralized system.[25]

2. The Division of Enforcement

The CFTC's Division of Enforcement (DOE) investigates and prosecutes civil enforcement actions that allege violations of the CEA and regulations promulgated by the CFTC.[26] Potential violations include market fraud or manipulation in connection with commodities, futures, or swaps transactions; disruptive trading practices;[27] registration irregularities; and participation in Ponzi schemes or improper representation of commodity investments to retail investors.[28] Additionally, Commission Regulation 166.3 requires each registrant to ''diligent[ly] supervise'' the activities of its partners, officers, employees, and agents. When considering an enforcement action, the Commission will thus often assess whether there has also been a violation of Regulation 166.3. At the conclusion of an investigation, the DOE may recommend that the Commission initiate administrative proceedings or seek relief in a federal district court.

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[17] Notwithstanding its broad regulatory responsibilities, the CFTC's budget is miniscule compared to the SEC's—a point that takes on extra significance given that, as SEC Chairman Jay Clayton observed in 2018, 'The IT budget of one of our largest banks was over five times the SEC's total budget.'' SEC, Remarks at Ceremonial Swearing In of Commissioners Hester M. Pierce and Robert J. Jackson, Jr. (Jan. 26, 2018), https://www.sec.gov/news/speech/clayton-swearing-ceremony-peirce-jackson. For example, in the same fiscal year (2018) that the CFTC was given $249 million, Congress approved a $1.897 *billion* operating budget for the SEC. CRS, FSGG FY2018 APPROPRIATIONS: INDEPENDENT AGENCIES AND GENERAL PROVISIONS, at 4 tbl.3 (July 2018). In 2017, the CFTC was given a $250 million budget, while the SEC received $1.605 billion. *Id.* These inequities, not unique to recent years, have led many to view the CFTC as ''the scrawny younger brother of the S.E.C.'' Peter Henning, *CFTC Is Set to Get Tougher on Fraud*, N.Y. TIMES DEALBOOK (Nov. 1, 2010), https://archive.nytimes.com/dealbook.nytimes.com/2010/11/01/c-f-t-c-is-set-to-get-tougher-on-fraud.

[18] CFTC, Annual Performance Report for Fiscal Year 2011, at 11 (Feb. 2012), http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2011apr.pdf.

[19] CFTC, PRESIDENT'S BUDGET AND PERFORMANCE PLAN FOR FISCAL YEAR 2014, at 9 (Apr. 2013).

[20] Press Release, CFTC, Statement of Chairman J. Christopher Giancarlo on Passage of FY2019 Appropriations (Feb. 15, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement021519; Consolidated Appropriations Act, 2019, Pub. L. No. 116-6 (2019).

[21] Consolidated Appropriations Act, 2023, Pub. L. No. 117-328 (2022).

[22] 7 U.S.C. § 2(a). No more than three sitting members of the CFTC may belong to the same political party.

[23] 7 U.S.C. § § 2(b), 6. In the absence of a presidentially appointed and Senate-confirmed chairman, the Commission votes to designate a sitting Commissioner as ''Acting Chairman.'' *See* Chairman & Commissioners, CFTC, https://www.cftc.gov/About/Commissioners/index.htm. On December 15, 2021, the Senate confirmed President Biden's nominee, Rostin Benham, as Chairman of the CFTC. Chairman Benham had previously served as Acting Chairman. *See* Press Release, CFTC, U.S. Senate Unanimously Confirms Benham as Chairman (Dec. 16, 2021), https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement121621.

[24] *See* CFTC, Strategic Plan 2022-2026, at 18-20 (2022), https://www.cftc.gov/media/7081/CFTC2022_2026StrategicPlan/download.

[25] *See id.*

[26] *See* 17 C.F.R. § 11.2 (delegating to the Division of Enforcement the authority to ''conduct such investigations as [its Director] deems appropriate to determine whether any persons have violated, are violating, or are about to violate the provisions of the Commodity Exchange Act, as amended, or the rules, regulations or orders adopted by the Commission pursuant to that Act...''). To develop leads for enforcement actions, the Commission also accepts tips from various sources about potential wrongdoing and cooperates with state, federal, and international regulatory and criminal authorities. *See* CFTC, PRESIDENT'S BUDGET FOR FISCAL YEAR 2023, at 15 (Mar. 2022), https://www.cftc.gov/sites/default/files/2022 03/CFTC_FY_2023_President_Budget_Report_032122.pdf.

[27] One example of a disruptive trading practice is ''wash trading,'' whereby a trader uses two brokers to engage in simultaneous buy and sell transactions for the same product in order to give the appearance that purchases and sales have been made without actually incurring market risk or a change in position. This has the potential to give other traders the false impression of higher-than-actual trading volume. Another example is ''trading ahead,'' whereby a trader takes a futures or options position based on misappropriated confidential information regarding an impending transaction by another person in the same or related future or option.

[28] For a more detailed discussion of these actions, see 262 SPS § VI, *Recent Developments in CFTC Enforcement*.

Administrative sanctions may include civil monetary penalties; denial, restriction, suspension, or revocation of trading licenses; and orders of restitution or disgorgement. In fiscal year 2022, for example, the CFTC obtained orders imposing over $2.5 billion in restitution, disgorgement, and civil monetary penalties.[29] Injunctive and ancillary relief is available in federal court through such means as temporary restraining orders and preliminary or permanent injunctions to halt ongoing violations; appointment of a receiver; a freeze on assets; restitution; and disgorgement of wrongful gains. Individual states may join as co-plaintiffs in civil injunctive actions brought by the DOE to enforce the CEA.[30]

In addition to its expansive authority to pursue civil lawsuits, the DOE may also refer alleged criminal violations to the Department of Justice or state law enforcement authorities for prosecution. Criminal activity involving commodity-related instruments can result not only in prosecution for criminal violations of the CEA, but also for violations of other criminal statutes, such as mail fraud and conspiracy. In fiscal year 2021, for example, the DOE filed 13 actions in parallel with federal criminal authorities, including all of the Division's fraud and manipulation cases.[31] Meanwhile, the Commission worked cooperatively with other law enforcement and regulatory authorities in over 130 investigations.[32] Along with its core duties, the DOE provides technical assistance to other law enforcement agencies (including the assignment of its staff to U.S. Attorney's Offices); participates in all registration denial cases; and may be involved in fitness checks of applicants or registrants.

By expanding the CFTC's mission and scope, the passage of Dodd-Frank has significantly increased the workload of the DOE. For example, the DOE has been given the additional tasks of policing:

- fraud-based manipulation by registered entities (as opposed to only price-based manipulation);
- fraud-based manipulation of swaps;
- new prohibitions targeting disruptive trading, practices, and conduct at registered entities;
- new prohibitions against reporting false information and making false statements; and
- retail commodity transactions, such as precious metals.

The CFTC is currently exploring the extent of its new authority and expanding its enforcement activity into a variety of areas. For example, the CFTC has asserted that decentralized digital currencies, such as Bitcoin, fall under the definition of ''commodity'' set forth in the CEA and are therefore subject to regulatory oversight by the Commission.[33] Consistent with this view, the CFTC brought more than 20 enforcement actions alleging digital asset-related misconduct in fiscal year 2021 and 18 in fiscal year 2022.[34] As early as 2015, the CFTC brought an action against an unregistered bitcoin options trading platform for, among other things, failing to register as a facility for trading or processing ''commodity options'' (i.e., a Swap Execution Facility or Designated Contract Market) as required under the CEA and CFTC regulations promulgated thereunder.[35] The CFTC has also brought enforcement actions against registered exchanges for failing to enforce the Commission's anti-fraud prohibitions with respect to bitcoin swap transactions.[36] In 2021, the CFTC accepted a $6.5 million settlement offer from a digital currency trading platform after the Commission found the platform ''deliver[ed] false, misleading or inaccurate reports concerning transactions in digital assets, including Bitcoin.''[37] More recently, the CFTC filed fraud charges against FTX Trading Ltd., Alameda Research LLC, Samuel Bankman-Fried, and other corporate officers in connection with the high-profile collapse of the cryptocurrency exchange and hedge fund.[38]

The CFTC is also testing how far its authority might extend beyond the U.S. For example, the Commission has

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[29] Press Release, CFTC, CFTC Releases Annual Enforcement Results (Oct. 20, 2022), https://www.cftc.gov/PressRoom/PressReleases/8613-22.

[30] *See* CFTC, *Enforcement*, CFTC.GOV, https://www.cftc.gov/LawRegulation/Enforcement/OfficeofDirectorEnforcement.html.

[31] CFTC, PRESIDENT'S BUDGET FOR FISCAL YEAR 2023, at 17 (Mar. 2022), https://www.cftc.gov/sites/default/files/2022-03/CFTC_FY_2023_President_Budget_Report_032122.pdf.

[32] *Id.*

[33] *See generally* CFTC, BACKGROUNDER ON OVERSIGHT OF AND APPROACH TO VIRTUAL CURRENCY FUTURES MARKETS (Jan. 4, 2018), https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/backgrounder_virtualcurrency01.pdf. The Securities and Exchange Commission has posited that cryptocurrencies are securities that should fall within their regulatory purview. *See* Jesse Pound, *SEC Chairman Gary Gensler says more investor protections are needed for bitcoin and crypto markets*, CNBC (May 7, 2021), https://www.cnbc.com/2021/05/07/sec-chairman-gary-gensler-says-more-investor-protections-are-needed-for-bitcoin-and-crypto-markets.html; *see also* Eliminate Barriers to Innovation Act of 2021, H.R. 1602, 117th Cong. (2021) (establishing a joint SEC-CFTC digital asset working group); Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. (2022) (granting exclusive jurisdiction to the Commodity Futures Trading Commission over activity involving digital commodities).

[34] Rostin Benham, Chairman, CFTC, Keynote Address at the Brookings Institution Webcast on the Future of Crypto Regulation (July 25, 2022), https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam24; *see also* Press Release, CFTC, CFTC Releases Annual Enforcement Results (Oct. 20, 2022), https://www.cftc.gov/PressRoom/PressReleases/8613-22.

[35] *In re Coinflip, Inc.*, Dkt. No. 15-29 (C.F.T.C. Sept. 17, 2015). No financial penalty was imposed.

[36] *In re TeraExchange LLC*, CFTC Dkt. No. 15-33 (Sept. 24, 2015). Although TeraExchange had only provisional status as a Swap Execution Facility at the time of the action, the CFTC has since granted the exchange full formal registration. Stan Higgins, CFTC Grants Full Registration to Bitcoin Swaps Trading Platform, COINDESK.COM (May 26, 2016), https://www.coindesk.com/us-swap-platform-registration-cftc. In July 2017, the CFTC also gave Swap Execution Facility status to a new Bitcoin exchange called LedgerX, paving the way for LedgerX to become the first federally recognized exchange for trading in Bitcoin options. Gunjan Banerji, Bitcoin Options Exchange Wins Approval From CFTC, WALL ST. J. (July 24, 2017).

[37] *In re Coinbase, Inc.*, Dkt. No. 21-03 at 2 (CFTC Mar. 19, 2021).

[38] Press Release, CFTC, CFTC Charges Sam Bankman-Fried, FTX Trading and Alameda with Fraud and Material Misrepresentations (Dec. 13, 2022), https://www.cftc.gov/PressRoom/PressReleases/8638-22; Press Release, CFTC, CFTC Charges Alameda CEO and Alameda and FTX Co-Founder with Fraud in Action Against Sam Bankman-Fried and his Companies (Dec. 21, 2022), https://www.cftc.gov/PressRoom/PressReleases/8644-22.

pursued charges against offshore trading platforms that operate online and offer options to U.S. customers without registering with U.S. regulators. To this end, in November 2012, the CFTC filed a civil complaint in federal district court in Washington, D.C., against InTrade—a popular, Ireland-based betting website that facilitated wagers on everything from political outcomes to the price of gold—for running an unauthorized and unregulated exchange.[39] More recently, in July 2018, the Commission brought a civil enforcement action against JAFX, ltd., a retail foreign exchange dealer operating from Bulgaria and St. Vincent and the Grenadines.[40] JAFX, ltd. was alleged, among other things, to have solicited U.S. customers to trade foreign currencies without registering as a Retail Foreign Exchange Dealer with the CFTC.[41] The CFTC has also enacted regulation that requires overseas offices of American-based foreign institutions and hedge funds to turn over data on foreign trades if they involve American customers, or are guaranteed by a financial institution with American ties. The regulation went into effect on July 12, 2013, with full compliance required by December 21, 2013.[42] In May 2016, the Commission imposed still-tighter restrictions on U.S. banks that move swap operations overseas, requiring them to comply with Dodd-Frank margin rules even when the American parent company is not executing the trade itself.[43] The rule became effective on August 1, 2016.[44]

As a result of its broadened mandate, the CFTC has brought a record number of enforcement cases since the passage of Dodd-Frank. In fiscal year 2022 the Commission filed 82 enforcement actions—more than double the typical amount filed before Dodd-Frank and the financial crisis.[45] The Commission still faces very real difficulties, however, as it seeks to overcome its historically weak regulatory reputation and assert itself ''as the new financial sheriff for the 21st century.''[46]

First, in the immediate aftermath of Dodd-Frank, the Commission's aggressive use of its expanded enforcement powers arguably created an internal fracture amongst its staff, as the Commission struggled to develop a new defining philosophy and approach to enforcement. While some of the DOE's attorneys had worked at the CFTC for more than a decade and were trained under a very different regime—when the Commission was still a much less aggressive institution—others had joined only recently as part of a newly energized effort led by David Meister, who was head of Enforcement from 2010 to 2013.[47] Although the CFTC has since appeared to come to terms with its post-Dodd-Frank mandate and exhibit more internal coherence, the Trump Administration's Executive Order directing a comprehensive review of Dodd-Frank regulations added to the uncertainty about the future enforcement priorities of the CFTC.[48] Priorities have shifted again under the Biden Administration, as President Biden revoked President Trump's Executive Order.[49]

Second, notwithstanding its expanded powers and ambitions, the CFTC's enforcement efforts have been hindered by financing and staffing concerns. As former CFTC Chairman Gary Gensler explained, Congress has not adjusted the agency's budget in proportion to its increased responsibilities, thus creating an unmanageable situation akin to the ''National Football League if there were eight times the number of games but

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[39] Press Release, CFTC, CFTC Charges Ireland-based ''Prediction Market'' Proprietors Intrade and TEN with Violating the CFTC's Off-Exchange Options Trading Ban and Filing False Forms with the CFTC (Nov. 26, 2012), https://www.cftc.gov/PressRoom/PressReleases/6423-12. Notably, in October 2014, the Commission issued a no-action letter to PredictIt, a political and economic prediction market run on a not-for-profit basis through a university in New Zealand. Press Release, CFTC, CFTC Staff Provides No-Action Relief for Victoria University of Wellington, New Zealand, to Operate a Not-For-Profit Market for Event Contracts and to Offer Event Contracts to U.S. Persons (Oct. 29, 2014), https://www.cftc.gov/PressRoom/PressReleases/7047-14. Since then, while operating within the limits set out by the Commission's no-action letter, PredictIt has grown into a trading platform of 50,000 international users. *See generally* Jessica Contrera, *Here's how to legally gamble on the 2016 race*, WASH. POST (Mar. 28, 2016), https://www.washingtonpost.com/lifestyle/style/heres-how-to-legally-gamble-on-the-2016-race/2016/03/28/14397dde-f1dc-11e5-85a6-2132cf446d0a_story.html.

[40] Press Release, CFTC, CFTC Sues Forex Dealer for Registration and Disclosure Violations (July 31, 2018), https://www.cftc.gov/PressRoom/PressReleases/7765-18.

[41] Avi Abdel-Qader, JAFX Violated the Commodity Exchange Act and Agency Rules by Not Registering as a Retail Foreign Exchange Dealer, FINANCE MAGNATES (July 31, 2018); Press Release, CFTC, CFTC Sues Forex Dealer for Registration and Disclosure Violations (July 31, 2018), https://www.cftc.gov/PressRoom/PressReleases/7765-18.

[42] See Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013); Exemptive Order Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 43,785 (July 13, 2013). At times, it was unclear whether the regulation would go into effect as planned because it was the subject of much pushback by American financial institutions. *See* Eric Lipton, Banks Rally Against Strict Controls of Foreign Bets, N.Y. TIMES (Apr. 30, 2013), http://www.nytimes.com/2013/05/01/business/banks-criticize-strict-controls-for-foreign-bets.html.

[43] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross- Border Application of the Margin Requirements, 81 Fed. Reg. 34,818 (May 31, 2016).

[44] *Id.*

[45] Press Release, CFTC, CFTC Releases Annual Enforcement Results (Oct. 20, 2022), https://www.cftc.gov/PressRoom/PressReleases/8613-22; cf. CFTC, Performance and Accountability Report Fiscal Year 2006 (Nov. 2006), https://www.cftc.gov/sites/default/files/idc/groups/public/@aboutcftc/documents/file/2006performacctreport.pdf (30 enforcement actions prior to Dodd-Frank).

[46] Zachary Brez & Jon Daniels, *The New Financial Sheriff: CFTC Anti-Fraud Authority After Dodd-Frank*, 44 SEC. REG. & L. REP. 1209 (2012) (highlighting remarks by the former CTFC Director of Enforcement David Meister that he ''intends to use the new Dodd-Frank authority aggressively'' and that the Dodd-Frank Act is a ''game-changer'' for the Commission).

[47] *See* Press Release, CFTC Announces Departure of Enforcement Director David Meister (Oct. 1, 2013). Mr. Meister's departure from the CFTC was announced on October 1, 2013.

[48] Executive Order 13772, Presidential Executive Order on Core Principles for Regulating the United States Financial System, 82 Fed. Reg. 9965 (Feb. 3, 2017).

[49] Executive Order 14018, Revocation of Certain Presidential Actions, 86 FR 11855 (February 24, 2021).

only the same number of referees.''[50] According to Gensler, resource constraints caused the CFTC to begin ''shelving enforcement matters'' it would have otherwise pursued, and prevented it from investigating firms that it ''need[s] to examine.''[51] CFTC leadership spoke out against inadequate funding during the Trump administration, before the Commission's budget was finally increased for the 2019 fiscal year.[52]

3. The Operating Divisions

In addition to the DOE, the CFTC has several other operating divisions, which underwent a reorganization effective November 8, 2020.[53] During fiscal year 2022, DOE was one of four programmatic divisions,[54] along with the Division of Market Oversight, the Division of Clearing and Risk, and the Market Participants Division. Each of these divisions refers potential matters of interest to the DOE for investigation and communicates with the DOE in connection with rejected registration applications. The Commission's Legal Division and Division of Data, as well as the Whistleblower Program, which is part of DOE, also support the work of, and frequently interact with, the DOE.[55]

a. Division of Market Oversight

The Division of Market Oversight is tasked with maintaining the integrity of the futures, options, and swaps derivatives markets. Of all the offices within the CFTC, practitioners have the most contact with this Division. The regulatory functions of the Division include consideration of new exchange applications and continuing oversight of existing exchanges; trade practice assessments and investigations; supervision of trade execution facilities and data repositories; evaluation of rule filings by exchanges, and review of rule amendments related to products or markets.[56] The Division of Market Oversight interacts frequently with the DOE; for example, it confers with the DOE in connection with any denied registration applications, and refers any potential violations of the CEA or CFTC regulations to the DOE for further investigation.

b. Division of Clearing and Risk

The Division of Clearing and Risk supervises derivatives clearing organizations (DCOs) and other market participants in the clearing process.[57] Examples of DCOs include the Chicago Mercantile Exchange, Inc. and the Options Clearing Corporation. In addition, the Division assesses DCO compliance with Commission regulations; conducts risk assessments and surveillance, including of futures commission merchants; and makes recommendations pertaining to DCO applications, rule submissions, and the types of swaps to be cleared. The Division of Clearing and Risk may refer matters involving suspected misconduct to the DOE for further review. As of the end of March 2022, the CFTC oversaw 15 DCOs, ten of which were in the United States and five were located abroad.[58]

c. Market Participants Division

The Market Participants Division was formed in October 2020 following an agency reorganization.[59] Prior to the reorganization, the Division was known as the Division of Swap Dealer and Intermediary Oversight (DSIO), which had been established in 2011, to help manage the new responsibilities imposed on the CFTC by the Dodd-Frank Act.[60] In its oversight function, the Division supervises commodity pool operators,

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[50] Interview by Maria Bartiromo with Gary Gensler, former Chairman, CFTC, on CNBC (Mar. 1, 2013) (noting that the CFTC ''was sized in the 1990s to regulate the futures market'' and is ''just not sized to the new job'' of overseeing the swaps market as well).

[51] *Id. See also* Jean Eaglesham, *CFTC Delays Cases, Shelves Probes, in Funding Squeeze*, WALL ST. J., Oct. 21, 2013 (discussing the Commission's resource constraints and their impact on its enforcement initiatives).

[52] Press Release, CFTC, Statement of Chairman J. Christopher Giancarlo on Passage of FY2019 Appropriations (Feb. 19, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement021519; Pete Schroeder, *CFTC 'astounded' as Congress prepares to cut budget*, REUTERS (Mar. 22, 2018), https://www.reuters.com/article/us-usa-cftc-budget/cftc-astounded-as-congress-prepares-to-cut-budget-idUSKBN1GY2E0.

[53] Press Release, CFTC, CFTC Announces Organizational Changes to Enhance Agency's Operational Effectiveness (Oct. 29, 2020), https://www.cftc.gov/PressRoom/PressReleases/8297-20; *see also* CFTC Organization, CFTC.GOV, https://www.cftc.gov/About/CFTC-Organization/index.htm; CFTC, CFTC Organization Chart (Apr. 2021), https://www.cftc.gov/media/5881/cftcorgchart0421/download.

[54] CFTC, Fiscal Year 2022 Agency Financial Report, at 7 (November 2022), https://www.cftc.gov/media/7941/2022afr/download.

[55] The rest of the Commission's 13 operating divisions and offices, following the 2020 reorganization, are: (i) Division of Data; (ii) Division of Administration (DA); (iii) Office of the Chief Economist; (iv) Office of International Affairs; (v) Office of Public Affairs; (vi) Office of Technology Innovation; (vii) Office of Customer Education and Outreach; (viii) Office of Legislative and Intergovernmental Affairs; and (ix) Office of Minority and Women Inclusion. For an overview of these offices, *see* CTFC Organization, CFTC.GOV, http://www.cftc.gov/About/CFTCOrganization/index.htm.

[56] The Division of Market Oversight was created in 2002 and was jointly delegated (with another new division that has since been restructured) the responsibilities that were formerly within the domain of the Division of Trading and Markets and the Division of Economic Analysis. Functions pertaining to the Division of Trading and Markets include responsibility for the Commission's registration, market regulation, compliance auditing, and financial review programs. Functions pertaining to the Division of Economic Analysis include analyzing the economic implications of CFTC policies and regulations; conducting economic research and studies pertaining to futures markets; and daily market surveillance and trading analysis. *See* PHILIP MCBRIDE JOHNSON & THOMAS LEE HAZEN, DERIVATIVES REGULATION 951-53 (3d ed. 2004).

[57] The CEA provides for mandatory central clearing and exchange-trading of most derivatives as a means to mitigate risk, encourage price transparency, and facilitate liquidity. *See* 7 U.S.C. § 2(h).

[58] CFTC, PRESIDENT'S BUDGET FOR FISCAL YEAR 2023, at 8, 60–61 (Mar. 2022), https://www.cftc.gov/sites/default/files/2022-03/CFTC_FY_2023_President_Budget_Report_032122.pdf (discussing DCOs generally and providing a complete list of the DCOs registered with the CFTC).

[59] Market Participants Division (MPD), CFTC.GOV, https://www.cftc.gov/About/CFTCOrganization/MPD

[60] CFTC, PRESIDENT'S BUDGET AND PERFORMANCE PLAN FOR FISCAL YEAR 2013, Chairman's Transmittal Letter (2012), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcbudget2013.pdf. CFTC, President's Budget and Performance Plan for Fiscal Year 2018, at 17-18 (May 2017), https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/

commodity trading advisors, merchants, introducing brokers, and retail foreign exchange dealers, floor brokers and traders, as well as designated self-regulatory organizations (SROs), including U.S. derivatives exchanges and the National Futures Association (NFA).[61] Additionally, the Division oversees swap dealers and major swap participants.[62] Its associated regulatory responsibilities include developing and monitoring compliance with regulations addressing registration, business conduct standards, capital adequacy, and margin requirements.[63] In the event of a possible violation of the CEA or the Commission's regulations by an intermediary, swap participant, or swap dealer, the Markets Participants Division may refer the matter to the DOE.

d. Legal Division

The Legal Division, which was formed by the merger of the Office of the General Counsel with the Office of the Executive Secretariat, provides legal services and support to the CFTC.[64] Its responsibilities include representing the CFTC's interests in defensive, appellate, and amicus curiae litigation; assisting the Department of Justice in criminal litigation concerning futures law violations; performing various adjudicatory functions;[65] drafting and applying CFTC regulations; interpreting the CEA; and advising on legislative, regulatory, and operational issues.[66]

The CFTC appoints the General Counsel, who reports directly to the Commission and serves at its pleasure.[67] The CFTC also appoints other attorneys whom it deems necessary to assist the General Counsel in performing his or her duties.[68]

e. Whistleblower Program

The Whistleblower Program was established under the Dodd-Frank Act to provide the public with a forum to anonymously report market misconduct.[69] The Whistleblower Program refers promising information to the DOE and maintains communication with the DOE regarding the status of referred whistleblower related matters, including the level of assistance provided by the whistleblower.[70] During its first five years of operation, the Whistleblower Program issued only a handful of whistleblower awards, totaling slightly over $10 million with an average award amount of over $3 million. In an effort to expand the scope of its whistleblower program, the CFTC adopted certain rule amendments on May 22, 2017 to simplify and improve the claims review process, reduce bureaucratic red tape, and strengthen whistleblower protections.[71] Since the inception of the Whistleblower Program, the CFTC has granted awards totaling more than $330 million, including a record $200 million award to a single whistleblower in fiscal year 2022.[72] The total sanctions ordered in all whistleblower-related enforcement actions surpassed $3 billion in fiscal year 2022.[73]

cftcbudget2018.pdf (discussing the progress and operation of the Division of Swap Dealer and Intermediary Oversight).

[61] Market Participants Division (MPD), CFTC.GOV, https://www.cftc.gov/About/CFTCOrganization/MPD.

[62] Section 721 of the Dodd-Frank Act added definitions of the terms ''swap dealer'' and ''major swap participant'' to the CEA, and instructed the CFTC and SEC to jointly develop a further definition for these terms. The final definitions were issued in May 2012. A ''swap dealer'' is defined as any person who (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) or engages in activity causing itself to be commonly known in the trade as a dealer or market maker in swaps. 77 Fed. Reg. 30,597. A ''major swap participant'' is defined as any person who is not a swap dealer, and (i) who maintains a substantial position in swaps for certain major swap categories as determined by the Commission; (ii) whose outstanding swaps generate substantial counterparty exposure that can have a serious impact on financial markets; or (iii) is a highly leveraged financial entity that is exempt from certain capital requirements and maintains a substantial position in swaps for certain major swap categories as determined by the Commission. 7 U.S.C. § 1a(33)(A)(i)(1). *See generally* CFTC, Final Rules Regarding Further Defining ''Swap Dealer,'' ''Major Swap Participant'' and ''Eligible Contract Participant'' (2013), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/msp_ecp_factsheet_final.pdf. An entity may be classified as a major swap participant for a single type, class, or category of swaps in which it engages: for example, a hedge fund may be considered a major swap participant with respect to its credit default swaps, but not its equity swaps.

[63] CFTC, President's Budget and Performance Plan for Fiscal Year 2018, at 45 (May 2017), https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/cftcbudget2018.pdf.

[64] Press Release, CFTC, CFTC Announces Organizational Changes to Enhance Agency's Operational Effectiveness (Oct. 29, 2020), https://www.cftc.gov/PressRoom/PressReleases/8297-20.

[65] *See, e.g.*, 17 C.F.R. § 10.109 (delegating to the General Counsel the authority to grant or deny certain procedural motions in administrative and reparations cases). Reparations proceedings provide a forum whereby individuals injured by violations of the CEA may seek redress before the CFTC. *See generally* Reparations Program, CFTC.GOV, https://www.cftc.gov/LearnAndProtect/ReparationsProgram/index.htm.

[66] *See* 17 C.F.R. § 140.96 (requiring the General Counsel's concurrence to publish proposed rules in the Federal Register).

[67] 7 U.S.C. § 2(a)(4). Prior to the creation of the Office of the General Counsel in 1974, the Department of Agriculture provided legal support to the Commission. This system subjected the Commission to bureaucratic delays and uncertainty and hindered its independence. *See* JERRY W. MARKHAM, THE HISTORY OF COMMODITY FUTURES TRADING AND ITS REGULATION 123 (1986).

[68] 7 U.S.C. § 2(a)(4).

[69] As explained by former CFTC Chairman Gary Gensler, the Whistleblower Office ''provides the public an avenue to help catch misconduct in the markets and improve the CFTC's ability to be an effective cop on the beat.'' Press Release, CFTC, CFTC Chairman Names Vincente Martinez as Director of Recently Opened Whistleblower Office (Jan. 6, 2012), https://www.cftc.gov/PressRoom/PressReleases/6166-12.

[70] *See generally* CFTC, Whistleblower Program & Customer Education INITIATIVES 2022 ANNUAL REPORT (Oct. 2022), https://www.whistleblower.gov/sites/whistleblower/files/2022-10/FY22%20Customer%20Protection%20Fund%20Annual%20Report%20to%20Congress.pdf.

[71] Richard Hill, CFTC Authorized to File Whistle-Blower Retaliation Claims, BLOOMBERG BNA (May 23, 2017), https://www.bna.com/cftc-authorized-file-n73014451366; 17 CFR Part 165, Whistleblower Awards Process, http://src.bna.com/o6I.

[72] CFTC, Whistleblower Program & Customer Education Initiatives 2022 Annual Report, at 3-4, (Oct. 2022), https://www.whistleblower.gov/sites/whistleblower/files/2022-10/FY22%20Customer%20Protection%20Fund%20Annual%20Report

f. Division of Data

The Division of Data was formed by the CFTC's 2020 reorganization, bringing together data personnel from throughout the Commission, including the Office of Data and Technology and the Department of Market Oversight.[74] The Division is responsible for the Commission's data reporting, analysis, and governance functions and strategy and uses data to inform the Commission's understanding of market conditions.[75]

C. U.S. Exchanges and Other Self-Regulatory Organizations

1. Overview

The CFTC relies heavily on futures exchanges and boards of trade to perform extensive regulatory functions covering members' business conduct and operations, as well as the products that may be listed on exchanges.[76] These SROs engage in ongoing monitoring and regulation of their participants' market and trading activities to prevent abusive practices. As articulated by the Chairman of the CME Group, ''self-regulation in the context of futures markets regulation is a misnomer, because the regulatory structure of the modern U.S. futures industry is in fact a comprehensive network of regulatory organizations that work together to ensure the effective regulation of all industry participants.''[77] While the Commission is ultimately responsible for oversight of the U.S. futures industry, the exchanges and NFA share primary responsibility for ensuring that market participants are in compliance with CFTC regulations and exchange rules.

Regulation of the commodities and futures markets is also conducted by independent organizations that represent association members; set standards of conduct for their members; audit and enforce compliance with CFTC regulations and their own rules; and provide input on proposed CFTC regulations.[78] These member SROs focus on pre-screening members for fitness, and on regulating areas such as disclosure, capital requirements, reporting and solicitation.[79] To this end, member SROs conduct periodic audits and maintain constant financial surveillance over Futures Commission Merchants (FCMs) and Introducing Brokers (IBs). Specifically, member SROs monitor and enforce requirements pertaining to (i) the minimum net capital that must be maintained by FCMs; (ii) the segregation of customer trading funds and secured amounts from the FCM's own Funds; (iii) recordkeeping with respect to each FCM customer and transaction; and (iv) the filing and reporting of monthly or semi-annual unaudited financial reports as well as annual certified financial reports (factors (i)-(iv) collectively, the key requirements).

An inevitable result of self-regulation—and its biggest criticism—is the inherent tension between the regulatory and business interests of the SROs. As for-profit entities, SROs rely on members' fees and investments to ensure their own financial viability—yet at the same time, SROs are tasked with policing and punishing their customer base through their regulatory responsibilities. Against this backdrop, much of the concern about self-regulation has been grounded in the perception that SROs are subject to conflicts of interest between their regulatory responsibilities and their business operations, and are unduly influenced by the industry in the formation of regulatory policy.

Nonetheless, SROs have several significant incentives to maintain vigorous regulatory oversight of their members. First, their own financial viability is dependent upon their ability to maintain public confidence in the integrity of their markets. As commercial enterprises, SROs could not attract and retain business if their markets were not perceived to function fairly and effectively. Similarly, as public companies, SROs could not protect shareholder value if they were subject to reputational crises stemming from insufficient regulation or improper conflicts. Second, SROs have a direct economic stake in ensuring that their members comply with all the relevant rules and regulations. For example, SROs must cover any capital deficiencies in the event that a clearing firm fails to post sufficient collateral to cover a default. Third, SROs are themselves subject to regulatory oversight by the CFTC. The CFTC conducts periodic reviews of SROs to ensure that they are effectively fulfilling their responsibilities, and SROs may face sanctions or other penalties if their compliance and enforcement mechanisms are inadequate.

All domestic SROs are members of the Joint Audit Committee (JAC or Committee), a voluntary consortium of representatives from various U.S. futures exchanges and regulatory exchanges that participate in a joint audit and financial surveillance program approved and overseen by the CFTC. The purpose of the Committee is to decrease the regulatory burden for FCMs that are members of multiple exchanges. The Committee serves: (i) to foster uniform and efficient auditing practices across exchanges and (ii) to facilitate information sharing regarding the financial condition and compliance of exchange participants. The Committee assigns primary regulatory oversight responsibility for particular clearing firms to a single SRO, which—upon approval of the plan by the CFTC— is appointed a Designated Self-Regulatory Organization (DSRO)

%20to%20Congress.pdf

[73] *Id.* at 3.

[74] Press Release, CFTC, CFTC Announces Organizational Changes to Enhance Agency's Operational Effectiveness (Oct. 29, 2020), https://www.cftc.gov/PressRoom/PressReleases/8297-20.

[75] Division of Data, CFTC.GOV, https://www.cftc.gov/About/CFTCOrganization/DOD.

[76] John Carson, *Self-Regulation in Securities Markets* (World Bank, Pol'y Res. Working Paper No. 5542, 2011).

[77] *Examining the Lessons Learned from the Collapse of MF Global: Hearing before the S. Comm. On Banking*, 112th Cong. 61 (2012) (statement of Terrence A. Duffy, Executive Chairman, CME Group Inc.) (''The futures industry is a very highly-regulated industry with several layers of oversight. The industry's current regulatory structure is not that of a single entity governed by its members regulating its members, but rather a structure in which exchanges, most of which are public companies, regulate the activity of all participants in their markets—members as well as non-members—complemented with further oversight by the NFA and CFTC.'').

[78] *See* 262 SPS § III-D, *Membership Organizations*.

[79] *See, e.g.*, NFA, 2022 ANNUAL REVIEW, (2022), https://www.nfa.futures.org/about/annual-reviews-files/2022-annual-review.pdf. Another major difference between the exchange SROs and independent member SROs is that the exchanges have significant business operations, whereas the member organizations are non-profit entities established by their members solely to act in a regulatory capacity.

for a particular FCM. FCMs interact most frequently with their DSROs—as opposed to the CFTC or other self-regulatory bodies—through regulatory inquiries and audits. The responsibilities of the JAC, as well as the practices and procedures to be followed by DSROs in conducting FCM audits and reviews, are set forth in the Joint Audit Agreement entered into by all participants. Regulatory inquiries may be targeted to specific suspected violations, or may represent routine information-gathering or market-oversight activities. Audits include an assessment of the firm's financial condition and its compliance with key requirements; results of all other audits and examinations; results of any special reviews; and the general operating conditions and internal controls applied by the firm. The results of a DSRO's audit of a target FCM may be shared with the other exchanges on which that firm clears.

2. Disciplinary proceedings of various SROs

All SROs affiliated with the commodities industry generally employ similar disciplinary procedures and enforcement structures, as outlined in their respective rulebooks. Although the CFTC does not directly enforce the individual rules set forth by the SROs, there is significant overlap between their respective authorities.[80] Because SROs model their rules after CFTC regulations and guidelines, the violation of an SRO rule also frequently violates a parallel CFTC rule; the offender may therefore be subject to discipline by both the Commission and the SRO. In most cases, a violation that falls under the jurisdiction of both the Commission and an SRO will be pursued by only one of these organizations. SROs generally meet weekly, or at least periodically, with the CFTC to determine which agency should take the lead in the enforcement process.

Given the similarities between the CFTC's rules and those promulgated by SROs themselves, it is advisable to refer to both SRO and CFTC enforcement actions, decisions, no action letters, and other releases for guidance regarding how SROs are likely to interpret and enforce various provisions. It is important to remember that SROs do not share the Commission's authority to seek injunctive and ancillary relief in federal court and to directly refer cases to the Department of Justice for criminal proceedings.[81] Information about recent settlements and enforcement activities conducted by each SRO are available through press releases and archives maintained on the websites of each individual SRO.

The operation of SROs overseen by the CFTC and a brief overview of their respective enforcement programs is described below.[82]

[80] *See Rule Enforcement Reviews of Designated Contract Markets*, CFTC.GOV, https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmruleenf.html.

[81] *Id.*

[82] In addition to the SROs overseen by the CFTC, there are also several SROs regulated by the SEC—such as the Nasdaq BX, Inc., Nasdaq ISE, LLC, and Nasdaq PHLX LLC—which also provide futures and options contracts to their members. A discussion of these organizations is beyond the scope of this Portfolio.

a. CME Group, Inc.

The CME Group, Inc. is a diverse entity that owns the Chicago Mercantile Exchange (CME), [83] the Chicago Board of Trade (CBOT), [84] the New York Mercantile Exchange (NYMEX), [85] and the Commodity Exchange, Inc. (COMEX).[86] In 2012, it purchased the Kansas City Board of Trade (KCBT)[87] and integrated its product offerings within the CME Group portfolio. The CME Group also has a stake in foreign exchanges like the Dubai Mercantile Exchange Limited, as well as strategic partnerships with various other international exchanges.

The CME Group's wholly-owned subsidiaries—CBOT, CME, NYMEX, and COMEX—allow for trading of options and futures contracts on virtually every commodity and all major asset classes;[88] provide trading platforms to exchanges; and offer clearing services through CME Clearing, a wholly-owned subsidiary which monitors and processes over one billion trades per year, worth in excess of $1,000 trillion.[89] Each remains a separate self-regulatory organization and operates as an independent exchange with its own rules.[90] The CFTC conducts enforcement reviews of these entities on a rolling basis.[91]

The compliance departments for the CME Group subsidiaries have all been integrated into a single division—the CME Market Regulation Department—which now provides regula-

[83] The CME was originally known as the Chicago Butter and Egg Board, which was formed in 1898. It wasn't until 1919 that it became CME. In 2007, the CME merged with CBOT, which subsequently merged with CME Group Inc. later that same year. *See* CFTC, Trading Organizations—Designated Contract Markets (DCM), CFTC.GOV, http://sirt.cftc.gov/sirt/sirt.aspx?Topic=TradingOrganizations.

[84] CBOT was originally organized as a grain cash market in 1848. It became a subsidiary of CME Group Inc. in 2007.

[85] The NYMEX was founded in 1872 as the Butter and Cheese Exchange of New York and became the NYMEX in 1882. Since 1994, the COMEX has operated as a subsidiary of the NYMEX. In turn, in 2008, NYMEX became a subsidiary of CME Group, Inc.

[86] CME GRP., Rulebooks (2013), http://www.cmegroup.com/market-regulation/rulebook.

[87] The CME Group acquired KCBT for $126 million in October of 2012. Tony Dreibus, Kansas City Wheat Pit Trade Ends 157-Year Run in Move to Chicago, BLOOMBERG (June 27, 2013), http://www.bloomberg.com/news/2013-06-27/kansas-city-wheat-pit-trade-ends-157-year-run-in-move-to-chicago.html. The KCBT was established by local Kansas City merchants in 1856 as a means of trading grain and preventing abuses in the grain market; it primarily trades wheat futures and options contracts. CFTC, Trading Organizations—Designated Contract Markets (DCM), CFTC.GOV, http://sirt.cftc.gov/sirt/sirt.aspx?Topic=TradingOrganizations.

[88] CME Group at a Glance, CMEGROUP.COM, http://www.cmegroup.com/company/history.

[89] Clearing, CMEGROUP.COM, https://www.cmegroup.com/clearing.html.

[90] CME GRP., Rulebooks (2013), http://www.cmegroup.com/clearing.

[91] *See generally* Rule Enforcement Reviews of Designated Contract Markets, CFTC.GOV, https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmruleenf.html.

tory services to CME, CBOT, NYMEX and COMEX.[92] The Market Regulation Department serves as the primary enforcer for all of these exchanges; in this role, it investigates possible violations and determines whether to proceed with an enforcement action. The Market Regulation Department is comprised of various groups, each of which is entrusted to different specified tasks. These include: (i) an Investigations team,[93] which is responsible for trade practice surveillance and investigation; (ii) an Enforcement team,[94] which prosecutes disciplinary cases; (iii) a Data Investigations team,[95] which ensures audit trail integrity and compliance; and (iv) a Market Surveillance team,[96] which monitors trading and trading firms that use the CME's trading pits, as well as its worldwide electronic trading system, for potential trade practice abuses and other market concerns. As of its most recent enforcement review in 2017, the CFTC found that the Market Regulation Department had only 13 total enforcement attorneys, which it deemed sufficient based on the department's efficiency in reviewing cases.[97]

The CME subsidiaries all have a similar approach to enforcement of exchange rules;[98] twelve chapters of the NYMEX and COMEX rulebooks are exactly the same.[99] The primary enforcement arm of each CME subsidiary is its respective Business Conduct Committee (BCC). The BCC selects Hearing Panels to consider cases of alleged violations and any relevant appeals. The Hearing Panel has broad disciplinary authority, including the ability to fine, suspend, and expel members for their violations.[100]

b. CBOE Futures Exchange

The Chicago Board Options Exchange, Inc. (CBOE) is an SEC-regulated exchange on which a wide variety of options contracts are traded. The CBOE Futures Exchange (CFE) is a subsidiary of the CBOE and operates as its futures trading facility.[101] The CFE is a Designated Contract Market on which a series of Volatility Index futures linked to various exchanges, oil, and real estate are traded.[102] The CFTC regulates the CFE pursuant to its authority under the CEA.[103] As an independent SRO, the CFE has the authority to enforce its rules with respect to its members through fines, suspensions, expulsions, or other disciplinary measures.[104]

The CFE investigates possible rule violations upon request by the CFTC or various internal committees, and also upon the discovery or receipt of information relating to a potential violation.[105] The CBOE's Regulatory Services Group is responsible for all of the CBOE's surveillance, examination, and investigative functions, which it performs through its various departments.[106] Additionally, any person can make oral or written complaints alleging violations or injury. If charges are brought, a hearing takes place before a panel of the CBOE's Business Conduct Committee.[107] The number of enforcement actions by the CFE has been inconsistent in recent years: after publishing three disciplinary decisions in 2012 and two in 2013, the CFE published seven disciplinary decisions in 2014, nineteen in 2015, nine in 2016, seven in 2017, four in 2018, nine in 2019, seven in 2020, two in 2021, and four in 2022.[108]

c. Intercontinental Exchange, Inc.

For proof of the growing importance and power of futures markets, one need look no further than the Intercontinental Exchange (ICE). The ICE was launched in 2000 and, by 2013, had achieved such success that it was able to purchase America's oldest exchange—the New York Stock Exchange

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[92] *See generally* Market Regulation, CMEGROUP.COM, https://www.cmegroup.com/market-regulation.html.

[93] *See generally* Investigations, CMEGROUP.COM, https://www.cmegroup.com/market-regulation/investigations.html.

[94] *See generally* Market Regulation Enforcement, CMEGROUP.COM, https://www.cmegroup.com/market-regulation/enforcement.html.

[95] *See generally* Data Investigations, CMEGROUP.COM, https://www.cmegroup.com/market-regulation/data-investigations.html.

[96] *See generally* Market Surveillance, CMEGROUP.COM, https://www.cmegroup.com/market-regulation/market-surveillance.html.

[97] CFTC, Rule Enforcement Review of the Chicago Board of Trade and the CBOT, CME, COMEX, and NYMEX at 9–10 (Nov. 30, 2017), https://www.cftc.gov/sites/default/files/idc/groups/public/@iodcms/documents/file/rercmegroupdisciplinary113017.pdf (noting that there were appropriate factors for those cases that were delayed); *cf.* CFTC, Rule Enforcement Review of the CBOT, CME, COMEX, and NYMEX, at 7-9 (Nov. 21, 2014), https://www.cftc.gov/sites/default/files/idc/groups/public/@iodcms/documents/file/rerdisciplinaryprogram112114.pdf (noting that the 13 attorney enforcement staff was insufficient based on the inefficiency in reviewing cases due to staff delay).

[98] *See* Exchange-Specific Rules for CME, CBOT, NYMEX, and COMEX, CMEGROUP.COM, https://www.cmegroup.com/market-regulation/rulebook.html (''To provide a common regulatory framework for market users, the rulebooks have been substantially harmonized, making the rules parallel in structure, numbering, and language where possible.''). The description of enforcement proceedings is generally applicable to all CME Group, Inc. subsidiaries. There are, however, some notable technical and substantive differences between such subsidiaries, in terms of membership categories and requirements; fees; broker associations; block trades; pre-execution communications; all-or-none trades; trading at settlement; dual trading/top step restrictions; and delivery rules. As such, the various rulebooks should be consulted for any questions regarding a specific subsidiary. *Compare* CME Rules 400–44; *with* CBOT Rules 400–44; *and* Joint NYMEX and COMEX Rules 400–44.

[99] *See NYMEX Rulebook*, CMEGROUP.COM, https://www.cmegroup.com/rulebook/NYMEX (listing ''Joint NYMEX AND COMEX Chapters'').

[100] *See, e.g.*, CME Rule 402.B.

[101] *See generally* CBOE Futures Exchange, CBOE.COM, https://www.cboe.com/us/futures/overview.

[102] *Id.*

[103] *See* CFTC, Trading Organizations—Designated Contract Markets (DCM), CFTC.GOV, http://sirt.cftc.gov/sirt/sirt.aspx?Topic=TradingOrganizations.

[104] CFE Rule 711 (a) (Apr. 8, 2021).

[105] *Id.* at 702.

[106] The CBOE's Regulatory Group performs regulatory functions for all of its subsidiaries, including the CFE. *See* CBOE, CBOE Holdings, Inc., and Subsidiaries, Regulatory Independence Policy for Regulatory Group Personnel at 1 (Mar. 23, 2021), https://cdn.cboe.com/resources/regulation/Regulatory_Independence_Policy_For_Regulatory_Group_Personnel.pdf.

[107] CFE Rule 706.

[108] *Cboe Futures Exchanges Disciplinary Actions*, CBOE.COM, https://www.cboe.com/us/futures/regulation/disciplinary_actions/cfe.

(NYSE)—for $8.2 billion.[109] The deal was formally approved by the European Commission on June 24, 2013.[110]

The ICE is a for-profit, publicly traded company that also owns several futures exchanges, including ICE Futures U.S. and ICE Futures Europe.[111] ICE Futures U.S. facilitates trading of agricultural, energy, foreign exchange and equity index futures and options[112] and serves as the second largest futures exchange in the U.S.[113] Notably, ICE Futures U.S. is home to the U.S. Dollar Index.[114] ICE Futures U.S. is regulated by the CFTC pursuant to its authority under the CEA.[115]

The ICE Futures U.S. Market Regulation Department, supervised by the Regulatory Oversight Committee, investigates and prosecutes violations of ICE's rules.[116] The Compliance staff conducts investigations of possible violations and then determines whether to prosecute the alleged violation before a Business Conduct Committee (BCC) hearing panel.[117] The BCC operates via sub-panels that generally consist of seven individuals, four of whom are exchange members or member firm employees, and three of whom are non-members.[118] As of 2016, the Market Regulation Department consisted of only 16 staff members, including the Vice President of Market Regulation, the Chief Compliance Officer, an Assistant General Counsel, a Compliance Systems Manager, two Compliance Managers, several Investigators, and other administrative staff.[119] Against this backdrop, it is perhaps not surprising that, in its most recent enforcement review, the CFTC noted that the average length of time that a case remained open was an average of 461 days.[120]

d. Minneapolis Grain Exchange

The Minneapolis Grain Exchange (MGEX) was established by the Minneapolis Chamber of Commerce in 1881 as an organization designed to promote trade in grains and to prevent abuses in the grain market.[121] The primary contracts traded on the MGEX are agriculture-based futures and options.[122] MGEX's Board of Directors delegates enforcement of Exchange rules to a Disciplinary Committee consisting of five members.[123] The Disciplinary Committee is responsible for preventing price manipulation or the cornering of any commodity, as well as investigating alleged violations of MGEX Rules and Regulations.[124] Prior to October 2012, MGEX's disciplinary committee operated in two parts: the Futures Trading Conduct Committee (FTCC) and the Business Conduct Committee. The FTCC had jurisdiction over all matters related to futures and options trading, while the BCC had jurisdiction over all other potential violations, such as registration issues and margins. The FTCC and BCC subsequently were combined into a single disciplinary committee that now maintains jurisdiction over all disciplinary matters.[125]

D. Membership Organizations

In addition to exchange and board of trade SROs, the commodities and futures enforcement regime in the U.S. also

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[109] Foo Yun Chee, *ICE to Win EU Approval For $8.2 Billion NYSE Bid*, REUTERS (June 17, 2013).

[110] Ethan Bilby, *EU Clears ICE's $8.2 Billion Takeover of NYSE Euronext Without Conditions*, REUTERS (June 24, 2013), https://www.reuters.com/article/us-nyse-ice-eu/eu-clears-ices-8-2-billion-takeover-of-nyse-euronext-without-conditions-idUSBRE95N0Q120130624.

[111] In addition to futures exchanges, the ICE owns cash exchanges, OTC markets, and central clearing houses. *See* Exchanges, THEICE.COM, https://www.theice.com/about/exchanges-clearing.

[112] Ice Futures U.S., THEICE.COM. ICE Futures U.S. was known as the New York Board of Trade (NYBOT) before its purchase by the Intercontinental Exchange in 2007. NYBOT was formed in 1998 with the merger of the Coffee Sugar and Cocoa Exchange (CSCE) and the New York Cotton Exchange (NYCE). The contract market designations of CSCE and NYCE were extinguished and transferred to NYBOT in June of 2004. Trading Organizations—Designated Contract Markets (DCM), CFTC.GOV, http://sirt.cftc.gov/sirt/sirt.aspx?Topic=TradingOrganizations.

[113] *See* FIA, ANNUAL REVIEW OF 2022 ETD TRADING TRENDS, at 12 (Feb. 2, 2020), https://www.fia.org/sites/default/files/2023-02/2022%20Annual%20Review%20ETD%20Trading%20Trends_updated%20v2%5B15%5D_0.pdf.

[114] *See US Dollar Index Futures*, THEICE.COM.

[115] 7 U.S.C. § § 7–8(a).

[116] *See generally* ICE Futures U.S.: Regulation, THEICE.COM, https://www.theice.com/futures-us/regulation; ICE Futures U.S., *ICE Futures U.S. Regulatory Oversight Committee* (2018), https://www.theice.com/publicdocs/futures_us/ICE_Futures_US_Regulatory_Committee.pdf; ICE Futures U.S. Disciplinary Rules, Rule 21.01(a); CFTC, ICE Futures U.S. Trade Practice Rule Enforcement Review, at 2-4 (Dec. 2, 2016), https://www.cftc.gov/sites/default/files/idc/groups/public/@iodcms/documents/file/rericefutures120216.pdf.

[117] ICE Futures U.S. Rule 21.13. If the Hearing Panel finds the Respondent guilty of any rule violation charged, it issues a written decision, including any sanctions, and the respondent on whom sanctions are levied may appeal the decision to an appeals committee whose decision is final. For more detail on the intricacies of ICE enforcement, *see* ICE Futures U.S. Rule 21.00-42.

[118] CFTC, ICE FUTURES U.S. RULE ENFORCEMENT REVIEW (Dec. 2, 2016).

[119] The CFTC reviews various SROs on a rolling basis. The most recent rules enforcement review of ICE Futures U.S. took place in 2016 and covered the period from March 1, 2014 through February 28, 2015. CFTC, Rule Enforcement Review of ICE Futures U.S., at 10, 20 (Dec. 2, 2016), https://www.cftc.gov/sites/default/files/idc/groups/public/@iodcms/documents/file/rericefutures120216.pdf.

[120] *Id*. at 20.

[121] *Trading Organizations—Designated Contract Markets (DCM)*, CFTC.GOV, http://sirt.cftc.gov/sirt/sirt.aspx?Topic=TradingOrganizations. In 1947, it became the MGEX and subsequently MGEX, Inc., upon its merger with and into the latter entity, on Sept. 20, 2010.

[122] About MGEX: Our History, MGEX.COM, http://www.mgex.com/about.html. All MGEX, Inc. transactions are cleared by one of its 12 ''clearing members''; each of these members is required to make a security deposit of $500,000, of which at least $100,000 must be cash, and meet CFTC minimum financial requirements. MGEX Clearing Members, MGEX.COM, http://www.mgex.com/clearing_firms.html.

[123] Enforcement pertaining to conduct or activity related to the Exchange Room itself is carried out by the Exchange Room Enforcement Committee. MGEX Rules 255.00, 264.00, 266.00 (June 15, 2017).

[124] *Id.* at Rule 264.00.

[125] CFTC, Rule Enforcement Review of the Minneapolis Grain Exchange, at 51 (Sept. 6, 2013), http://www.cftc.gov/ucm/groups/public/@iodcms/documents/file/rermgex090613.pdf; *see also* CFTC, Rule Enforcement Review of the Minneapolis Grain Exchange (June 5, 2015), https://www.cftc.gov/idc/groups/public/@iodcms/documents/file/rerngexmineapolis060515.pdf (most recent review).

relies on the National Futures Association (NFA), a membership organization that assists with the regulation of futures markets. The CFTC granted the NFA its designation as a ''registered futures association'' in September 1981, and the NFA began operations in October 1982.[126] The NFA's primary regulatory activities are establishing and enforcing rules and standards for customer protection; auditing and performing surveillance of members to enforce compliance with NFA requirements; providing arbitration for futures- and foreign exchange-related disputes; and screening to determine fitness for becoming or remaining an NFA member.[127] The NFA also performs registration functions for exchange members[128] pursuant to authority granted under § 17 of the CEA.[129]

The NFA is managed by a board of 32 elected directors, 22 of whom represent various member entities, with several seats allocated to each entity type, and 10 of whom are public directors.[130] The board makes all decisions about bylaws, budgets, funding, plans, and priorities of the NFA.[131] An Executive Committee is comprised of the Chairman of the Board, 13 directors, and an ex officio, non-voting member president.[132] The NFA regulates its members by screening, imposing financial requirements and ethical standards, and conducting disciplinary and arbitration proceedings.[133] In fiscal year 2021, the NFA's Business Conduct Committee issued 17 complaints against 26 respondents; in the same time period, the NFA's disciplinary panels issued 26 decisions ordering a total of 15 expulsions and seven suspensions, also collecting $1.5 million in fines.[134] NFA investigations involved collaboration with the CFTC and other regulators.[135] With the addition of the duty to register and monitor swap dealers and participants imposed by Dodd-Frank, the NFA's Board of Directors approved a budget increase of 18 percent for fiscal year 2014, for a total of $74 million, and anticipated that the NFA would add about 100 new employees to its staff.[136] By fiscal year 2022, NFA's budget had increased to over $113 million, primarily to accommodate this increase in staff, with revenues coming largely from membership dues as membership has grown.[137] This reflects that a significant number of financial entities, previously familiar only with SEC audit practices, are now registered with and subject to the requirements of the NFA.

E. Federal Regulators

Practitioners should also be aware of the overlapping jurisdiction between the CFTC and other federal regulators like the Federal Energy Regulatory Commission (FERC) and the Federal Trade Commission (FTC).

The Federal Energy Regulatory Commission is an agency within the U.S. Department of Energy.[138] FERC's authority and responsibilities have increased considerably over time through the passage of legislation.[139] Of particular significance for futures market participants, the Energy Policy Act of 2005 significantly expanded FERC's authority to regulate manipulation in energy markets.[140] Because the CEA grants the CFTC exclusive jurisdiction over transactions conducted on futures markets—which include energy futures traded on NYMEX, a CFTC-regulated exchange—the contours of FERC's authority in relation to the CFTC are not always entirely clear. In consequence, there have been instances where the two agencies have brought enforcement actions against the same entity for the same conduct.

In one well-known example, both the CFTC and FERC pursued enforcement actions against the hedge fund Amaranth Advisors, LLC and two of its employees for the same conduct—manipulating natural gas futures traded on NYMEX.[141] After Amaranth trader Brian Hunter was fined $30 million in a

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[126] The NFA was established in 1976 to become a futures industry self-regulatory organization under Section 17 of the Commodity Exchange Act, but it was not fully established until 1981. About NFA, NFA.FUTURES.ORG, https://www.nfa.futures.org/about/index.html.

[127] *Id.*

[128] This function was previously performed by the CFTC.

[129] *See generally* NFA RULEBOOK, https://www.nfa.futures.org/rulebook/rules.aspx (last accessed Feb. 22, 2023); 7 U.S.C. § 21. NFA's programs extend to all Futures Commission Merchants (FCMs), Introducing Brokers (IBs), Commodity Trading Advisors (CTAs), Commodity Pool Operators (CPOs), and Retail Foreign Exchange Dealers (RFEDs). *See* NFA Members, NFA.FUTURES.ORG, https://www.nfa.futures.org/members/index.html. Additionally, under NFA Bylaw 1101 and 17 C.F.R. § 170.15, membership is mandatory in NFA for any FCM, IB, CTA and CPO that transacts futures business with the public. It is important to recognize that, since NFA membership is mandatory for any FCM, RFED, IB, CTA, and CPO that transacts foreign exchange transactions with the public, an enforcement action which leads to suspension or loss of membership can have serious ramifications.

[130] *See* Board of Directors, NFA.FUTURES.ORG; and NFA RULEBOOK Art. VII.

[131] NFA Rulebook, https://www.nfa.futures.org/rulebook/rules.aspx (last accessed Feb. 22, 2023).

[132] Executive Committee, NFA.FUTURES.ORG, https://www.nfa.futures.org/about/committees/executive-committee.html.

[133] *See generally* About NFA, NFA.FUTURES.ORG, https://www.nfa.futures.org/about/index.html.

[134] NFA, 2021 Annual Review at 5 (Nov. 8, 2021), https://www.nfa.futures.org/about/annual-reviews-files/2021_AnnualReview.pdf.

[135] *Id.*

[136] NFA's board approves expanded Fiscal Year 2014 Budget, NFA.FUTURES.ORG (June 6, 2013).

[137] NFA, 2022 Annual Review, at 25 (Nov. 3, 2022), https://www.nfa.futures.org/about/annual-reviews-files/2022-annual-review.pdf.

[138] 16 U.S.C. § § 791a, et seq.; *see also*, FERC.GOV, https://www.ferc.gov/.

[139] *See generally* Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005); *see also*, FERC.GOV, https://www.ferc.gov/.

[140] The Energy Policy Act, which amended § 4A of the Natural Gas Act, and makes it—

> ''unlawful for any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas or the purchase of sale of transportation services subject to the jurisdiction of the Commission, any manipulative or deceptive device of contrivance . . . in contravention of such rules and regulations as the Commission may prescribe as necessary in the public interest or for the protection of natural gas ratepayers.''

15 U.S.C. § 717c-1. FERC subsequently promulgated regulations prohibiting manipulative trading in natural gas. *See* 18 C.F.R. § 1c.1.

[141] *See* Associated Press, *Energy Regulator Seeks $291 Million from Traders and Failed Fund*, N.Y. TIMES July 27, 2007), https://archive.nytimes.com/dealbook.nytimes.com/2007/07/27/regulator-seeks-291-million-from-amaranth. The CFTC filed a civil enforce-

FERC administrative proceeding, he challenged FERC's jurisdiction in federal court, on the grounds that the CFTC has exclusive jurisdiction over all transactions involving commodity futures contracts. The CFTC intervened in the suit in support of Hunter on this issue. In a closely watched decision, the D.C. Circuit agreed with Hunter that ''manipulation of natural gas futures contracts falls within the CFTC's exclusive jurisdiction.''[142] Specifically, the Court concluded that the CFTC has oversight of the natural gas futures markets while FERC has oversight of the natural gas cash markets. Although the full implications of the Court's ruling will be determined only with the passage of time, it has certainly clarified some of the jurisdictional disputes between the CFTC and FERC.[143]

Similar issues of jurisdictional overlap arise for the Federal Trade Commission (FTC), an independent federal consumer protection agency whose mandate intersects with that of both the CFTC and FERC.[144] For example, both the FTC and CFTC pursued actions against American Precious Metals, LLC for running a bogus investment scheme, wherein clients were tricked into buying, on credit, high-fee and risky investments.[145] Although the CFTC's action was dismissed in late 2011 for want of regulatory jurisdiction, the district court opinion does not discuss the respective scope of each agency's authority, and the possibility remains that futures market participants may be subject to the authority of multiple regulators.[146]

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ment action against Amaranth employee Brian Hunter on July 25, 2007; FERC filed an administrative enforcement action against him the very next day.

[142] Hunter v. FERC, 711 F.3d 155, 156 (D.C. Cir. 2013); *but see FERC v. Barclays Bank PLC*, 105 F. Supp. 3d 1121 (E.D. Cal. 2015), *as amended* (May 22, 2015) (holding that the CFTC did not have exclusive jurisdiction to assess penalties against electricity traders who used swap contracts on a commercial market exempt from CFTC's exclusive jurisdiction).

[143] On Apr. 29, 2013, Sen. Dianne Feinstein, chairwoman of the Energy and Water Development Appropriations Subcommittee, and Sens. Ron Wyden and Lisa Murkowski, chairman and ranking member of the Committee on Energy and Natural Resources, sent a letter to the CFTC and FERC urging a quick resolution to remaining jurisdictional disputes that have hampered more rigorous oversight of U.S. energy markets. Specifically, these Senators encouraged the CFTC and FERC to execute more robust Memorandums of Understanding (MOUs) to ''ensure complete integration of data and other information used to monitor and investigate natural gas and energy market trading'' so that market manipulators cannot ''exploit gaps in regulatory oversight'' caused by a lack of cooperation between the agencies. See Press Release, Sen. Dianne Feinstein, Feinstein to CFTC, FERC: Resolve Disputes on Energy Market Oversight (Apr. 29, 2013), https://www.feinstein.senate.gov/public/index.cfm/press-releases?ContentRecord_id=6b7a01ee-2a5e-4354-9078-db52714c4f54. On Jan. 2, 2014, the two agencies entered into an MOU ''to establish procedures for: (1) applying the Participating Agencies' respective authorities in a manner so as to ensure effective and efficient regulation in the public interest; (2) resolving conflicts concerning overlapping jurisdiction between the Participating Agencies; and (3) avoiding, to the extent possible, conflicting or duplicative regulation.'' CFTC, FERC and the CFTC (Jan. 2, 2014), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcfercjmou2014.pdf. This MOU replaced a previous information sharing agreement that had been in place between the CFTC and FERC since 2005. Press Release, CFTC, FERC, CFTC Sign MOUs on Jurisdiction and Information Sharing (Jan. 2, 2014), https://www.cftc.gov/PressRoom/PressReleases/6816-14.

[144] Pursuant to the Energy Independence and Security Act of 2007, the FTC has the authority to police market manipulation and false reporting in the petroleum industry. One notable difference between the FTC's authority and that of the CFTC and FERC is that the FTC is limited to investigating false reporting to the government, whereas the CFTC and FERC can investigate false reporting even to private bodies.

[145] Complaint, *CFTC v. Am. Precious Metals, LLC*, No. 0:11-cv-61072-WJZ (S.D. Fla. May 10, 2011).

[146] *CFTC v. Am. Precious Metals, LLC*, 845 F.Supp.2d 1279 (S.D. Fla. 2011). The FTC case settled in 2012. Stipulated Final Judgment, FTC v. Am. Precious Metals, LLC, No. 0:11-cv-61072-RNS (Nov. 19, 2012).

IV.
CFTC Enforcement Actions

A. Overview

The CFTC's Division of Enforcement (Enforcement) is tasked with investigating and prosecuting violations of the Commodity Exchange Act (CEA)[1] and the rules and regulations promulgated thereunder. The enforcement process has several steps: (i) the generation of leads regarding potential violations; (ii) the investigation process; (iii) the Commission's so-called ''Wells Process;'' (iv) administrative proceedings and sanctions; and (v) appeals. Each stage in the enforcement process represents an escalation from the previous stage, and occurs with less frequency than those preceding it.

This chapter describes these steps of the CFTC enforcement process.

B. Referral of Potential Violations

Enforcement has broad authority under the CEA to investigate suspicious market activity or potential violations of the federal commodities laws, CFTC regulations, and self-regulatory organization (SRO) rules.[2] The Commission initiates investigations on the basis of internal and external referrals concerning potential violations of the rules and regulations governing commodities trading. Referrals or leads may come from a variety of sources, such as (i) Enforcement itself; (ii) other divisions within the CFTC; (iii) the Bank Secrecy Act information, including Suspicious Activity Reports, (iv) SROs; (v) individual complainants; (vi) Congress; (vii) federal or state government authorities; and (viii) whistleblowers.

1. Referrals from within Enforcement

Staff attorneys within Enforcement have the authority to initiate investigations based on their own suspicions of wrongdoing. For example, a staff attorney may determine that certain events mentioned in a newspaper article are worth examining, and accordingly may exercise his or her prerogative to open an investigation.

2. Referrals from other CFTC divisions

The Division of Market Oversight, the Division of Clearing and Risk, and the Market Participants Division (together, the Oversight Divisions) share responsibility for market and trade practice surveillance. Pursuant to this role, the Oversight Divisions monitor general market trends and areas of activity that may be susceptible to manipulation, as well as the trade practices and positions of individual market participants. This monitoring frequently generates leads on potential violations, and it is therefore unsurprising that the Oversight Divisions are the primary source of internal referrals to Enforcement.

To fulfill their responsibilities, the Oversight Divisions rely on two primary information-gathering programs: (i) the market surveillance program; and (ii) the large trader reporting program. The goal of the market surveillance program is ''to identify situations that could pose a threat of manipulation and to initiate appropriate preventive actions.''[3] To achieve this goal, CFTC staff collect and review information from a variety of both publically available and proprietary sources, all of which they aggregate and analyze to evaluate market trends and developments. Publicly available sources include ''data on the overall supply, demand, and marketing of the underlying commodity; futures, option, and cash prices; and trading volume and open interest data.''[4] Proprietary sources include ''highly confidential'' information provided by exchanges, intermediaries, large traders, and others.[5] For example, exchanges must ''report daily positions and transactions of each clearing member to the Commission'' so that the ''the aggregate position and trading volume of each clearing member in each futures and option contract'' may be tracked.[6] A group of specialized surveillance economists compiles the data collected through the market surveillance program into weekly summary reports, which are reviewed by regional supervisors for potential violations or market anomalies.

The Commission relies on its large trader reporting program to comprehensively and systematically collect information on market participants from exchanges, clearing members, futures commission merchants, foreign brokers and traders who hold positions at or above specific reporting levels set by the Commission.[7] This information includes daily market data and position information for individual market participants as well as daily trading data for clearing members. Aggregate data are published by the CFTC in its weekly Commitments of Traders (COT) reports ''to help the public understand market dynamics.''[8] To ensure the accuracy of the data it receives, the CFTC staff compares the information provided by clearing members with that provided by the exchanges and seeks clarification from one or both parties when the reported positions differ.

3 Leads from the Bank Secrecy Act

The Division of Enforcement FY2020 Annual Report notes that ''[Bank Secrecy Act (''BSA'')] information can provide valuable leads in investigations.''[9] The BSA ''is designed to prevent, detect, and prosecute international money launder-

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[1] 7 U.S.C. § 1 et seq.

[2] *See* 7 U.S.C. § 12 (codifying § 8 of the Commodity Exchange Act (CEA) and noting that the CFTC has the authority to ''make such investigations as it deems necessary'' to assess compliance with federal commodities laws and regulations). According to CFTC regulations:

> ''The Director of the Division of Enforcement and members of the Commission staff acting pursuant to his authority and under his direction may conduct such investigations as he deems appropriate to determine whether any persons have violated, are violating, or are about to violate [the CEA and regulations thereunder] or whether an applicant for registration or designation meets the requisite statutory criteria.''

17 C.F.R. § 11.2.

[3] CFTC Market Surveillance Program, CFTC.GOV.

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *See generally* 17 C.F.R. § § 15–19, 21 (setting forth the requirements of the large trader reporting program); Large Trader Reporting Program, CFTC.GOV.

[8] *Id. See also* CFTC Commitments of Traders, CFTC.GOV.

[9] CFTC, CFTC Division of Enforcement Manual, at 7 (May 20,

ing and the financing of terrorism.''[10] Registrants are required to establish anti-money laundering (''AML'') programs, file Suspicious Activity Reports (''SARs''), verify the identity of customers, and perform enhanced due diligence to specific accounts that involve foreign persons.[11]

4. Referrals from SROs

SROs maintain the most direct contact with market participants and are often the first to detect potential misconduct. Although SROs are themselves required to investigate potential rule violations—and to initiate their own enforcement actions as necessary—they are also encouraged to share information directly with the CFTC. To this end, the Commission conducts periodic meetings with each of the various SROs under its jurisdiction to discuss market oversight activities, share surveillance data, and identify possible leads. As a general matter, SROs are given the first opportunity to resolve potential violations by their members.[12] However, in certain circumstances, the Commission may intervene in, or take over, the SRO's enforcement process. For example, the Commission may become involved in the enforcement process where it determines that an SRO is not taking appropriate action in response to a potential violation of the CEA, where the alleged misconduct occurs across exchanges, or where the conduct at issue is particularly egregious or implicates one of the Commission's enforcement priorities. It has historically been rare for both the exchange and the Commission to bring parallel enforcement proceedings arising from the same misconduct. Notwithstanding recent signals by the Commission suggesting that it will strive to further reduce such overlaps, however, this sort of double-dipping has increased in recent years.[13]

5. Referrals from individual complainants

The CFTC maintains a grievance procedure, through which any individual may submit directly to the Commission a written complaint concerning a market participant. Complainants can choose to remain anonymous. To ensure the integrity of the referral process, the CEA criminalizes the knowing provision of untruthful information.[14]

6. Referrals from Congress

The CFTC may receive information and complaints from members of Congress on behalf of their constituents, providing leads or information in connection with an ongoing investigation or litigation.[15]

7. Referrals from government agencies

Referrals regarding possible violations of the CEA or CFTC regulations frequently originate from state and federal authorities such as state attorneys general, the SEC, or the Department of Justice. These agencies often uncover relevant information in the course of their own investigations; when the focus of such investigations is unrelated or incidental to misconduct in the commodity futures sector, the agencies will simply refer the matter to the CFTC. However, in cases where

2020).

[10] *Id.*

[11] *Id.*

[12] The SRO enforcement process is discussed in 262 SPS § V, *Other Regulatory Enforcement Actions*.

[13] Fromer Chairman Giancarlo said that, ''where appropriate, the CFTC should look to delegate responsibility to the National Futures Association and other SROs for certain compliance matters.'' Testimony of J. Christopher Giancarlo Acting-Chairman, Commodity Futures Trading Commission before the U.S. House of Representatives Committee on Appropriations Subcommittee on Agriculture, Rural Development and Related Agencies, Prepared Remarks (June 8, 2017); see also Remarks of Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL Remarks, CFTC: A New Direction Forward (Mar. 15, 2017) (''[T]he CFTC should look to delegate responsibility to the National Futures Association, the exchanges and the other [SROs] in matters where SROs are able to act effectively.''). Moreover, the Commission has pushed SROs to implement rule changes that would expand their authority over manipulation and fraud claims, suggesting that the CFTC is seeking to offset some of its enforcement responsibility onto SROs.

For examples where the CFTC and SROs have pursued enforcement actions in conjunction, *see, e.g.*, Press Release, CFTC, CFTC Orders New York Trader Simon Posen to Pay a $635,000 Civil Monetary Penalty and Permanently Bans Him from Trading in CFTC-Regulated Markets for Spoofing in the Gold, Silver, Copper, and Crude Oil Futures Markets (July 26, 2017) (NYMEX Action: NYMEX, Simon Posen, Notice of Disciplinary Action, NYMEX 13-9258-BC (June 18, 2015)); https://cftc.gov/PressRoom/PressReleases/7594-17 Press Release, CFTC, CFTC Orders Rosenthal Collins Capital Markets LLC, Now Known as DV Trading LLC, to Pay a Civil Penalty of $5 Million for Engaging in Illegal Wash Sales Designed to Generate Exchange Rebate Fees (June 29, 2017) (CME Action: and CME, Rosenthal Collins Capital Markets LLC (now doing business as DV Trading LLC), Notice of Disciplinary Action, CME-12-9575-BC (July 28, 2017)); , https://www.cftc.gov/PressRoom/PressReleases/7582-17 Press Release, CFTC, Federal Court in New York Imposes Permanent Registration and Trading Bans against Defendants Gary Creagh and His Company, Wall Street Pirate Management, LLC, and Orders Them to Pay a $125,000 Civil Monetary Penalty (June 26, 2017) https://www.cftc.gov/PressRoom/PressReleases/7577-17; Press Release, CFTC, CFTC Orders Former Citigroup Global Markets Inc. Traders Stephen Gola and Jonathan Brims to Pay $350,000 and $200,000, Respectively, and Bans Them from Trading for 6 Months for Spoofing in U.S. Treasury Futures Markets (March 30, 2017) (CBOT Actions: CBOT, Stephen Gola, Notice of Disciplinary Action, CBOT 12-8860-BC (Jan. 22, 2015); https://www.cftc.gov/PressRoom/PressReleases/7542-17 CBOT, Jonathan Brims, Notice of Disciplinary Action, CBOT 12-8860-BC-1 (Jan. 22, 2015). . Most recently, the CFTC Division of Enforcement Manual identified NFAs as one of the most significant sources of leads for the Division of Enforcement, among other sources. CFTC, CFTC Division of Enforcement Manual, at 7–8 (May 20, 2020). The Report also provides that, ''[a]t times, the SRO and the Division may engage in parallel investigations and disciplinary/enforcement actions.'' Id. at 8.

[14] Section 26(m) states:

> ''A whistleblower who knowingly and willfully makes any false, fictitious, or fraudulent statement or representation, or who makes or uses any false writing or document knowing the same to contain any false, fictitious, or fraudulent statement or entry, shall not be entitled to an award under this section and shall be subject to prosecution[.]''

7 U.S.C. § 26(m).

[15] CFTC, CFTC Division of Enforcement Manual, at 7 (May 20, 2020).

another agency has an interest in pursuing violations over which the CFTC has jurisdiction, the agencies may work together to build a case.[16] Less frequently, the CFTC may also receive referrals from foreign governments or SROs. When the Division of Enforcement receives a referral or information from foreign governmental agencies, Staff work closely with the Office of Chief Counsel (''OCC'').[17]

8. Referrals through the whistleblower program

On August 4, 2011, in response to directives issued in § 748 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank),[18] the CFTC approved and adopted final rules implementing a whistleblower program.[19] These rules are intended to encourage more robust reporting of possible misconduct in the commodity futures markets by providing protection and substantial financial awards—namely, 10 to 30 percent of the total monetary sanctions recovered[20]—for individuals who voluntarily provide critical information leading to successful prosecutions under the CEA.[21] Although the CFTC encourages whistleblowers to first report possible violations through internal compliance systems, it also accepts and investigates any information it receives directly.[22]

The number of whistleblower tips has steadily increased over time. In its first (fiscal) year of operation, the Whistleblower Office received 58 tips; the following year, the number jumped to 138.[23] In fiscal year 2016, the Office received 273

[16] A recent example of cooperation between the CFTC and domestic entities is its investigation into Thomas C. Lindstrom for engaging in fraud in connection with his options trading of Treasury note futures, which involved extensive cooperation with the U.S. Federal Bureau of Investigation and the U.S. Attorney's Office for the Northern District of Illinois. *See* Press Release, Federal Court in Chicago Enters $14 Million Judgment against Options Trader for Fraudulent Options Scheme (Oct. 11, 2018). Another example of cooperation between the CFTC and domestic and international entities is its investigation into Jon Corzine and MF Global's misuse of customer funds, which involved extensive cooperation with the U.K. Financial Conduct Authority (''FCA''). *See* Press Release, CFTC, Federal Court in New York Orders Jon S. Corzine to Pay $5 Million Penalty for his Role in MF Global's Unlawful Use of Nearly $1 Billion of Customer Funds and Prohibits Corzine from Registering with the CFTC in any Capacity or Associating with an FCM (Jan. 5, 2017). In addition, the Commission and the UK FCA recently signed a Memorandum of Understanding on cooperation and information exchange regarding regulated firms that operate in both the United States and the United Kingdom. *See* Press Release, CFTC, CFTC Signs MOU with UK Financial Conduct Authority to Enhance Supervision of Cross-Border Regulated Firms (Oct. 6, 2016)

[17] CFTC, CFTC Division of Enforcement Manual, at 9 (May 20, 2020), https://www.cftc.gov/PressRoom/PressReleases/8323-20.

[18] Pub. L. No. 111-203, 124 Stat. 1376, 1739 (2010).

[19] CFTC Whistleblower Incentives & Protection Final Rule, 76 Fed. Reg. 53,172 (Aug. 4, 2011). These rules are codified in the newly-added § 23 of the CEA, and apply only to information provided to the CFTC after the implementation of Dodd-Frank on July 21, 2010. 17 C.F.R. § 165.2(k)(5).

The SEC also implemented a whistleblower program in response to Dodd-Frank; this program went into effect on May 25, 2011. *See* SEC Rules Implementing the Whistleblower Provisions of Section 21F of Securities Exchange Act of 1934, SEC Release No. 34-64545, 76 Fed. Reg. 34,300 (May 25, 2011).

[20] The CFTC maintains full discretion to decide the amount of the award pursuant to the procedures set forth in 17 C.F.R. § 165.15. In determining the amount of the award, the Commission will consider, among other things, (i) the extent to which the information contributed to a successful judicial or administrative action; (ii) the ″degree of assistance″ offered by the whistleblower or his or her legal representative in a judicial or administrative action; (iii) the value of the information to the Commission's law enforcement interests; (iv) ″whether the award otherwise enhances the Commission's ability to enforce the [CEA], protect customers, and encourage the submission of high quality information from whistleblowers'' and (v) potential adverse incentives from oversize awards. *See* 17 C.F.R. § 165.9 (outlining the criteria for determining the amount of a whistleblower award).

[21] To recover under the Whistleblower Program, the whistleblower must provide information that leads to a successful enforcement action, in which fines of at least $1 million are collected. 7 U.S.C. § 26(1)(1); *see also* CFTC, CFTC Whistleblower Program & Customer Education Initiatives 2020 Annual Report (Oct. 2020).

[22] To this end, first, the Commission maintains a look-back provision, under which it treats a whistleblower's submission as ''original information''—thus ensuring that the whistleblower is eligible to collect a reward—even if the whistleblower has provided the same information to an internal compliance program, Congress, a state or another federal authority, or an SRO in the preceding 180-day period. 17 C.F.R. § 165.2(i)(3). This provision is more generous than its 120-day SEC counterpart, which extends only to information provided first to ''Congress, any other authority of the Federal government, a state Attorney General or securities regulatory authority, any self-regulatory organization, or the Public Company Accounting Oversight Board, or to an entity's internal whistleblower, legal, or compliance procedures.'' 17 C.F.R. § 240.21F-4(v)(C)(7). Second, under CFTC rules, the CFTC will attribute all of the information that a company provides following a whistleblower-initiated investigation to the whistleblower's tips—even information that the whistleblower did not originally report to the Commission—so long as the whistleblower reports its concerns internally at the same time or within 120 days prior to providing the same information to the Commission. 17 C.F.R. § 165.2(i)(3). The Commission's proposed whistleblower rules did not originally contain these provisions, and were subject to much industry backlash, due to concerns that individuals would be financially motivated to bypass entirely the internal compliance systems and report violations directly to the CFTC.

[23] *See* 76 Fed. Reg. 53,199 (Aug. 25, 2011); *see also* 17 C.F.R. § 165; Rachel Louise Ensign, *Q&A: Christopher Ehrman, Director, CFTC's Whistleblower Office*, WALL ST. J. BLOGS, RISK & COMPLIANCE J., Oct. 18, 2013. *Cf.* Press Release, SEC, SEC Announces Enforcement Results for FY 2013 (Dec. 17, 2013) (noting that the SEC received 3,238 whistleblower tips in fiscal year 2013). The vast majority of the tips received by the Commission have been focused on issues related to the commodities market and futures and derivatives as a whole, rather than to retail investors. *Id.* Specifically, the tips have involved, among other things, price manipulation, trade practice violations, foreign exchange fraud, Ponzi schemes, and the dissemination of false information. *Id.* Whistleblowers who provide original information leading to a judicial or administrative action that results in a recovery exceeding $1 million are eligible for cash rewards, ranging from 10 to 30 percent of the ultimate penalty applied for the violation. *See* 7 U.S.C. § 26. The Whistleblower Office has ultimate discretion to decide the exact amount of the award based on a number of factors, including the ''significance'' of the information, the level of assistance provided by the whistleblower, the ''programmatic interest'' of the Commission in deterring violations of the law, and any such additional relevant factors as the CFTC may establish by rule or regulation. *Id.*

tips.[24]The Office received 465, 760, 455, between 2017 and 2019, respectively, culminating in a record high of 1,030 tips in 2020.[25] On May 22, 2017, the CFTC unanimously approved amendments to the whistleblower rules that likely encouraged more whistleblowers to come forward. In fact, the Office received 760 tips during fiscal year 2018, marking a 60 percent increase from that of the previous year.[26] Moving forward, the new amendments may impact whether whistleblowers report their concerns internally before going to the CFTC.[27] Among other things, these amendments (i) strengthen whistleblower protections by allowing the CFTC or the whistleblower to bring an action against an employer for retaliation against the whistleblower; (ii) encourage increased reporting of possible violations by prohibiting employers from using confidentiality or other agreements to impede potential whistleblowers from communicating directly with CFTC staff; and (iii) expand certain eligibility requirements for whistleblowers.[28]

Comment: The Commission has undertaken a number of steps to strengthen its whistleblower program and catch up to the SEC. First, as part of its May 2017 rule amendments, the Commission implemented procedural changes to more closely align its program with that of the SEC. For example, the CFTC replaced its whistleblower determination panel with a claims review staff like that of the SEC. The Commission also gave overall responsibility for the whistleblower program to the Director of Enforcement, like the SEC does. Second, the CFTC has sought to increase public awareness of its program and launched a new website in January 2016 to make it easier for potential whistleblowers to submit tips. Third, the CFTC is finally garnering more in awards than the laying some money on the table so that whistleblower program's administrative expenses no longer exceed award amounts: at of the end of fiscal year 2018, it had issued five awards totaling more than $75 million.[29]

In recent years, the Whistleblower Program has expanded and, according to the FY 2020 Division of Enforcement Annual Report, ''the Division expects the whistleblower program to continue to grow.''[30] As of 2020, ''between 30 to 40% of the Division's ongoing investigations [ ] involve some whistleblower component.''[31] Indeed, in its FY 2022 Whistleblower Annual Report, the CFTC noted that it awarded a record-breaking award of nearly $200 million to a single whistleblower, and that total sanctions in all whistleblower-related enforcement actions had surpassed $3 billion.[32]

C. Investigations

1. Informal investigations

Enforcement may commence inquiries in response to internal or external referrals indicative of a potential violation, or as part of Enforcement's regular market surveillance activities. An enforcement inquiry generally begins as an ''informal investigation.'' An informal investigation effectively is a preliminary fact-finding mission, whereby Enforcement staff seek the voluntary production of information, documents, or testimony from relevant individuals and entities to determine whether an actionable violation is likely to have occurred. Although Enforcement does not have subpoena power at this stage, market participants nonetheless must be mindful that CFTC regulations subject futures commission merchants (FCMs) and other Commission registrants to various recordkeeping requirements. Significantly, any books or records so maintained must be furnished to the Commission at any time upon its request.[33] The CFTC's Legal Division (formerly known as the Office of General Counsel)[34] has stated that the failure to provide ''immediate and unreserved'' access to books and records is considered to be an ''extremely serious'' violation of the CEA. Specifically, a refusal to provide Enforcement with such access may lead to an administrative enforcement proceeding and significant financial penalties.[35]

Comment: Due to the routine nature of informal investigations, market participants should not be surprised to

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[24] CFTC , Annual Report on the Whistleblower Program and Customer Education Initiatives (Oct. 30, 2016) *Cf.* SEC, 2016 Annual Report to Congress on the Dodd-Frank Whistleblower Program (Nov. 15, 2016) (noting that the SEC received more than 4,200 tips from the whistleblower program in FY 2016.).

[25] CFTC, Whistleblower Program & Customer Education Initiatives 2020 Annual Report (Oct. 2020), https://whistleblower.gov/sites/whistleblower/files/2020-11/FY20 Report to Congress.pdf.

[26] CFTC, Annual Report on the Whistleblower Program and Customer Education Initiatives, at 4 (Oct. 2018); See also CFTC Staff, Annual Report on the Whistleblower Program and Customer Education Initiatives at 4 (Oct. 2017) (noting that the Office received 465 tips during fiscal year 2017).

[27] Fact Sheet, CFTC, Strengthening Anti-Retaliation Protections for Whistleblowers and Enhancing the Award Claims Review Process (May 22, 2017), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/wbruleamend_factsheet052217.pdf

[28] *Id.*; *see generally* Zachary Brez, Helen Gugel, and Caitlin Giaimo, *CFTC Whistleblower Reward Program Overcomes its Growing Pains*, Westlaw Journal Derivatives (Oct. 6, 2016).

[29] CFTC, Commodity Futures Trading Commission Agency Financial Report FY 2018, at 32 (Nov. 14, 2018) (reporting a total of $75.6 million dollars in whistleblower awards during fiscal year 2018).

[30] CFTC, CFTC Division of Enforcement Manual, at 10 (May 20, 2020).

[31] *Id.*

[32] CFTC Whistleblower Program & Customer Education Initiatives 2022 Annual Report (October 2022), at 3.

[33] Section 4g of the CEA requires registered FCMs, introducing brokers, floor brokers, and floor traders to maintain and keep open to inspection books and records pertaining to customer transactions and positions in commodities for future delivery on any exchange. *See* 7 U.S.C. § 6g. Pursuant to CFTC Regulation 1.31, books and records must be maintained for at least five years and must be readily accessible during the first two years of that five year period. 17 C.F.R. § 1.31. Enforcement staff may seek inspection without prior authorization of the Commission itself. 17 C.F.R. § 11.2.

Commission regulations do not expressly define the term ''books and records.'' However, CFTC Regulation 18.05 suggests that the Commission is entitled to ''*any* pertinent information concerning [a trader's reportable] positions, transactions, or activities in a form acceptable to the Commission.'' 17 C.F.R. § 18.05(c) (emphasis added).

[34] Legal Division (LD), CFTC.GOV.

[35] CFTC Interpretative Ltr. No 77-4 (Apr. 14, 1977) (stating that Enforcement is prepared to initiate administrative proceedings in which it requests that the Commission (i) ''impose a civil money

receive inquiry letters in the ordinary course of business. An inquiry letter does not necessarily foreshadow a formal investigation or further enforcement activity. Nonetheless, because an informal inquiry can potentially lead to an enforcement proceeding, the receipt of an inquiry letter should prompt a timely and careful response.

During or at the close of an informal investigation, Enforcement may: (i) seek a formal order of investigation; (ii) recommend that the Commission file an action in federal court or commence an administrative proceeding; (iii) refer the matter to other federal, criminal, or civil agencies; (iv) refer the matter to SROs, state or local agencies, or a state or local professional organization; or (v) close the investigation without taking further action.

Comment: Pursuant to CFTC Rule 1.12(m), FCMs must notify the Commission within 24 hours of receiving (i) a notification from the Securities and Exchange Commission (SEC), a securities SRO, or a futures SRO that it is the subject of a formal investigation; or (ii) correspondence from the SEC or a securities SRO that raises issues with the adequacy of the FCM's capital position, liquidity to meet its obligations or otherwise operate its business, or internal controls. The FCM must provide the Commission with a copy of any examination report issued by the SEC or a securities SRO within 24 hours. The FCM must also provide notice or a copy of an examination report to the SEC or designated SRO, except to the extent that these entities originally provided the communication or report to the FCM.

The rule presents practical compliance challenges. For example, it does not define ''formal investigation,'' leaving open questions such as whether notice is required with respect to routine SRO inquiries related to day-to-day trading activities. Similarly, it does not define ''examination report,'' which may arguably include routine examination requests in addition to targeted examination findings. As a matter of best practice, entities are generally better served by erring on the side of caution and providing more information to the extent that there are any questions about may or may not be required under the rule.

In any event, the purpose of the rule –to ensure that the CFTC is apprised of relevant events that may require additional oversight or investigation –is likely frustrated by its structural limitations. For example, the rule does not require FCMs to inform the CFTC when a formal investigation is converted into charges. As such, the CFTC may have difficulty discerning truly significant reportable events from relatively trivial ones given the vast amounts of information it likely receives pursuant to the rule.

a. Steps to take when subject to an informal investigation

(1) Retain experienced counsel

At the onset of any investigation, it is advisable that the respondent[36] seek assistance from experienced counsel, either from within the organization or from an outside law firm. When considering whether to retain outside counsel, it is important to assess (i) the scope of the inquiry; (ii) the gravity of the potential violation; (iii) the extent to which in-house counsel has the necessary experience and competence to navigate a CFTC investigation; and (iv) the possibility that a full and independent internal investigation into the underlying activity may be warranted.[37] A company should also consider whether it is appropriate to retain separate counsel for any individual employees or affiliates whose interests might diverge from those of the company. In the event that outside counsel is retained, it is standard practice to notify Enforcement staff and request that all contact to company officers and employees be routed through outside counsel.

(2) Preserve and gather relevant information

To adequately respond to the inquiry, it is imperative that the respondent understand what specific information or documentation Enforcement staff is seeking. If the scope and focus of any requests are unclear, the respondent or its counsel should seek clarification from Enforcement staff as soon as possible. If the respondent determines that the request for information is overly broad or burdensome, it may present its concerns to Enforcement staff and seek to have the request narrowed.

Once the scope of the document request has been made clear, the respondent must gather and evaluate documents and information relevant to the investigation. This often involves (i) conducting internal interviews with the relevant employees or individuals involved; (ii) reviewing electronic communications associated with the activity at issue; and (iii) seeking records or other documents from the back office or other divisions within a company. Generally, respondents should also immediately issue a written document preservation notice. The notice should (a) instruct any employees who may possess relevant informa-

penalty, not to exceed $100,000, for each [books and records] violation'' and (ii) ''determine, on an expedited basis, whether to suspend the registration or the designation of the individual or entity involved until complete access to records has been obtained''). *See, e.g.*, *Complaint*, CFTC v. Hartshorn, 16-cv-09802 (S.D. N.Y. Dec. 20, 2016) (seeking court order imposing civil penalties of triple the monetary gain or $140,000 against respondent who failed to produce books and records upon the Commission's request), http://www.cftc.gov/enf/00orders/enfferguson.htm; Dominick Anthony Cognata, CFTC Docket No. 13-06 (Sept. 30, 2013) (providing notice of intent to revoke, suspend, or restrict respondent's registration as a floor broker for, among other things, his failure to produce books and records upon the Commission's request), http://www.cftc.gov/ucm/groups/public/%40lrenforcementactions/documents/legalpleading/enfcognatanotice093013.pdf.

SROs also impose recordkeeping requirements on their members and follow a similar approach in terms of sanctions for the failure to provide staff to access to books and records upon request.

[36] Technically speaking, investigative targets do not become respondents until they are subject to formal charges. For ease of reference, however, this Chapter uses the term ''respondent'' to refer to both investigative targets and those subject to formal charges.

[37] Internal investigations, a facet of most corporate compliance programs, are frequently used to inquire into the circumstances surrounding a regulatory issue. The purpose of an internal investigation is to determine the facts, in order to (i) enable a firm to comply with its regulatory obligations; (ii) discourage regulators from instituting a formal investigation or enforcement proceedings; (iii) ward off private litigation; and (iv) enable the firm to publicly state that it has investigated any compliance issues and has taken appropriate action.

tion to preserve any such documents; and (b) order the suspension of all regularly scheduled destruction of those documents.

(3) Respond to the inquiry with care

The respondent must take care to provide only accurate and truthful information in responding to a written inquiry from Enforcement staff. Failure to do so may subject the respondent to an enforcement action, based on the provision of false information to the Commission.[38] Moreover, the respondent should be mindful that a reply letter presents an opportunity for measured advocacy that can ultimately deter an enforcement action. At the very least, it allows for relationship-building with Enforcement staff. A cooperative and focused response can lay a foundation for mutual goodwill as the matter proceeds; in turn, the subject individual or company may be granted greater control over the scope and timing of the investigation. Conversely, an adversarial approach might prompt Enforcement staff to escalate the inquiry into a formal investigation, so that staff can compel the respondent's cooperation through subpoenas. In responding to the inquiry, it is also important to answer the questions raised, either directly or through the inclusion of responsive documents, and to apprise Enforcement staff of any steps being undertaken to address any underlying compliance issues. Should the respondent determine that it is not the appropriate source for the information—such as in cases where a company does not have access to documents pertaining to a trade executed by a customer elsewhere—it should notify Enforcement staff as soon as possible.

Generally, any information gathered by the Commission in the course of an investigation is treated as confidential and is not made public.[39] However, Section 8 of the CEA authorizes the CFTC to publish the results of its investigations, except where doing so would disclose (i) transactions or market positions by any person; (ii) trade secrets; or (iii) the names of customers.[40] Such information may, however, be transmitted to the exchanges, Congress, or other governmental agencies.[41] Moreover, the Commission may make public information that is requested under the Freedom of Information Act (FOIA).[42] As a precautionary measure, a respondent should petition the Commission to maintain the confidentiality of any information discovered in the course of an investigation and to take steps to shield such information from discovery under FOIA.[43]

(4) Cooperate with Enforcement staff

While Enforcement staff cannot compel the production of documents or testimony during the course of an informal investigation, respondents are highly encouraged to cooperate to the greatest extent possible. First, a willingness to share information may alleviate the regulatory concerns prompting the inquiry and preempt a formal investigation altogether. In turn, respondents could be saved the protracted hassle, expense, and publicity associated with a formal investigation. Second, cooperation generally allows the investigation to remain informal for a longer period of time. Third, even if a formal investigation is ultimately initiated, it will generally be less extensive, intrusive, and expensive if the company or individual has cooperated along the way. For these reasons, the respondent should maintain open communications with the Enforcement staff; oblige the Commission's requests for documents or testimony where possible;[44] and, if necessary, conduct an independent internal investigation to help uncover relevant information. In addition, companies should consider whether a presentation to Enforcement staff, either in phone or in person, would be helpful to resolve any issues and address the staff's concerns. An early meeting provides an opportunity for the respondent to make its case to the individuals who decide whether to escalate the matter beyond an informal investigation.

(5) Disclosure issues

A company should assess whether it has an obligation to disclose the investigation to the public or to specific third-parties like insurers. As a practical matter, given the routine nature of informal investigations, public disclosure will rarely be necessary, unless the inquiry touches upon issues that may

[38] *See* 7 U.S.C. § 13(a)(4) (''It shall be a felony . . . for [a]ny person willfully to falsify, conceal, or cover up by any trick, scheme, or artifice a material fact, make any false, fictitious, or fraudulent statements or representations, or make or use any false writing or document knowing the same to contain any false, fictitious, or fraudulent statement or entry to a registered entity, board of trade, swap data repository, or futures association designated or registered under this chapter acting in furtherance of its official duties under this chapter.'').

[39] *See* 17 C.F.R. § 11.3.

[40] 7 U.S.C. § 12.

[41] *Id*.

[42] *See* 5 U.S.C. § 552.

[43] FOIA provides individuals with the right (enforceable in court) to request access to records or information held by federal agencies. *See* 5 U.S.C. § 552. Unless the requested record or information is protected from disclosure by any of the nine statutory exemptions or three exclusions set forth in FOIA, it must be produced.

To request that information submitted to the CFTC be withheld when requested under FOIA, a company must follow the procedures set forth in CFTC Regulation 145.9. *See* 17 C.F.R. § 145.9. *See also FOIA: How to File a Petition for Confidential Treatment*, CFTC.GOV., https://www.cftc.gov/FOI/foia_confidential_treatment.html. Specifically, the company must submit a written request that is clearly marked ''FOIA Request for Confidential Treatment'' and includes its name, address, and telephone number. The company must also specify the grounds on which confidential treatment is being sought, which may include any of the following: (i) disclosure is specifically exempted by statute; (ii) disclosure would reveal the company's trade secrets or other confidential commercial or financial information; (iii) disclosure would constitute a violation of personal privacy; (iv) disclosure would reveal investigatory records compiled by law enforcement purposes and thus deprive the company of a fair trial or due process, constitute a violation of personal privacy, or otherwise—in cases of designated contract markets or registered futures associations—interfere with enforcement proceedings or disclose investigative techniques and procedures. Generally, the request for confidential treatment (RCT) should accompany the material for which confidential treatment is sought. Unlike the underlying material, the RCT is considered a public document.

The CFTC will not make a determination with respect to a RCT until it receives a FOIA request for the material for which confidential treatment is being sought. However, even if information is protected under FOIA, it may still be shared between domestic and foreign government agencies at the Commission's discretion. 7 U.S.C. § 16(f).

[44] Generally, information should not be provided voluntarily where doing so would contravene statutory, contractual, or professional obligations to maintain information in confidence.

be of material value to investors. If disclosure is warranted, the company should work closely with internal and outside disclosure counsel to draft the relevant language for a press release or public filing.

2. Formal investigations

To escalate an informal investigation into a formal one—and thereby secure the power to subpoena witnesses and documents—Enforcement staff must obtain authorization from the Director of Enforcement or from members of the Commission staff acting pursuant to the Director's authority. In practice, such authorization generally is freely given. Enforcement staff simply submit a confidential memorandum to the Commission that describes the activities it seeks to investigate, as well as the potential violations at issue. In response, the Commission will almost always issue a ''formal order of investigation.'' The formal order designates which individuals on the Enforcement staff have the power to issue subpoenas in the course of the investigation and gives a broad description of the investigation's scope.[45]

While Enforcement is entitled to collect a broad array of information without a subpoena, the commencement of a formal investigation allows Enforcement to collect information in three types of situations where it would otherwise be unable to do so: (i) where Enforcement seeks information from people with no statutory duty to allow Enforcement to inspect and copy documents; (ii) where Enforcement seeks testimony as opposed to documents or other records; or (iii) where an individual under investigation refuses to comply with an informal request for information.

The Commission's power to issue subpoenas is very broadly construed and may be used in good faith to seek information that is ''reasonably relevant'' to an investigation within the agency's authority and is ''not too indefinite.''[46] CFTC subpoenas are not self-executing, and the Commission does not have the independent authority to compel compliance. As such, the Commission must file a complaint in a federal court to enforce its subpoena. The judiciary will enforce a subpoena, provided the Commission can establish that: (i) the purpose of the investigation is legitimate; (ii) the subpoenaed information may be relevant to the investigation's purpose; (iii) the subpoena is not requesting information that the CFTC already has in its possession; and (iv) the proper procedures have been followed.[47] Subpoenas—or the delegation of the power to issue subpoenas—must be directly authorized by the CFTC and may only be issued in the context of a specific investigation.[48]

As a practical matter, formal investigations proceed in much the same way as informal investigations. Accordingly, in responding to a formal investigation, respondents should expect to follow procedures similar to those outlined above for informal investigations. However, due to the exacting legal obligations imposed by a subpoena and the more imminent possibility of an enforcement action, the response to a formal investigation should assume a heightened sense of urgency and rigor. In particular, a respondent must reevaluate its approach with respect to three facets of its response: (i) securing legal counsel; (ii) implementing a preservation order for subpoenaed documents and communications; and (iii) conducting an internal investigation.

First, a respondent that did not retain outside counsel during the initial phase of the investigation generally does so once the inquiry becomes a formal investigation. An experienced attorney can help the respondent protect its interests (legal and otherwise) throughout the course of an investigation, and can facilitate an acceptable resolution of the matter with the Commission, while providing an appropriate buffer between the government and the targeted company or individual. Second, once it receives a subpoena, a respondent must take extra care to ensure that potentially responsive documents and communications are preserved.[49] While a respondent may have already taken steps to ensure that relevant information is retained—such as by instructing officers and employees to maintain any potentially responsive documents and communications in their possession and by suspending the regularly scheduled destruction of business documents—it needs to reassess its preservation measures to make sure they are adequate and

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[45] Pursuant to CFTC Regulation 11.7, anyone who receives a subpoena from the Commission has the right to examine—but not retain—a copy of the formal order pursuant to which it has been issued. 17 C.F.R. § 11.7. However, because formal orders of investigation provide scant information about the nature or scope of the investigation, this entitlement is of little practical value.

[46] EEOC v. Aerotek, Inc., 815 F.3d 328, 33 (7th Cir. 2016) (In deciding whether to enforce an administrative subpoena, ''it is sufficient if the inquiry is within the authority of the agency, the demand is not too indefinite and the information sought is reasonably relevant.'').

[47] CFTC v. Tokheim, 153 F.3d 474, 477 (7th Cir. 1998) (upholding enforcement of CFTC administrative subpoena and stating that the CFTC ''is granted broad powers under the [CEA] to investigate compliance with the Act's provisions''); *see also* United States v. Andersen, 109 F. Supp. 3d 1049, 1054 (N.D. Ind. 2014) (rejecting probable cause requirement and citing Tokheim). There are two critical features of subpoena procedure. First, a subpoena must be validly served. CFTC regulations allow for natural persons to be validly served by (a) personal delivery; (b) leaving it at the person's office with the person in charge or in a ''conspicuous place'' in the office; (c) leaving it with person of suitable age or discretion at the person's usual abode; (d) mailing the subpoena via registered or certified mail to the person's last known address; or (e) ''any other method whereby actual notice is given to him.'' 17 C.F.R. § 11.4. Second, where the subpoena demands witness testimony rather than the production of documents, special considerations must be followed. Specifically, witnesses are entitled to (i) see the Commission's order granting the subpoena, unless Enforcement determines that doing so would compromise the investigation or the privacy of the respondent; and (ii) any fees that witnesses in federal court would otherwise receive. 17 C.F.R. § 11.7.

[48] Subpoenas must contain three elements in order to be deemed valid and enforceable on their face—a general description of the investigation and its scope; a recitation of the applicable authority that allows the CFTC to conduct the investigation; and the identity of the individuals with authority to issue subpoenas. 17 C.F.R. § 11.4.

[49] *See, e.g.*, Broadspring, Inc. v. Congoo, LLC, No. 13-CV-1866 JMF, 2014 WL 4100615, at *19 (S.D.N.Y. Aug. 20, 2014) (imposing sanctions for failure to preserve potentially relevant instant messages); Pension Comm. v. Banc of Am. Sec., LLC, 685 F. Supp. 2d 456, 496-97 (S.D.N.Y. Jan. 15, 2010) (imposing sanctions for failure to preserve potentially relevant documents, and for failing to execute comprehensive searches for documents); MOSAID Techs. Inc. v. Samsung Elecs. Co., 348 F. Supp. 2d 332, 336–40 (D.N.J. 2004) (noting that a company may face sanctions for failing to implement adequate measures to preserve potentially discoverable evidence).

encompass all of the information sought in the subpoena. The company should also make sure that its procedures for retaining relevant information are memorialized in writing and are circulated internally within the company. In addition, depending on such factors as the scope of the Commission's investigation or the complexity of the possible legal issues and violations, a company should consider conducting internal audits to ensure that all relevant documents and information are discovered and preserved. Third, a company should reconsider whether to conduct an internal investigation, if it has not already undertaken one.

Once a formal investigation is underway, Enforcement may, at some point: (i) make a finding that there was no misconduct and conclude the enforcement process;[50] (ii) enter into a settlement with the respondent;[51] (iii) initiate an administrative proceeding or file a complaint in federal court; or (iv) refer the matter to an SRO or to a federal, state, or local agency or professional association.

3. Witness testimony

Witness testimony is one of Enforcement's primary means of gathering information, and is often a substantial component in Enforcement's decision whether to proceed with an enforcement action. While witnesses may occasionally be interviewed off-the-record, they are generally requested to testify on the record and under oath. In either event, however, the testimony is subject to federal law prohibiting false statements to government officials.[52] In the event that a witness fears potential future exposure to criminal liability on the basis of his or her testimony, he or she may invoke his or her constitutional right against self-incrimination and ''take the Fifth'' in response to specific questions.

a. Witness preparation

It is critical that any witnesses be thoroughly prepared to ensure that their testimony is accurate, credible, and effective. Witnesses should be advised that the Commission has total control over the proceeding and is not restrained by the Federal Rules of Evidence, so that it may pursue virtually any line of questioning—and in whatever form—that it deems fit. Because no formal charges have yet been filed, the Commission may also probe into areas that are not obviously related to the investigation, as it has been presented to witness and counsel. Ample witness preparation limits the extent to which a witness will attempt to overreach or speculate, make inconsistent statements, or provide unresponsive information.

Comment: Among other things, witnesses should be advised to: (i) tell the truth; (ii) maintain composure even when they feel provoked; (iii) take the time to understand the questions being asked, especially compound questions, and seek clarification when questions are unclear; (iv) refrain from speculating when the answer is unknown; (v) limit answers to only the question being asked and not volunteer extraneous information; (vi) not hesitate to qualify an answer as necessary or to point out when a question is based on a premise that is unfounded or incorrect; (vii) request consultation with counsel as necessary; and (viii) avoid combative or openly non-cooperative commentary to Enforcement staff. The style and expertise of the Enforcement staff attorneys varies considerably, so witnesses should be prepared to respond appropriately to vague, compound, or confusing questions.

b. Right to counsel

Under the Commission's rules, all persons who are compelled or volunteer to participate in an investigation by Enforcement are entitled to be represented by counsel ''during any aspect of an investigative proceeding.''[53] Nonetheless, the role of counsel is limited during witness testimony. Because the Federal Rules of Evidence do not apply—and Enforcement has broad discretion to probe for information in any manner it sees fit—there is little that the counsel can do during the course of the proceedings to protect his or her client from problematic questioning. To this end, counsel may object to questions that infringe on certain privileges held by the witness, misstate the witness's prior testimony, or are overly harassing or hostile. However, counsel should take care not to vociferously object to questions that are leading, irrelevant, or lack any foundation in the record; given that Enforcement staff are afforded broad discretion to interview witnesses in any manner they choose, such objections are essentially baseless. Moreover, the Commission may exclude counsel from further participation in an investigation if it determines, at its discretion, that the counsel is displaying ''dilatory, obstructionist or contumacious conduct'' and it provides the counsel with ''due notice'' that his or her behavior is problematic.[54] Excessive objections could also result in other—less overt, but just as negative—collateral consequences. For example, a sufficiently annoyed Enforcement staff attorney may use his or her discretion to deny counsel's request to cross-examine the witness and clarify certain testimony.[55]

[50] If Enforcement elects to close the investigation, it may—but is not required to—issue a No-Action letter informing the subject of its decision. Such letters are extremely rare in practice, and respondents should not expect to receive them in the usual course of business, even if an investigation is closed.

[51] In the event of a settlement, Enforcement may continue to have contact with the respondent to monitor compliance with any ongoing terms.

[52] Although only testimony that is under oath is subject to federal perjury law, all testimony before the Commission is subject to federal criminal law prohibiting false statements to government officials. *See* 18 U.S.C § 1621 (providing criminal sanctions for perjury); 18 U.S.C. § 1001 (criminalizing false statements made to government officials, even when not under oath).

[53] 17 C.F.R. § 11.7. In addition, the Administrative Procedure Act provides that any ''person compelled to appear before an agency is entitled to be accompanied, represented, or advised by counsel.'' 5 U.S.C. § 555(b). Nonetheless, at least one federal district court has held that there is no constitutional right to counsel in an administrative proceeding, so the right to counsel is grounded solely in administrative regulations and is not absolute. *See* Collins v. CFTC, 737 F. Supp. 1467 (N.D. Ill. 1990) (reasoning that the 6th Amendment right to counsel applies only in the context of criminal proceedings and is not available in administrative proceedings, which do not implicate criminal conduct).

[54] 17 C.F.R. § 11.7. *See also* 17 C.F.R. § § 14.1–14.10 (Rules Relating to Suspension or Disbarment from Appearance and Practice).

[55] 17 C.F.R. § 11.7.

c. Testimony transcripts

The Commission is required to record and transcribe all witness testimony.[56] As a practical matter, however, a witness will be hard-pressed to obtain a transcript of his or her testimony—even though the Commission's regulations assert that witnesses are ''entitled'' to a copy of the transcript absent ''good cause.''[57] This is because the Commission has interpreted the ''good cause'' exception in a manner that ultimately swallows the rule, by maintaining, in almost every case, that there is a danger that the transcript will be used to prepare and conform the testimony of subsequent witnesses. As a result, until the proceeding has concluded, witnesses are generally permitted to review the transcript only under the Commission's supervision and may not make copies or take notes.[58] There are some collateral benefits, however, to the Commission's stance on refusing to provide transcripts. For instance, the witness will be unable to comply with a subpoena or document request, in a related private civil action, that seeks copies or transcripts of testimony before federal regulators.

D. The Enforcement Process

1. Wells Process

The so-called Wells Process is a two-step due process mechanism whereby the subject of the CFTC investigation may, at the Commission's discretion, be advised of the proposed charges against it and offered an opportunity to dissuade the CFTC from bringing an enforcement action.[59] First, the CFTC's Enforcement Division may issue a ''Wells Notice'' to inform prospective defendants of the existence of the investigation and ''the nature of the allegations pertaining to them.''[60] Second, a prospective defendant who receives a Wells Notice may be allowed to explain its case through a ''Wells Submission,'' which sets forth in writing the prospective defendant's position, defenses, and interests.[61] The Wells Process occurs at the conclusion of the investigation by Enforcement but before the matter is forwarded to the Commission to determine whether an enforcement action is warranted.

The CFTC has explained that the Wells Process is intended ''to make information available to assist in [Enforcement's] determination to recommend the action and, ultimately, in the Commission's determination whether and in what manner it is in the public interest to commence an enforcement proceeding.''[62] The Wells process ostensibly serves the interests of both the government and the prospective defendant. It allows the CFTC to allocate its scarce resources more efficiently by identifying cases that are unlikely to lead to an enforcement action—and that should thus be settled or dropped—earlier in the review process. As a practical matter, respondents should be aware that cases are rarely dropped entirely without further disciplinary action or settlement, once a Wells Notice has been issued. Additionally, the Wells Process gives prospective defendants the chance to avert the negative and often devastating publicity associated with the filing of formal charges by persuading the Commission to reduce or drop charges, or to enter into settlement discussions.[63]

a. Background

The so-called Wells process originated within the context of SEC enforcement actions. On January 27, 1972, then-Chairman of the SEC, William J. Casey, appointed a three-person advisory committee led by New York attorney John A. Wells (the Wells Committee) to evaluate the SEC's enforcement program.[64] In addition to soliciting feedback from persons within the bar, the Wells Committee considered an internal memo issued by the SEC in 1970 regarding procedures to be followed in enforcement proceedings (the SEC Memo).[65] The SEC Memo required staff to provide a summary of the prospective defendant's arguments in its recommendation memo to the

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[56] 17 C.F.R. § 11.5.

[57] 17 C.F.R. § 11.7.

[58] To this end, witnesses—and their attorneys—are prohibited from employing their own court reporters to transcribe the testimony. 17 C.F.R. § 11.5. Counsel is allowed, however, to take summary notes. *Id.*

[59] Although the CFTC uses the term ''Wells Process'' to refer to these steps, as discussed later in this section, the term was coined by the SEC and, thus, arguably is properly applied only in the context of the SEC enforcement process. For purposes of consistency with CFTC practice, however, we use the term here with respect to the Commission's enforcement mechanisms.

[60] 17 C.F.R. § 11, App. A.

[61] *See, e.g.*, First NBC Bank v. Murex, LLC, No. 16-CV-7703 (PAE), 2017 WL 1536014, at *19 (S.D.N.Y. Apr. 28, 2017). *Cf.* Bullard v. City of New York, No. 01-CV-11613 (S.D.N.Y. Apr. 19, 2004). According to the *Bullard* court:

> ″Stated simply, a 'Wells Submission' is a written submission . . . by an individual or entity whose conduct is within the scope of the SEC's investigation, and is usually made in an effort to persuade the SEC that either no violation has occurred or that any violation that has occurred is not as serious as the SEC may believe.

Id. A Wells Submission is entirely voluntary: ''The procedure permits a written statement only and neither creates a right nor an obligation to make such a statement.'' CFTC Notice of Informal Procedure, Publication of Appendix Setting Forth Informal Procedure Relating to the Recommendation of Enforcement Proceedings, 52 Fed. Reg. 19,500 (May 26, 1987).

[62] CFTC Notice of Informal Procedure, 52 Fed. Reg. 19,500 (May 26, 1987).

[63] The reputational damage incurred by the filing of a CFTC enforcement action may well be fatal to the livelihood of its target, even if the charges are ultimately dropped. *Cf.* 7 C.F.R. § 200.66 (acknowledging, in the SEC's Canon of Ethics, that ''[t]he power to investigate carries with it the power to defame and destroy'').

[64] The other two members of the Wells Committee were former SEC Chairmen Manuel F. Cohen and Ralph H. Demmler. Wells was designated as chair of the Commission specifically because he was not a securities lawyer and could bring a broad range of experience to the group. *See* William J. Casey, Chairman, SEC, The Securities Bar and The Securities Laws, Address at the New York State Bar Association: Banking, Corporation and Business Law Section 5 (Jan. 27, 1972), http://www.sec.gov/news/speech/1972/012772casey.pdf.

The express mandate of the Wells Committee was, among other things, ''(1) to advise how the SEC's enforcement objectives and strategies may be made still more effective, (2) to assess the due-process implications of enforcement practices, [and] (3) to evaluate enforcement policies and procedures.'' Paul S. Atkins, Chairman, SEC, Address at Fordham Law School 191 (Oct. 9, 2007), *reprinted in The Eighth Annual A.A. Sommer, Jr. Lecture on Corporate, Securities, and Financial Law*, 13 FORDHAM J. CORP. & FIN. L. 193–94 (2008).

[65] Atkins, 13 FORDHAM J. CORP. & FIN. L. 186, at 193–94.

SEC.[66] The Wells Committee incorporated this concept among the 43 recommendations it made to the SEC, several of which ultimately gave rise to the Wells Process.[67]

Although prospective defendants were allowed to make written submissions to the SEC prior to 1972 on the basis of the SEC Memo, the practice was not publicized and was known only to experienced securities lawyers.[68] As a result, less knowledgeable counsel, lacking notice of the policy, generally did not file such statements.[69] The Wells Process was intended to democratize the opportunity for prospective defendants to present their arguments before being subject to an enforcement action.[70] In a release dated September 27, 1972, the SEC publicly announced the implementation of the Wells Process as a discretionary informal procedure.[71]

The CFTC eventually followed suit, adopting the Wells Process in 1987.[72] Under Appendix A of the Regulations, the disclosure is not mandatory, ''and the Division [of Enforcement] has the discretion whether and to whom to issue a Wells Notice.''[73] The Director of the Division must approve the issuance of a Wells Notice. The Division's staff considers various factors in determining whether to issue a Wells Notice, including: (i) ''whether the investigation is substantially complete as to the recipient of the Wells Notice''; (ii) ''whether immediate enforcement is necessary''; (iii) ''whether providing a Wells Notice may alert potential defendants to a possible asset freeze or otherwise put at risk funds that the recommendation is intended to protect; (iv) ''whether there is a parallel criminal investigation that may be adversely affected by providing a Wells Notice''; and (v) ''whether a Wells Submission would be useful to the Division and Commission in evaluating complicated factual, legal or policy issues.''

b. Issuing a Wells Notice

The decision to issue a Wells Notice is ''entirely within the discretion of the Division [of Enforcement].''[74] As a matter of general practice, in the event that Enforcement decides to issue a Wells Notice, it first notifies the subject in a brief phone call (the Wells Call) that includes the Enforcement staff attorney tasked with the inquiry as well as a higher-ranking Enforcement official. During the Wells Call, Enforcement staff customarily gives the subject of the enforcement action little substantive information regarding the Commission's focus or position. Instead, the subject is informed that Enforcement will recommend formal action to the Commission in connection with the subject's potential infringement of a specified provision of the CEA or CFTC regulations. Although the subject is given an opportunity to ask questions during a Wells Call, as a practical matter, these are rarely substantively answered. As a result, it is difficult to discern the nature of the case against the subject during the early stages of the Wells Process.

Although the Wells Call may sometimes serve as a complete substitute for written notice, it is more frequently the case that a Wells Notice—in the form of an email, or less commonly,

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[66] *See* SEC, Memorandum on Procedures Followed in the Institution of Enforcement Proceedings (Sept. 1, 1970), *reprinted in* SEC v. Nat'l Student Mktg. Corp., 68 F.R.D. 157, 165–66 (D.D.C. 1975) (Appendix A).

> In regard to both administrative proceedings and injunctive actions, the Commission requests that the staff's memoranda to the Commission recommending the particular action set forth separately any arguments or contentions as to either the facts or the law involved in the case which have been advanced by the prospective respondents and which countervail those made by the staff in its memoranda as a basis for recommendation.

68 F.R.D. at 166.

[67] *See generally* SEC, REPORT OF THE ADVISORY COMMITTEE ON ENFORCEMENT POLICIES AND PRACTICES (1972) (Wells Committee Report); Commencement of Enforcement Proceedings and Termination of Staff Investigations, SEC Release No. 33-5310 (Sept. 27, 1972). Among other things, the Wells Committee recommended that—

> ''[e]xcept where the nature of the case precludes, a prospective defendant or respondent should be notified of the substance of the staff's charges and probable recommendations in advance of the submission of the staff memorandum to the Commission recommending the commencement of enforcement action and be accorded an opportunity to submit a written statement to the staff which would be forwarded to the Commission together with the staff memorandum . . . .''
>
> The procedures whereby a prospective defendant or respondent is permitted to present to the Commission his side of the case prior to authorization of an enforcement action should be reflected in a rule or published release.

Wells Committee Report, at iv.

[68] *In re* Initial Pub. Offering Sec. Litig., No. 21 MC 92 (SAS) (S.D.N.Y. Jan. 12, 2004) (discussing the history of the Wells Process).

[69] *See* Wells Committee Report, at 31–32 (''As a practical matter, only experienced practitioners who are aware of the opportunity to present their client's side of the case have made general use of these procedures.'').

[70] *In re* Initial Pub. Offering Sec. Litig., No. 21 MC 92 (SAS) (S.D.N.Y. Jan. 12, 2004) (''The Wells process was implemented so that the Commission would have the opportunity to hear a defendant's arguments before deciding whether to go forward with enforcement proceedings, *in every case*.'' (emphasis in original)).

[71] SEC Release No. 33–5310, at 2 (''The Commission . . . wishes to give public notice of a practice, which it has heretofore followed on request, of permitting persons involved in an investigation to present a statement to it setting forth their interests and position.''). The Commission declined to adopt a mandatory procedure on the grounds that formal rules would ''limit the scope and timeliness of its possible action, and inappropriately inject into actions it brings issues, irrelevant to the merits of such proceedings, with respect to whether or not the defendant or respondent had been afforded an opportunity to be heard prior to the institution of proceedings against him and the nature and extent of such opportunity.'' *Id.*

[72] *See* CFTC Notice of Informal Procedure, 52 Fed. Reg. 19,500 (May 26, 1987) (''The Commodity Futures Trading Commission . . . hereby adopts . . . an informal procedure regarding the submission of voluntary written statements by persons who may be named in proposed enforcement proceedings.'').

[73] CFTC, CFTC Division of Enforcement Manual, at 19 (May 20, 2020); *see* 17 C.F.R. § 11 App. A.

[74] CFTC, Denial of Petition for Rulemaking and Adoption of Interim Informal Procedure Relating to the Recommendation of Enforcement Proceedings, 51 Fed. Reg. 13,548, 13,549 (Apr. 22, 1986) (''There is no obligation that the Division inform anyone of the proposed proceeding.'').

a mailed letter—is issued immediately following the call.[75] In either instance, the written notification offers little more information than that originally provided during the Wells Call. As a practical matter, in contrast to SEC practice, it makes little difference to the perceived importance and severity of the inquiry whether the Wells Notice is issued from the CFTC's headquarters in Washington, D.C., or from one of its regional offices throughout the country.

c. Disclosing receipt of a Wells Notice

There is no express statutory duty to disclose an ongoing or imminent CFTC investigation. Nonetheless, respondents must be mindful that Section 6c of the CEA requires the public disclosure of ''material information,'' and there are certain circumstances where a Commission investigation may fall under this rubric. For example, disclosure may be required to ensure that a company's prior statements are not misleading, where the company has made affirmative statements that it is fully in compliance with the CEA and the Commission's rules. Moreover, corporate by-laws or applicable non-futures laws (such as SRO rules, federal securities, or criminal laws) may mandate disclosure. Hence, respondents should always consult with counsel, including outside disclosure counsel, to determine whether to disclose receipt of a Wells Notice.[76]

In cases where disclosure is deemed necessary or desirable, respondents should take care to include any required material information without making overly broad disclosures. Due to a variety of related securities laws, the scope of which are beyond that of this Portfolio, it is also highly advisable for companies to closely limit the individuals who may respond to inquiries from the press or other interested parties, and to prepare responses to anticipated questions in advance in order to ensure accuracy and consistency of message.

d. Preparing a Wells Submission

(1) Considering whether to make a Wells Submission

A Wells Submission allows prospective defendants the rare opportunity to communicate directly with the decision-makers within the CFTC. As such, a Wells Submission provides a useful forum to advocate for reduced charges in exchange for settlement, or even perhaps to convince the Commission to forego charges entirely. However, an individual who is offered the opportunity to submit a Wells Submission should not do so before assessing the risk that a third party may be able to discover these statements in a subsequent or contemporaneous proceeding.[77] Any arguments, defenses, or positions that are disclosed to the CFTC in a Wells Submission may inadvertently provide private plaintiffs with crucial insights into the subject's litigation strategies or even expose the subject to additional civil or criminal liability. As the CFTC has warned, statements made in Wells Submissions, including factual assertions, may be used ''in an administrative or judicial proceeding by the Commission, as well as by another government agency or even by a private party who may obtain the statement under the Freedom of Information Act or pursuant to subpoena.''[78]

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[75] *See* CFTC Notice of Informal Procedure, 52 Fed. Reg. 19,500-01 (May 26, 1987).

[76] While there is little judicial guidance regarding the obligation to disclose a CFTC-issued Wells Notice, a case from the securities context is instructive. In *Richman v. Goldman Sachs Group*, a federal district court in the Southern District of New York concluded that a Wells Notice issued by the SEC did not have to be disclosed to investors. Richman v. Goldman Sachs Grp., 868 F. Supp. 2d 261 (S.D.N.Y. 2012). The case involved an SEC investigation that commenced in August 2008 with respect to a synthetic collateralized debt obligation transaction that Goldman Sachs (Goldman) had closed the prior year. In its 10-K SEC filing dated January 27, 2009, Goldman disclosed that ''it had 'received requests for information from various governmental agencies and self-regulatory organizations relating to subprime mortgages, and securitizations, collateralized debt obligations and synthetic products relating to subprime mortgages,' and that Goldman was 'cooperating with the requests.' '' *Id.* at 270 (citation omitted). On July 29, 2009, the SEC issued a Wells Notice to Goldman, notifying the firm that Enforcement staff intended to recommend an enforcement action. Goldman did not disclose receipt of the Wells Notice, but responded to the Wells Notice with a written submission and met with the SEC on numerous occasions to discuss the matter. Ultimately, on April 16, 2010, the SEC filed an enforcement action against Goldman, and the company's stock dropped 13 percent. Investors filed suit on the grounds that Goldman was required to disclose the Wells Notice.

The court disagreed, and granted a motion to dismiss any claims predicated on the non-disclosure. The court observed that, under federal securities law, a company is required to describe any ''material pending legal proceedings . . . known to be contemplated by governmental authorities.'' *Id.* at 272. The court reasoned that receipt of a Wells Notice does not meet this standard because a Wells Notice does not necessarily mean that charges will be filed against the target. The court noted that a staff recommendation that enforcement action is warranted is not ''authoritative,'' and that a Wells Notice is intended to give the subject an opportunity to be heard before any final charging decisions are made. Moreover, while the court acknowledged that receipt of a Wells Notice may foreshadow an enforcement action, it concluded that such a notice falls ''well short of litigation'' and does not create an implicit duty of disclosure. Nonetheless, the court suggested that disclosure may be required when an investigation ''matures to the point where litigation is apparent and substantially certain to occur.'' *Id.* at 274-75.

Although the analysis in *Richman* was limited to disclosure requirements under the federal securities laws, it underscores that the obligation to disclose an ongoing investigation is dependent on the particular facts of the case. Participants in the commodity futures markets should discuss their particular circumstances with outside counsel and make a careful determination as to whether disclosure is necessary or prudent.

[77] *See, e.g.*, *In re* Steinhard Partners, L.P., 9 F.3d 230, 236 (2d Cir. 1993) (finding that a Wells Submission given voluntarily to the SEC resulted in a complete waiver of work-product privilege as to subsequent civil litigants); *In re* Initial Pub. Offering Sec. Litig., No. 21 MC 92 (SAS) (S.D.N.Y. Jan. 12, 2004) (holding that Wells Submissions are generally discoverable in private civil litigation, even if they contain settlement offers, so long as they meet the minimal showing of relevance under the Federal Rules of Civil Procedure). *See also In re* Columbia/HCA Healthcare Corp. Billing Practices Litig, 293 F.3d 289, 299 (6th Cir. 2002) (holding that party who made voluntarily submission to the government pursuant to a confidentiality agreement waived attorney-client and work product privilege, and was thus precluded from subsequently raising privilege with respect to third parties).

[78] CFTC Notice of Informal Procedure, 52 Fed. Reg. 19,500-01 (May 26, 1987).

(2) The procedural framework for a Wells Submission

The procedures governing Wells Submissions are set forth in Appendix A to the CFTC's Rules Relating to Investigations.[79] A Wells Submission must be made within 14 days of the receipt of the Wells Notice and cannot exceed 20 double-spaced pages in length. Enforcement may authorize deviations from the stated deadline or the standard page limit upon request, though in practice it rarely does so.[80] This stands in sharp contrast to the SEC's practice: although the SEC has not standardized page limits or deadlines or Wells Submissions, it typically allows respondents one month to prepare a 40-page reply, and liberally grants time extension or page increases upon written request.[81] As a result of the Commission's strict limits on the Wells Submission—particularly when coupled with the opaqueness of the CFTC's focus—subjects face great difficulty in presenting an effective response that might deter enforcement action against them.

The Wells Submission should set forth the prospective defendant's ''views of factual, legal or policy matters relevant to the commencement of an enforcement proceeding.''[82] However, the Commission ''is more interested in a submission that focuses upon legal and policy argument'' than one that focuses on the facts; as the Commission explains, ''disagreements as to factual matters are best left to be resolved through litigation because the Commission is not well positioned to adjudicate factual disputes in the absence of a fully developed factual record.''[83] Unlike with SEC Wells Submissions, any factual statements contained within a Wells Submission provided to the CFTC ''must be sworn to by a person with personal knowledge of such fact''[84] and cannot ''simply be made by counsel upon information and belief.''[85] Wells Submissions are initially reviewed by Enforcement, but may be forwarded to the Commission at the request of the prospective defendant. In contrast, the SEC refers every Wells Submission that it receives to both Enforcement staff and the Commissioners of the SEC for review.

e. Impact of Wells Submissions

Even when Wells Submissions are accepted, they are generally perceived to have little impact on the Commission's decision of whether to authorize an enforcement action. First, the Commission is entitled to ''consider all, any portion or none of the submission when it considers the staff recommendation to commence an enforcement proceeding.''[86] Thus, the Commission can choose to disregard a Wells Submission entirely, without reviewing its content or offering an explanation. Second, the Commission is primarily—if not exclusively—comprised of non-lawyers who tend to defer to Enforcement's judgment about whether to pursue formal charges.[87] The Commission is thus likely to follow the staff recommendation as a matter of course. Third, Enforcement may not apprise a prospective defendant of the full evidentiary and factual basis for the investigation against him or her, thus depriving the defendant of the chance to effectively deconstruct the CFTC's case and otherwise fully defend him- or herself through a Wells Submission. Fourth, Enforcement frequently restricts access to evidentiary materials and therefore impedes the quality of the Wells Process. For example, Enforcement allows a witness to review a transcript of his or her testimony only after agreeing that no copies of the transcript will be made, so that only one copy of the transcript can be in circulation at any given time, and that no party besides the witness and his counsel will review the transcript. This system has multiple drawbacks that complicate legal advocacy, create logistical difficulties, and impede efficiency. For example, it (i) requires a witness to personally meet with his or her legal counsel—whether or not they reside in the same locale—in order to read and discuss the transcript; and (ii) precludes multiple lawyers in the same case from working with the transcript simultaneously.

f. Settlement

At the close of an investigation, if an enforcement action is to be recommended, Enforcement staff will generally provide the respondent with an opportunity to propose an offer of settlement. In addition to setting out a civil penalty, the settlement terms offered must: (i) acknowledge proper service of the complaint; (ii) accept the CFTC's jurisdiction in the case; (iii) waive a hearing and all post-hearing procedures; (iv) stipulate to the record and the specific findings of fact contained within the complaint; and (v) consent to the entry of an order that reflects the terms of the settlement.[88] Theoretically, respondents do not have to admit or deny wrongdoing in a settlement offer; however, the CFTC will generally refuse to settle if the party continues to deny the allegations at this point.[89]

Enforcement forwards to the Commission any settlement offers that it receives, along with its own recommendation as to whether the offer should be accepted or rejected.[90] If the Commission decides to heed Enforcement's recommendation—which it usually does—it will consider the offer of settlement. In cases where Enforcement has decided to present a negative

[79] *See generally* Informal Procedure Relating to the Recommendation of Enforcement Proceedings, 7 C.F.R. § 11 App. A.

[80] *See, e.g.*, CFTC Notice of Informal Procedure, 52 Fed. Reg. 19,500 (May 26, 1987) (noting that ''unless otherwise provided by the Director of the Division, all submissions must be no longer than 20 pages . . .'').

[81] For additional differences between the CFTC's and the SEC's procedures, *compare* SEC Enforcement Manual (Nvo. 28, 2017), https://www.sec.gov/divisions/enforce/enforcementmanual.pdf *with* 17 C.F.R. § 11 App. A.

[82] 17 C.F.R. § 11 App. A.

[83] CFTC Notice of Informal Procedure, 52 Fed. Reg. 19,500-01 at n.1 (May 26, 1987).

[84] 17 C.F.R. § 11 App. A.

[85] CFTC Notice of Informal Procedure, 52 Fed. Reg. 19500-01 (May 26, 1987). In light of this requirement, it is customary to include sworn affidavits with any Wells Submissions. Such affidavits do not count towards the page limit.

[86] 17 C.F.R. § 11 App. A. *See also* CFTC Notice of Informal Procedure, 52 Fed. Reg. 19500-01 (May 26, 1987) (''[N]o rights or obligations are created by Appendix A, and the Commission has no obligation to consider a written statement or any part thereof.'').

[87] Jerry W. Markham, *Commodities Regulation: Fraud, Manipulation & Other Claims, CFTC Investigations*, 13A COMMODITIES REG. § 22:6 (Apr. 2017).

[88] *Id.*

[89] *See* CFTC Rules of Practice, 63 Fed. Reg. 55,784 (Oct. 19, 1998).

[90] 17 C.F.R. § 10.108.

recommendation, the respondent is given an opportunity to withdraw the settlement offer before it is presented to the Commission.[91] The Commission has full discretion to accept or reject any settlement offer. If it decides to accept a settlement offer, it will issue an opinion and order accepting its terms, thus concluding the enforcement proceeding.[92] If it rejects the offer, the offer is deemed to be withdrawn; any proposed admissions, waivers, and stipulations contained in the settlement offer are considered to be void; and the proceeding continues in its normal form.[93]

In determining whether to settle, respondents must be aware of two possible collateral consequences. First, plaintiffs in federal class action litigation have successfully convinced courts to take judicial notice of CFTC settlements and their allegations, notwithstanding the fact that such settlements expressly do not constitute an admission of guilt, in order to bolster their chances of withstanding a motion to dismiss.[94] For example, in *In Re Natural Gas Commodity Litigation*, a federal district court took judicial notice of settlements that defendants had entered into with the CFTC and ruled that these settlements could be used to bolster plaintiffs' broader allegations, even though they could not be used to establish specific facts.[95]

Second, settling an action with the CFTC generally will not preclude civil or criminal action by another agency. As one federal court has explained, ''it is well established that more than one governmental agency may investigate the same conduct simultaneously and bring simultaneous civil and criminal actions based on such conduct so long as the respective remedies are not mutually exclusive and there is an otherwise rational basis for their individual proceedings.''[96] Hence, companies subject to a CFTC enforcement action should attempt to coordinate with all agencies who might possibly be interested in prosecuting the conduct in question, to ensure that new investigations and penalties do not continue to flow from the same conduct.

2. Civil proceedings

Should the Commission determine that an enforcement action is warranted, it may initiate an administrative adjudicatory proceeding or file a complaint in federal court.[97] Cases brought in federal court generally seek injunctive relief as well as civil penalties.[98] Because such civil proceedings are governed by federal procedural law, rather than by Commission-specific procedures, federal court cases are beyond the scope of this Portfolio. While the administrative process is fairly similar to the federal court process, there are differences that are significant enough to merit discussion here.[99] Respondents should be aware that they may make written settlement offers to Enforcement at any time during the administrative proceeding, and cases usually settle prior to a decision by an administrative judge.[100]

> **Comment:** The CFTC has traditionally preferred to proceed in federal court, perhaps because it does not have any administrative courts of its own and must use courts provided by other government agencies. Yet while the Commission has not pursued a contested administrative enforcement action since 2001, it has at least signaled a willingness to return to in-house enforcement.[101] For example, in November 2014, then- Director of Enforcement Aitan Goelman stated that the CFTC would follow the example of the Securities Exchange Commission and bring more of its enforcement actions in administrative courts.[102] Among other reasons, Goelman explained that the CFTC does not have the bandwidth to engage in discovery-intense litigation in federal court and suggested that administrative proceedings might be less taxing on the agency's scarce resources. He also noted that bringing cases in administrative court would allow the CFTC to develop its expertise (and legal precedent) in areas where it was granted new authority through Dodd- Frank. The plan to transition to increased use of administrative courts has not yet come to fruition however, at least in part due to the Supreme Court's recent ruling in *Lucia v. SEC* that administrative law judges are ''inferior officers'' for purposes of the Constitution's Appointments Clause.[103] Notably, in April 2018, the CFTC attempted to address the potential effects of Lucia by issuing its own order ratifying the

[91] *Id.*

[92] *Id.*

[93] *Id.*

[94] Athena Y. Velie, *Agency Settlements May Fuel Plaintiff Suits*: *In Re Natural Gas Commodity Litigation*, 24 FUTURES & DERIVATIVES L. REP. 15, 1 (Dec. 2004) (''Defendants, Beware! Plaintiffs are likely to use any settlement you enter into with the [CFTC], the Federal Energy Regulatory Commission ('FERC') or other federal agencies, even if you neither admit nor deny the agency's allegations or 'findings' against you, in subsequent civil litigation.'').

[95] *In re* Natural Gas Commodity Litig., 337 F. Supp. 2d 498 (S.D.N.Y. 2004).

[96] SEC v. Jos. Schlitz Brewing Co., 452 F. Supp. 824, 828 (E.D. Wis. 1978).

[97] 7 U.S.C. § 13a-1; *see also* CFTC v. Kimberlynn Creek Ranch, 276 F.3d 187 (4th Cir. 2002); CFTC v. Topworth Int'l, Ltd., 205 F.3d 1107 (9th Cir. 1999).

[98] 7 U.S.C. § 13a-1 (authorizing the CFTC to seek injunctions and other types of equitable or monetary relief such as restitution, an asset freeze, disgorgement of profits and civil fines against ''any registered entity or other person [who] has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of this Act or any rule, regulation, or order thereunder, or is restraining trading in any commodity for future delivery'').

[99] Practitioners may consult the Commission's regulations for further information about administrative procedures. 17 C.F.R. § 10 et. seq. Moreover, the Commission's Enforcement Manual published in May 2020 provides guidance on administrative enforcement proceedings. *See* CFTC, CFTC Enforcement Manual, at 23–24, 25 (May 20, 2020).

[100] 17 C.F.R. § 10.108.

[101] See *DiPlacido v. Commodity Futures Trading Com'n*, 364 Fed. Appx. 657 (2d Cir. 2009) (affirming an administrative law judge's determination that the petitioner manipulated settlement prices for electricity futures contracts).

[102] *See* Jean Eaglesham, *CFTC Turns Towards Administrative Judges*, WALL ST. J. (Nov. 9 2014).

[103] *Lucia v. SEC*, 138 S. Ct. 2044 (2018).

appointment of its Judgment Officer, Kavita Kumar Puri, and ordering reconsideration of all pending cases.[104]

Notably, on April 12, 2021, the CFTC declined to comply with a subpoena issued by an Office of the Comptroller (OCC) administrative law judge.[105] In In re Richard Usher, an adjudicative proceeding pending before the OCC, the CFTC found that a subpoena issued by the OCC, which requested documents related to a 2014 CFTC order, was invalid. The Commission reasoned that the ALJ did not have authority to issue a subpoena to the CFTC and that ''Congress has not waived sovereign immunity regarding subpoenas issued by ALJs in OCC administrative adjudications to non-party federal agencies.''[106]

a. Notice and complaint

An administrative proceeding formally commences when the Commission files a complaint and notice of hearing with the CFTC's Office of Proceedings.[107] The complaint and notice of hearing must include: (i) the legal authority and jurisdiction under which the hearing is held; and (ii) the matters of fact and law to be considered and determined.[108] The complaint must include enough specificity to allow the respondent to respond to each allegation. The notice of hearing must notify the respondent of a right to a hearing, specify the required time-frame for the filing of an answer, and outline the consequences for failing to file an answer.[109]

The CFTC's Proceedings Clerk must formally serve the respondent or its agent with a copy of the complaint and notice to appear. Service may be affected in person, through confirmed telegraphic notice, or by registered certified mail to the last known business or residence address of the person or agent to be served.[110] Where service cannot be achieved through these methods, the Proceedings Clerk may, at the CFTC's discretion, serve notice by publication; this entails a weekly posting in a general circulation newspaper in the respondent's last known place of business or residence for three consecutive weeks or, alternatively, the continuous display of the documents on the CFTC's website for three consecutive weeks.[111]

b. Answers

After a respondent is served with the complaint and notice of hearing, the respondent must file an answer with the Proceedings Clerk within 20 days.[112] The respondent's answer must respond to each allegation in the complaint. The respondent may admit, deny, or state that it has insufficient information to admit or deny an allegation (a statement that is taken, at this stage, as a denial). If a response is not provided with respect to a particular allegation, the allegation will be deemed admitted. If the answer raises affirmative defenses, it must include a statement of facts in support of each such defense.[113] In the event that a respondent cannot, upon a reasonable showing, frame an answer to some or all of the allegations contained in the complaint, because the allegations are overly vague or broad, a party may make a motion for a more definite statement of charges within 10 days of service. Such a motion must specify the defects to particular allegations for which a more definite statement is sought.[114]

The failure to timely file an answer constitutes default, and all of the allegations contained in the complaint are deemed to be true.[115] In the event that a party admits all of the allegations in the complaint, the answer is construed as a waiver of the respondent's right to a hearing, although the presiding administrative law judge (ALJ) still has discretion to conduct a hearing at the request of any party.[116] If the parties do not wish to have a hearing on the charges, they nonetheless retain the opportunity to appeal any initial decision to the CFTC.[117]

c. Discovery

Discovery in CFTC administrative proceedings is primarily effectuated in the form of prehearing memoranda that are exchanged by the parties at a date determined by the ALJ.[118] Such a memorandum must include: (i) an outline of the party's case or defense; (ii) the legal theories on which the party will rely; (iii) the identity, city, and state of all witnesses expected to testify on the party's behalf, along with a brief summary of the subject of each witness's testimony; and (iv) a list of all documents that the party intends to introduce at the hearing, as well as copies of all documents that other parties do not already possess or which they cannot reasonably and readily access.[119]

Moreover, any party that intends to rely upon an expert witness must provide a statement setting forth: (i) the witness's qualifications; (ii) a list of any of the witness's publications in the preceding 10 years; (iii) a list of all cases in which the witness has testified as an expert at trial or a deposition in the preceding four years; (iv) a complete statement of all of the opinions and the basis and reason for the opinions that the expert will offer at trial; and (v) a list and copies of all docu-

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[104] CFTC, Ratification and Reconsideration Order, *In re: Pending Administrative Proceedings* (Apr. 9, 2018).

[105] In re Richard Usher, Dkt. No. AA-EC-2017-3 (OCC).

[106] *Id.* at 5.

[107] 17 C.F.R. § 10.21. All filings and communications pertaining to the adjudicatory process flow through the Office of Proceedings. *See* 17 C.F.R. § 10.4. Any filing with the Office of Proceedings is made through the Proceedings Clerk . If filing is made by fax or email, there is no need to send paper copies. *See* 17 C.F.R. § 10.12.

[108] 17 C.F.R. § 10.22.

[109] *Id.*

[110] *Id.*

[111] *Id.*

[112] 17 C.F.R. § 10.23. Practitioners should note that there are specific rules for the form and format of all submissions and filings that occur during a proceeding. *See* 17 C.F.R. § § 10.12, 10.25. In contrast to civil litigation, respondents in CFTC administrative proceedings are not provided an opportunity to file a motion to dismiss the complaint in lieu of an answer.

[113] 17 C.F.R. § 10.23.

[114] *Id.*

[115] *Id.*

[116] *Id.*

[117] *Id.*

[118] 17 C.F.R. § 10.42.

[119] *Id.* If a prospective witness will be unable to attend or testify at a hearing due to age, illness, infirmity, or incarceration, or because the witness will be outside of the U.S. at the time of the hearing, depositions and interrogatories may be used to introduce the witness's testimony into the record.

ments, data or other written information that the witness considered while forming his or her opinions.[120]

All parties also have the right to apply to the ALJ for a subpoena requiring a person to produce specified documentary or tangible evidence.[121] Such requests must generally be in writing and served upon all of the other parties to the proceeding, unless they are made on the record at a hearing or the requesting party can demonstrate why a written submission or service is not warranted.[122] The request must specify the nature, scope, and relevance of the evidence to be subpoenaed.[123] If the ALJ determines that these requirements are satisfied and the request is ''not unreasonable, oppressive, excessive in scope or unduly burdensome,'' he or she will issue the subpoena.[124] Conversely, if the ALJ determines that these requirements are not satisfied, he or she may either refuse to issue the subpoena entirely or issue the subpoena with certain modifications.[125]

Notwithstanding any obligation to produce certain materials, Enforcement may withhold documents for a variety of reasons. These include: (i) protecting the identity of a confidential source or confidential investigatory techniques and procedures; (ii) preventing disclosure of information related to and relevant to the outcome of another ongoing investigation by Enforcement or another government agency; (iii) maintaining an agreement with a domestic or foreign government agency that any shared information would be kept confidential; or (iv) preserving work product or other privileges.[126] If Enforcement decides to withhold documents, it must nonetheless disclose their existence to the respondent and provide a sufficiently detailed basis for their non-disclosure, such that the respondent is able to make a reasonable assessment as to whether the claimed protection or privilege is applicable. Any disputes about whether a document must be disclosed are resolved by the ALJ, who must determine whether non-disclosure is sufficiently prejudicial to the respondent to overcome Enforcement's reasons for withholding it.

Respondents must also generally share any relevant documents with Enforcement, but may withhold documents based on privilege, the work product doctrine or other protection doctrines available under applicable law.[127] Similarly, the respondent must produce an index of any withheld documents with reasonably detailed explanations for their non-disclosure. Enforcement may also be entitled to these documents if it demonstrates prejudice by their non-disclosure.[128]

d. Summary judgment

If a party to the administrative proceeding believes that there is no genuine issue of material fact, such that the party is entitled to a favorable decision as a matter of law, it may move for summary judgment in part or in full.[129] A motion for summary judgment must be filed at or before the first prehearing conference, unless otherwise allowed by the ALJ.[130] After such a motion has been filed and served, any adverse party has 20 days to serve opposing parties or countermove for summary judgment.[131] Motions for summary judgment must include a statement of undisputed material facts, as corroborated by pleadings, affidavits, or other verified statements like investigative transcripts, admissions, stipulations and depositions.[132] As a general matter, such motions are rarely granted.

e. Pre-hearing conferences

The presiding ALJ has general discretion to direct prehearing conferences in any proceeding. Although Commission regulations set forth eight specific reasons for which a prehearing conference may be held, the final reason—''promoting a fair and expeditious proceeding''—serves, for all intents and purposes, as a catch-all provision.[133] As such, it is highly likely that a pre-hearing conference will be granted if the ALJ thinks it would serve any beneficial purpose—even when that purpose is not specifically enumerated in the Commission's regulations. After a prehearing conference, unless a written transcript is available, the ALJ must serve each party with a prehearing memorandum that contains any agreements or procedural determinations made during the course of the proceedings.[134]

f. The hearing

In the rare circumstance that a proceeding advances to the hearing stage, all parties are given notice of the time and place of the hearing. There is no set time for the amount of notice parties must receive, but the relevant regulations state that the time and place should be fixed ''with due regard for the public interest and the convenience and necessity of the parties and their representatives.''[135] A party may request that a hearing be postponed or its location moved upon a demonstration of good cause.[136]

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[120] *Id.*

[121] 17 C.F.R. § 10.68.

[122] *Id.* Requests for subpoenas of Commission records or for the appearance of any federal agency employees are subject to more stringent requirements. For example, such requests must always be made in writing and must demonstrate that the material or information to be subpoenaed is not available from other sources. *Id.*

[123] *Id.*

[124] *Id.* Within 10 days after a subpoena has been served or at any time prior to the return date thereof, either party may file a motion to quash or modify the subpoena, or for a protective order limiting the use or disclosure of information covered by the subpoena, with the ALJ who issued it. The subpoena will be stayed pending the ALJ's decision. *Id.*

[125] *Id.*

[126] *Id.*

[127] *Id.*

[128] *Id.*

[129] 17 C.F.R. § 10.91.

[130] *Id.*

[131] *Id.*

[132] *Id.*

[133] 17 C.F.R. § 10.41. Other specific reasons include: examining the possibility of obtaining stipulations or admissions, limiting the number of witnesses, and discussing the adoption of shortened procedures. *Id.* at § § 10.41(b), 10.41(e), 10.41(g).

[134] 17 C.F.R. § 10.41.

[135] 17 C.F.R. § 10.61.

[136] *Id.*

The respondent may appear at the hearing in person, or via counsel or other designated representative.[137] If the respondent fails to appear for a hearing after filing an answer, it does not automatically lose the case, although it does waive the right to an oral hearing, and Enforcement is still able to present evidence before the ALJ.[138] A non-appearing respondent may still preserve the right to challenge evidence thus presented by Enforcement by filing a notice within three days of the hearing of the respondent's intent to continue participating in the proceedings.[139]

During the hearing, each party has the right to representation by counsel, to present oral and documentary evidence, to make objections and motions, and to cross-examine witnesses.[140] At the hearing, evidence is admitted in much the same way as it would be in a typical courtroom trial—that is, parties move to admit evidence, with immaterial, irrelevant, and repetitious material being excluded.[141] However, in an administrative proceeding, the ALJ is unfettered by the Federal Rules of Evidence and can ultimately make evidentiary determinations at his or her discretion. As such, the range of permissible evidence is often much broader than it would be in a proceeding in federal court. For example, the ALJ has the discretion to allow cross-examination of a witness without regard to the scope of the witness's direct examinations, so that he or she may be asked any questions that are relevant to the proceeding generally.[142] The ALJ also has discretion to order that an expert witness's direct testimony be confined to a verified, written statement as opposed to oral testimony.[143]

All CFTC administrative hearings are public in nature, although a respondent or witness may request that certain documents or testimony be considered in a non-public setting, to prevent unwarranted disclosure of trade secrets, protect sensitive financial or commercial information, or prevent an unwarranted invasion of personal privacy.[144] The ALJ may grant or deny such motions at its discretion. At the end of the hearing, each party receives a copy of the transcript and is given the opportunity to submit corrections to the record.[145]

g. Interlocutory appeals

Parties may seek interlocutory appeals from certain decisions rendered by the ALJ in the course of an enforcement proceeding, though these are highly disfavored by the CFTC and are granted only in extraordinary circumstances. Interlocutory appeals may be entertained only where: (i) the ALJ denies a motion for recusal; (ii) one of the attorneys has been suspended from participating in a particular proceeding; (iii) the ALJ has denied requests for intervention or limited participation in a proceeding; (iv) the ALJ has issued an order requiring an officer or employee of the Commission or another government agency to produce records or testimony; or (v) the ALJ has certified a ruling for review on the grounds that it involves a controlling policy or law question that would advance the ultimate resolution of the proceeding if reviewed immediately or would cause unnecessary delays or expense to the parties if later reversed.[146]

A party seeking an interlocutory appeal must file a motion with the Commission within five days of the relevant ruling or certification.[147] The motion may not exceed 15 pages and must be served on the other side within five days of its receipt by the Commission.[148] Generally speaking, interlocutory appeals are not subject to oral argument. The moving party may request a stay of the administrative proceeding while the Commission reviews the matter, but there is no guarantee that either the ALJ or the Commission would grant such a stay.[149]

h. Proposed factual filings

Enforcement may file proposed factual findings, conclusions, and an initial brief with the Commission after the hearing. The initial brief must include (i) a short, concise statement of the case; (ii) a statement of the specific questions that need resolution; and (iii) an argument presenting clear points of fact and law.[150] Generally, these materials must be submitted within 45 days of the close of the hearing but the ALJ has discretion to lengthen or shorten the time periods for any submissions as he or she deems fits.[151] Thereafter, the respondent usually has 30 days to respond with its findings, conclusions, and opposition brief. The opposition brief may omit the statement of the case but otherwise is identical in structure to the initial brief. Enforcement then has the opportunity to file a reply brief within 15 days after the answering submission has been filed.[152] Reply briefs are restricted to responding to matters raised in the initial and opposition briefs.

Following the close of the hearing and the parties' opportunity to submit post-hearing materials, the ALJ must file an initial decision with the Proceedings Clerk.[153] This decision will become final within 30 days, unless either party files an appeal or the CFTC has made its own decision to review the matter or stay the initial decision.[154]

3. Sanctions

Enforcement may credit cooperative conduct by company respondents in assessing the appropriate level of sanctions to

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[137] 17 C.F.R. § 10.62.

[138] *Id.*

[139] *Id.*

[140] 17 C.F.R. § 10.66.

[141] 17 C.F.R. § 10.67.

[142] 17 C.F.R. § 10.66. Because a witness's cross-examination likely could exceed the scope of direct examination, practitioners should carefully weigh the benefit of having a witness testify.

[143] *Id.* In the event that the expert's testimony is ordered to be written, the parties still have the opportunity to orally cross-examine the expert.

[144] 17 C.F.R. § 10.64.

[145] 17 C.F.R. § 10.65.

[146] 17 C.F.R. § 10.101.

[147] *Id.*

[148] *Id.*

[149] *Id.*

[150] 17 C.F.R. § 10.82.

[151] *Id.* Practitioners should note that any findings or conclusions that are not briefed may be regarded as waived.

[152] *Id.*

[153] *Id.*

[154] *Id.*

recommend in a given case.[155] Although Enforcement has discretion to consider or reject any factors that it deems fit, it generally considers the three dimensions of cooperation. These are (i) the value of the cooperation to the specific investigation or enforcement action;[156] (ii) the value of the cooperation to the Division's broader enforcement interests;[157] and (iii) the balance of culpability or a history of misconduct against acceptance of responsibility and mitigation[158] The presence or absence of factors evidencing cooperation are not dispositive, and do not commit Enforcement to taking any action whatsoever. Moreover, Enforcement may entirely offset the cooperation credit that a company would otherwise receive, if it determines that the company engaged in other conduct that impeded Enforcement's investigation or wasted government resources.[159] In its corporation advisory only, the Commission emphasizes its respect for attorney-client and attorney work product protections, protections that the Commission points out may promote compliance. It clarifies that these rights ''are not intended to be eroded or heightened by this advisory.''[160]

Other factors potentially relevant to Enforcement's sanctions recommendation include the level of the organization at which the misconduct occurred; whether the misconduct arose because of pressure by supervisors; how long the misconduct lasted after supervisors became aware of it; and whether the company took available action to mitigate any losses causes by the misconduct.

> Comment: In January 2017, the Commission issued two new enforcement advisories that update its approach to evaluating cooperation.[161] In a change from earlier guidance, there are now two separate enforcement advisories. One outlines cooperation considerations for individuals while the other outlines slightly different cooperation considerations for companies.[162] The Commission notes that it places a ''high value'' on cooperation and emphasizes that it wants to make cooperation's benefits ''more transparent.''[163]

4. Appeals

Once an initial decision has been issued, an appeal may be filed with the Commission by the parties and any interveners within 15 days.[164] In considering whether to file an appeal, respondents must be aware that the Commission will review the impositions of sanctions de novo, and has the power to increase any sanctions issued by the ALJ. The matter *In re Miller* is instructive: there, the respondent was fined $50,000 by an ALJ for fraudulently inducing his customers to purchase and sell certain commodity options. The respondent appealed, and upon de novo review, the Commission determined that the respondent's conduct was particularly egregious and assessed a civil monetary penalty of $600,000 against the respondent—12 times the amount originally imposed by the ALJ.[165]

The appellant's initial brief is due within 30 days of the notice of appeal. The appellee then has 30 days to file an opposition brief. The appellant's reply brief is due 14 days thereafter. Any failure to comply with this timeline allows all other parties to move for dismissal. Each brief must contain, in order: (i) a statement of issues for review; (ii) a statement of the case, beginning with a general description followed by the relevant facts corroborated by citations to the record; (iii) the argument, with reference to appropriate authorities; and (iv) a conclusion stating the precise relief sought. Any matters not briefed are considered waived. Oral arguments may be granted upon request within the brief filing deadline, and are generally

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[155] The Commission credits cooperative conduct by individual respondents as well as companies. It published updated guidelines to that effect in 2017. *See* CFTC Division of Enforcement, Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Individuals (2017) https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisoryindividuals011917.pdf; CFTC Division of Enforcement, Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Companies (2017) (Hereinafter, ''Individual Advisory'' or ''Company Advisory'' or collectively ''2017 Advisories.''), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisorycompanies011917.pdf. The Commission's previously published guidance, dating back to 2007, expressly elucidated the cooperation factors for only corporate respondents, even as they were largely understood to apply to individual respondents as well.

[156] Here, the Commission will consider: (i) the materiality of the assistance; (ii) the timeliness of cooperation; (iii) the nature of the cooperation, such as the means by which a company uncovered misconduct; and (iv) the quality of the cooperation. 2017 Advisories.

[157] Here, the Commission will consider: (i) for companies only, whether cooperation credit would encourage other corporations to likewise cooperate; (ii) the importance of the investigation or action, and in particular whether it posed a great harm or involved a Commission enforcement priority; (iii) whether the cooperation conserved Commission resources; (iv) whether the cooperation credit enhances the Commission's ability to pursue other violations. *Id.*

[158] Here, the Commission will consider: (i) the circumstances of the misconduct; (ii) any prior misconduct; (iii) any mitigation of the harm; (iv) for companies, any internal remediation to prevent future wrongdoing, (v) any acceptance of responsibility; and (vi) for individuals, the opportunity for future violations. *Id.*

[159] The Commission gives the following examples of uncooperative conduct: (i) Failing to respond to requests and subpoenas; (ii) falsely claiming that information is not available; (iii) failing to preserve or provide relevant information; (iv) misrepresenting or minimizing the extent of the misconduct; (v) providing specious explanation for instances of misconduct that are uncovered; (vi) advising or directing others not to assist and cooperate; and (vii) engaging in evasive, misleading, or obstructive conduct during testimony. *Id.* For companies only, the Commission gives the following examples: (i) limiting access to employees; (ii) issuing questionnaires to employees or conducting interviews that offer suggestive responses; (iii) providing employees or former employees access to documents or data beyond what they would have been privy to in the course of their employment; (iv) failing to search computer hard drives properly for documents, data, and electronic images; and (v) failing to comply with CFTC Data Delivery Standards. Corporate Advisory.

[160] *Id.*

[161] *Id.*

[162] *Cf.* CFTC Division of Enforcement, Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations (2007)

[163] 2017 Advisories at 1.

[164] 17 C.F.R. § 10.102. Any party seeking an appeal must comply with this timetable, even if another party has already made a timely filing.

[165] Howard Miller, CFTC Docket No. 92-4 (Mar. 12, 1998).

limited to 30 minutes for each party.[166] Parties must file an original version of their brief, along with 10 copies, with the Proceedings Clerk.

Separately from the brief, the parties must file an appendix containing the relevant factual record. The purpose of the appendix is to focus the Commission on specific evidence. The appendix does not limit what evidence the Commission may consider, and indeed, the Commission generally considers the ''whole record'' on appeal. The whole record includes the pleadings and notice of hearing; any applications and motions, with supporting papers; all rulings and exceptions thereto, submitted by the parties; any admissions, stipulations, and prehearing conference materials; the trial transcript and received exhibits; any statements filed under the shortened procedure; any official public records specified in any of the above; any proposed findings, conclusions, and supporting briefs; written communications received by the ALJ from limited participants and from commentators; the initial decision; the petition for review; and any other document appearing on the docket.[167] The Commission may also solicit new evidence.

In evaluating the appeal, the Commission reviews the record de novo and makes an ultimate decision to affirm, reverse, modify, set aside, or remand the ALJ's decision based on the ''record in the proceeding.''[168] If the Commission denies the appeal and the party has exhausted all other administrative remedies, the party may file an appeal in federal court.[169] Appeals to federal court are subject to the abuse of discretion standard for review; because this standard is very deferential to the Commission, such appeals are rarely successful.

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[166] 17 C.F.R. § 10.103.

[167] 17 C.F.R. § 10.34.

[168] 17 C.F.R. § 10.104.

[169] *See* Hirschberg v. CFTC, No. 02 Civ. 06483 (N.D. Ill. Aug. 27, 2003).

V. Other Regulatory Enforcement Actions

A. Introduction

As discussed at 262 SPS § III-C, *U.S. Exchanges and Other Self-Regulatory Organizations*, self-regulatory organizations (SROs) have the authority to monitor the market activities of member exchanges, investigate potential rule violations, prosecute cases, and discipline members who have engaged in wrongful conduct. This chapter describes the enforcement proceedings and priorities of several representative U.S. SROs.[1]

Pursuant to their market oversight activities, SROs frequently issue regulatory inquiries for routine information-gathering purposes or to investigate specific instances of suspected misconduct. These inquiries do not always (or even usually) foreshadow an enforcement proceeding, but they are a necessary precursor. The issuance of an inquiry letter is simply an investigative tool and is not intended to suggest wrongdoing. While an inquiry letter may be used to probe an alleged infringement of CFTC or SRO regulations, it is often indiscriminately issued to some or all market participants who engaged in a particular type of transaction during a given review period.

The first step in responding to an inquiry notice is to ensure familiarity with the rule(s) or regulation(s), if any, referenced in the letter. The cited rule or regulation will provide helpful context about the focus and scope of the inquiry, thus clarifying what information is being sought and to what end. For example, while some rules and regulations are narrowly tailored to specific violations, others are broad catch-all provisions designed to capture a wide array of conduct. If a review of the governing provisions does not clarify the requests in the inquiry letter, it may make sense to reach out to the signatory of the letter with any questions or concerns.

Once the relevant rules and regulations have been reviewed, the general protocol is to gather responsive information and documentation. This usually requires (i) speaking to any trader(s) or other employee(s) involved in the transactions at issue; (ii) coordinating with the appropriate divisions within the company to collect any requested records; and (iii) working with the back office and counsel of the company to draft a reply letter. If an individual employee is named or targeted in the inquiry, consideration needs to be given as to whether separate outside counsel should be retained for his or her representation, to avoid potential conflicts of interest as the inquiry proceeds.

Generally, extensions (usually of one week) are freely given, and may be requested orally or in writing up to the day the response is due. If the SRO grants an extension request by telephone, it is best practice to follow up with a written confirmation. Samples of inquiry notices are provided throughout this chapter.

B. The CME Group Inc.

1. The investigation

The Chicago Mercantile Exchange (CME) relies on its Market Regulation Department (Regulation Department) to actively monitor market participants and their trading practices, as well as to enforce compliance with the rules and regulations governing participants' conduct.[2] The Regulation Department is composed of various specialized units that focus on detecting and addressing specific types of violations. For example, a unit may be tasked with (i) conducting trade practice surveillance of individual transactions executed on the Exchange; (ii) reviewing large positions held at the Exchange; or (iii) policing the integrity of the data submitted to the Exchange.[3]

When the Regulation Department suspects that a party may have engaged in wrongful conduct, it initiates a formal investigation, pursuant to which it may collect documentary evidence and take recorded interviews or oral depositions of witnesses.[4] An example inquiry letter sent by the CME to a large financial institution in connection with a possible violation is provided in 262 SPS Practice Tool 3. Compliance with requests for documentation is enforced, as evidenced in a recent settlement between the CME and a member that failed to timely produce documents and records related to a Market Regulation inquiry.[5] Any evidence obtained in the investigation is deemed ''non-public and confidential'' and may not be disclosed by any party, absent extenuating circumstances.[6]

At the close of an investigation, the Regulation Department produces a report summarizing its findings (Investigation Report). The Regulation Department may also, in its discretion, issue the respondent[7] a warning letter regarding the contested conduct. The work of the Regulation Department is supervised by the Market Regulation Oversight Committee, which is comprised of ''public directors'' from the Board of Directors (Board) of CME Group Inc., Chicago Mercantile Exchange Inc., Board of Trade of the City of Chicago, Inc., New York Mercantile Exchange Inc., and Commodity Exchange, Inc.

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[1] Setting aside minor procedural variations, both the various SROs and the CFTC employ substantively similar enforcement processes. Thus, the preceding chapter should serve as an additional enforcement reference for practitioners.

[2] John W. Labuszewski et al., THE CME GROUP RISK MANAGEMENT HANDBOOK: PRODUCTS AND APPLICATIONS 98 (2010). In 2010, the Chicago Mercantile Exchange (CME) launched the Regulatory Outreach Program (Outreach Program) to provide market participants with easy access to information and resources related to regulatory requirements and compliance issues. The Outreach Program seeks to (i) ''[e]ffectively communicate rule modifications, rule advisories and other rules-based information to market participants;'' (ii) ''[p]romote a uniform understanding of Exchange rules and regulations;'' (iii) ''[s]erve as a resource for trade practice and surveillance based questions;'' and (iv) ''[b]uild constructive, ongoing relationships with industry participants.'' *See* CME Grp., *Regulatory Outreach Program*, CMEGROUP.COM.

[3] CME Group, Market Regulation: Meet the Team, https://www.cmegroup.com/education/courses/market-regulation/overview/market-regulation-meet-the-team.html# (last accessed April 18, 2021).

[4] CME Rule 407. Parties and witnesses may bring a legal representative to the interview; the rules are silent as to whether this allowance applies to deposition proceedings as well.

[5] CME Group, Notice of Disciplinary Action: # CME-15-0201-BC (Mar. 30, 2017), available at https://www.cmegroup.com/notices/disciplinary/2017/03/CME-15-0201-BC-WEDBUSH-SECURITIES-INC.html .

[6] CME Rule 407.

[7] For purposes of this Chapter, ''respondent'' refers to the subject of a regulatory investigation and/or disciplinary proceedings.

(collectively referred to as the Company), who review its budgets, operations, and case work.[8]

2. Disciplinary proceedings

a. Overview

The CME's disciplinary duties are primarily discharged by two entities within the Regulation Department—the Chief Regulatory Officer (CRO) and the Business Conduct Committee (BCC).[9] The role of Chief Regulatory Officer is assigned to one individual who may delegate their authority to the staff of the Regulation Department in order to carry out their duties.[10] The BCC is a five-person panel that includes one chair (Panel Chair), two non-CME members, and two members or representatives of member exchanges (at least one of whom must be from the contract market where the case originated).[11] The CRO and BCC work in tandem, such that the CRO must first assess whether the proposed charges are supported by probable cause, before the BCC can step in to oversee any disciplinary proceedings pursuant to formal charges.

The CRO considers the Investigation Report prepared by the Regulation Department and determines whether charges of a rule violation are warranted.[12] If the CRO concludes that a ''reasonable basis'' exists for a finding that a violation occurred, it may issue either charges or a warning letter.[13] Conversely, if the CRO concludes that ''no reasonable basis'' exists for finding that a violation occurred, it may direct that no further action be taken against the respondent.[14] If the CRO cannot make a determination without information beyond that provided in the Investigation Report, it may direct the Regulation Department to conduct another inquiry.[15]

If the CRO directs that charges be issued, the Regulation Department must provide the respondent with a Notice of Charges (Notice). The Notice must set forth (i) the rules at issue; (ii) the instructions for submitting a responsive answer; (iii) the time and place of the hearing before the BCC, if known; and (iv) the respondent's rights, including the right to submit a written answer within 21 days. The failure to timely file an answer or to deny a charge may be deemed an admission, such that the right to a hearing with respect to that charge is waived.[16]

The BCC holds hearings on contested charges to determine whether any rules have been violated and makes a ''reasoned'' conclusion with respect to each charge.[17] The BCC is ultimately responsible for enforcing CME rules with respect to matters relating to ''business conduct, trading practices, sales practices, trading ethics and market manipulations or other actions that threaten the integrity of the market.''[18]

COMMENT: The CME has the ability to issue summary fines for violations of CME Rule 512, which requires that all data, records, or other information subject to mandatory reporting under exchange rules be submitted in an accurate, complete, and timely manner. In the ordinary course, the CME will issue a warning letter for any first such offense and a summary fine thereafter. Pursuant to Rule 512, the summary fine may not be less than $1,000 or more than $5,000 per offense for individuals or $10,000 for firms or facilities. Factors that affect the amount of sanctions include the magnitude, frequency, and import of the reporting violation; previous disciplinary history; and any remedial actions taken to correct the identified issues.

Parties have fifteen calendar days following the receipt of a summary fine to submit evidence demonstrating that the fine should be rescinded or reduced.[19] If this evidence is rejected or deemed to be insufficient, then the affected individual or institution may file a written appeal with the CME's Market Regulation Department.[20] It is highly unlikely that an appeal will be successful, however. Under the CME's rules, a BCC panel will not set aside, modify, or amend the appealed decision unless it determines, by a majority vote, that the decision was (i) arbitrary, capricious, or constituted an abuse of discretion; (ii) in

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[8] A ''public director'' is a director who has no ''material relationship'' with the contract market: i.e., the director is not an officer, employee, or member of the exchange or its affiliates; does not, either personally or through his or her firm, receive more than $100,000 in combined annual payments from the exchange or its affiliates; and has no immediate family that has either of the preceding ties to the exchange. 74 Fed. Reg. 18,982-01 (Apr. 27, 2009). Pursuant to CFTC regulations, Designated Contract Markets (DCMs) must include a certain number of public directors on their boards (35 percent) and disciplinary panels (at least one on each panel).

[9] CME Rule 400.

[10] CME Rule 401.

[11] CME Rule 402.A.

[12] Respondents are not entitled to notice of the Regulation Department's intent to appear before the PCC to request charges. Nor do respondents have the right to appear before the PCC or to make any written submission on their behalf. CME Rule 406.

[13] *Id.* The Regulation Department may, without the consent of the PCC, revise the charging memorandum after a respondent has been charged, to account for new information regarding the underlying activity or another potential rule violation. However, new charges may not be added without the consent of the PCC. CME Rule 407.D.

[14] CME Rule 406; *cf.* CME Rule 411 (permitting the Regulation Department to appeal such a refusal to the Board within 10 business days. The Board is composed of three directors, one of whom is appointed by the Chairman of the Board to serve as Chairman of the panel).

[15] CME Rule 406.

[16] An answer must state whether the respondent admits, denies, or lacks sufficient knowledge to either admit or deny each of the charges. A statement of lack of sufficient knowledge is considered a denial. Charges not denied in whole or in part are deemed admitted. CME Rules 407.B–C.

[17] The BCC has the authority to: take emergency actions; take actions against non-members; conduct hearings on denials of access; conduct hearings, proceedings and appeals on all matters over which it has jurisdiction; and make findings on rule violations against members and non-members. CME Rule 402.A.

[18] *Id.* Other types of misconduct fall under the purview of less prominent CME committees, such as: (i) the Clearing House Risk Committee, which has authority under CME Rule 403 over applications for clearing memberships and for assignment of trading rights for clearing purposes; (ii) the Pit Committee, which has authority under CME Rule 404 over activities arising from pit trading or disputes related to the pit space; and (iii) the Floor Conduct Committee, which has authority under CME Rule 405 to resolve any disputes that are not resolved by the Pit Committee.

[19] CME Rule 512.B.

[20] CME Rule 512.C.

excess of the CME's authority or jurisdiction; or (iii) based on a clearly erroneous application of Exchange rules.[21]

Reporting infractions that are currently subject to sanctions under Rule 512 include reporting concerning large trader, open interest, and long positions eligible for delivery; registrar reports; block trade and, more recently, EFRP reporting; user IDs on CME Globex trades (Tag 50); automated or manual indicator on CME Globex trades (Tag 1028); sender location on CME Global trades (Tag 142); customer type indicator codes; front-end audit trail requirements; reporting related to accounts, including suspense account usage, account changes, and transfer reason codes; and CME Brokerage Reassignment trade recordation requirements; and requests for a bona fide hedge exemption..[22]

b. Settlement

The Regulation Department will generally attempt to settle a case throughout the disciplinary process. A respondent may submit a written offer of settlement to the adjudicating BCC Panel any time prior to when the BCC commences deliberations at a contested hearing. If a respondent submits a settlement offer without admitting or denying any rule violations on which the penalty is based, the offer must include a consent to an entry of findings by the BCC regarding the contested conduct and the penalty to be imposed. Notably, no offer of settlement may be submitted by a respondent to the BCC unless the Market Regulation Department supports the written offer. The BCC will consider the submission in conjunction with the Regulation Department's supporting statement, in addition to any relevant statements made during the settlement hearing.[23]

Should the BCC approve a settlement, it must prepare a written decision identifying (i) the panel's findings; and (ii) the sanction imposed, as well as provide the respondent with written notice of the decision.[24] Conversely, if the BCC declines to accept the offer of settlement, and the respondent and Regulation Department cannot thereafter agree on settlement terms, the matter will be resolved via a contested hearing. Notably, statements made or documents exchanged by the parties solely in relation to a withdrawn or rejected offer of settlement are inadmissible in any contested hearing.[25]

3. Hearing on contested charges

a. Prior to the hearing

Provided the timely filing of an answer, a respondent charged by the CRO is entitled to review the evidence offered in the Market Regulation Department's investigation file in advance of the hearing, subject to exceptions for protected work product or attorney-client communications (which include the investigation report itself).[26] The respondent may present written submissions outlining any procedural or evidentiary issues, as well as any pre-hearing motions, to the BCC Panel.[27] The Panel Chair has the authority to render final decisions on such submissions and pre-hearing motions.[28] Notably, no motions to dismiss some or all of the charges, or any other dispositive motion, may be filed at this stage.[29]

The respondent and Market Regulation Department must submit any tangible evidence upon which he or she will rely, as well as a list of possible witnesses, to the opposing party at least 28 days in advance of the hearing.[30] All ''information, records, materials and documents'' provided to the BCC, as well as ''all deliberations, testimony, information, records, materials and documents related thereto'' are considered to be ''non-public and confidential'' such that they ''shall not be disclosed, except as necessary to further an Exchange investigation or as required by law.''[31] No formal rules of evidence apply at the hearing.[32]

b. The hearing

The Regulation Department serves as the adversary party at the hearing and presents evidence of the alleged a rule violation(s). The respondent has the right to appear personally and testify; to be represented by counsel or another person of his or her choosing;[33] and to call or cross-examine witnesses.[34] At the close of the hearing, the BCC must determine, by majority vote, whether the Regulation Department has met its burden of establishing the respondent's guilt by a ''preponderance of the evidence.''[35]

The BCC must provide the respondent with a written report outlining its findings and conclusions. This report must include: (i) a summary of the charges; (ii) a summary of the answer, if one was submitted; (iii) a brief summary of the evidence produced at the hearing; (iv) a statement of findings and reasoned conclusions with respect to each charge, including the specific rules that the respondent is found to have

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[21] CME Rule 512.C.

[22] CME Group, Market Regulation Advisory Notice, CME Grp. (Nov. 5, 2018), https://www.cmegroup.com/rulebook/files/cme-group-Rule-512.pdf.

[23] CME Rule 408.C.

[24] CME Rule 408.C.

[25] *Id*. A respondent may withdraw an offer of settlement at any time prior to the start of the hearing on the proposed settlement before the BCC. *Id*.

[26] CME Rule 408.A. A respondent who seeks documents not in possession of the Regulation Department may request them from their custodian, or petition the Panel Chair in writing for an order compelling the production of documents from the custodian (assuming the custodian is subject to the CME's jurisdiction).

[27] All pre-hearing motions, save a motion to dismiss, must be submitted at least five days ahead of the hearing; motions to dismiss must be submitted in writing to the BCC's counsel and to the Regulation Department at least 21 days in advance of the originally scheduled hearing date. Upon receipt, the Regulation Department then has seven days to submit a written response to BCC's counsel and the respondent. Unless the Panel Chair determines, in his or her sole discretion, that oral arguments are necessary to resolve the pre-hearing motion, decisions will be made on the basis of the papers alone. CME Rule 408.B.

[28] CME Rule 408.B

[29] *Id*.

[30] *Id*.

[31] CME Rule 402.A.

[32] CME Rule 408.D.

[33] The person cannot be a member of any CME disciplinary committee or the CME Board; an employee of CME or its subsidiaries; or a person related to the underlying investigation.

[34] CME Rule 408.D.

[35] *Id*.

violated; (v) a declaration of any penalty imposed and the effective date of such penalty; and (vi) the availability, if any, of an appeal of the decision within the Exchange or to the CFTC.[36]

If the BCC concludes that a party, including a member respondent has engaged in wrongful conduct, it may issue sanctions or penalties, including:

- a fine of up to five million dollars per violation, plus restitution in the amount of the benefit wrongfully conferred;
- a period of probation;
- the restriction, suspension, or expulsion of an individual or entity from membership at the CME or its subsidiaries;
- an order of full restitution;
- an order that no Clearing Member accept new positions on behalf of the party;
- restricting, suspending, or terminating the party's access to any trading or clearing platform owned or controlled by the CME; or
- order ''such action as is necessary'' to prevent a threat to the contract or violation of the CEA or CME Rules.[37]

In the interim period between the BCC's determination that there has been a violation and the application of penalties, the Regulation Department and the respondent may present information to the BCC regarding their respective views on appropriate sanctions. In the event that the BCC determines that the violation may warrant a penalty in excess of its own authority, it may refer the matter to the Board; in turn, the Board may refer the matter to government or law enforcement agencies, such as the FBI or the U.S. Attorney's Office.

4. Enforcement priorities

The changing nature of commodities trading has impacted the enforcement priorities of the CME perhaps more than any other factor. For example, between 2008 and 2012, the CME's enforcement activities were focused on recordkeeping and procedural violations. Specifically, the CME primarily pursued floor trading violations—that is, violations related to trading activity that takes place on the trading floor of an exchange where traders meet to buy and sell financial futures using the open ''outcry method'' of communication.[38] Floor trading has, however, steadily declined in favor of electronic trading, such that only about 15 percent of overall trading occurs in open outcry today.[39] Many sophisticated firms now engage in high-frequency trading, a form of automated trading that uses computer algorithms to produce a high rate of orders, quotes, or cancellations.[40]

Recordkeeping and procedural violations are far rarer in the electronic realm, where databases are automatically updated with new trading information, and computer algorithms are programmed to respond automatically and consistently to market events. Accordingly, the CME has shifted its focus to electronic trading infractions, particularly with respect to wash trades and spoofing, as its traditional caseload has evolved.[41] In addition to demonstrating a consistent concentration on those violations, the CME has also recently initiated enforcement actions in the realm of EFRPs, block trades, and position limits.

a. Wash Trades

Wash Trades are an illegal form of market manipulation, whereby an investor simultaneously acts as buyer and seller in the same transaction.[42] Wash trading gives the appearance of increased trading volume, even though the traded instrument

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[36] CME Rule 408.E. A respondent may appeal a decision or sanction imposed by the BCC to a hearing panel of the Board of Directors within 10 business days of receiving the decision, provided that the sanction imposed is (i) greater than $25,000 (issued through any of a fine, disgorgement, or restitution) or (ii) includes an access denial or suspension of membership privileges for longer than 10 business days. Further, CME rules must not specifically prohibit an appeal under the circumstances in order for such an appeal to proceed. CME Rule 411. The Regulation Department may appeal a BCC decision or sanction to the Board within 10 business days. *Id.*

[37] The BCC may also order the party to cease and desist from certain wrongful conduct; impose additional capital or financing requirements; or require members to liquidate some portion of their open contracts. A full list of the sanctions available to the BCC is set forth in CME Rule 402.B.

[38] The open outcry method of communication involves shouting and the use of hand signals to transmit information about buy and sell orders.

[39] *See* Gail Marks Jarvis, *Chicago could get new open-outcry trading floor, even as frenzied trading declines*, CHI. TRIBUNE (July 28, 2017, 9:27 AM) (noting that ''[a]n estimated 85 percent of U.S. trading now is done electronically rather than live.''). Additionally, the decline of CME's open outcry has been exacerbated by the COVID-19 pandemic, which caused the group to close its open outcry in March of 2020. And, while CME reopened its open outcry floor for Eurodollar options in August 2020, the rest of the trading floor remained closed as of February 2021. *CME Group Inc. Reports Fourth-Quarter and Full-Year 2020 Financial Results*, PR NEWSWIRE (Feb. 10, 2021), https://www.prnewswire.com/news-releases/cme-group-inc-reports-fourth-quarter-and-full-year-2020-financial-results-301225505.html.

[40] *See* RENA S. MILLER & GARY SHORTER, CONG. RESEARCH SERV., 7-5700, HIGH FREQUENCY TRADING: OVERVIEW OF RECENT DEVELOPMENTS 1 (2016).

[41] In December 2016, in order to ''address the increasing complexity of disciplinary matters... [and] make the rules more applicable to the types of disciplinary cases going through the enforcement process,'' the CME announced an increase in potential fines for misconduct on its exchanges, from $1 million to $5 million. CME Group, Special Executive Report: # S-7808, CME GRP. (Dec. 1, 2016), http://www.cmegroup.com/notices/market-regulation/2016/11/SER-7808.pdf.

[42] Specifically, CME Rule 534, entitled ''Wash Trades Prohibited,'' provides that ''[n]o person shall place or accept buy and sell orders in the same product and expiration month, and, for a put or call option, the same strike price, where the person knows or reasonably should know that the purpose of the orders is to avoid taking a bona fide market position exposed to market risk (transactions commonly known or referred to as wash sales). Buy and sell orders for different accounts with common beneficial ownership that are entered with the intent to negate market risk or price competition shall also be deemed to violate the prohibition on wash trades. Additionally, no person shall knowingly execute or accommodate the execution of such orders by direct or indirect means.'' CME GRP., *Market Regulation Advisory Notice, Wash Trades Prohibited* at 1 (Nov. 16, 2016), https://www.c-

never actually changes beneficial owners. This apparent volume spike can prompt other traders into buying the position, which artificially increases the commodity price. Wash trading activity presents several unique enforcement challenges. First, given that an average trade can be executed in ''less than one millisecond,'' the volume of transactions to police is overwhelming.[43] Second, it is difficult to determine whether the suspect trading is intentional, as buy and sell orders may easily cross by mistake and are often the result of algorithmic trading systems.[44] Third, it is difficult to distinguish whether electronic buy and sell orders are coming from two separate parts of a firm, in which case the orders may be valid, or whether both sides of the transaction are part of the same trading strategy.[45]

In 2013, the majority of the wash trading violations in the futures markets occurred on the CME.[46] Regulators like the CFTC expressed concern that the Exchanges' systems were not sophisticated enough to flag irregularities or filter prohibited trades.[47] Against this backdrop, the CME worked to improve its electronic detection systems to capture more wash trading and other improper trading activity.[48] The CME also updated its wash trading guidelines to clarify the distinction between intentional and unintentional self-dealing.[49] Additionally, as part of its efforts to stem the flow of wash trading violations, the CME launched an optional feature on its electronic trading platform in June 2013 to prevent wash trades by allowing traders to block matching buy and sell orders from the same account.[50] In April 2019, the CME issued an Advisory Notice addressing Rule 534, which prohibits wash trades, in order to provide more comprehensive guidance for complying.[51] These efforts – together with continued active enforcement of wash trading violations – have improved CME oversight over wash trading activity.

The CME's increased policing of wash trading has paid off, as evidence by recent enforcement actions issued to certain financial institutions. For example, in December of 2019, the CME sanctioned a violator $20,000 and imposed a three-month suspension for engaging in trades opposite the same counterparty in which the two parties communicated and engaged in buy and sell orders in the same instruments, at the same price and quantity, constituting a wash transaction.[52] In another instance, the CME imposed a fine of $75,000 and a two year suspension on a violator who placed buy and sell orders in the same product and expiration month in such a manner as to avoid taking any bona fide market position exposed to market risk.[53] In 2022, the CME imposed a fine of $35,000 and a 30 day suspension on a violator who placed buy and sell orders for Class III Milk Futures for accounts that he owned that traded opposite each other where he knew or reasonably should have known that the purpose of the orders was to avoid market risk.[54] These actions, as well as others, indicate that wash trading remains near the top of the CME's enforcement agenda.[55]

b. Spoofing

Spoofing refers to the act of ''bidding or offering with the intent to cancel such bid or offer before execution''—in other words, pretending to make a trade without meaning to follow through.[56] A common purpose of such activity is to suggest that there is unusually high demand for a given product, allowing the trader to benefit from the increased market price. For purposes of establishing a spoofing violation, it is irrelevant whether the order is ultimately filled; the focus is on the trader's intent at the time the order is submitted. This intent may be demonstrated through contemporaneous evidence such as emails, phone recordings, and instant messages or through circumstantial evidence such as the computer code behind the

megroup.com/tools-information/lookups/advisories/market-regulation/files/RA1614-5.pdf.

[43] RENA S. MILLER & GARY SHORTER, CONG. RESEARCH SERV., 7-5700, HIGH FREQUENCY TRADING: OVERVIEW OF RECENT DEVELOPMENTS (2016), at 9. Currently, high-frequency trading makes up 80 percent of the volume of foreign exchange futures and roughly 66 percent of both interest rate futures and Treasury 10-year futures volumes.'' *Id*.

[44] In consequence, CME Rule 534 retains the ability to punish ''unintentional and incidental matching of buy and sell orders'' that occur on ''more than an incidental basis.'' CME Group, *Market Regulation Advisory Notice, Wash Trades Prohibited* at 5 (Nov. 16, 2016).

[45] Kevin McCoy, Regulator Seeks Inquiry of Super-Fast Trading, USA TODAY, June 24, 2013.

[46] A 2013 report from the Commission's surveillance staff described the amount of violations as ''shocking.'' Tom Polansek, *CME Group Shelves Update to Rules Barring Wash Trades*, REUTERS (June 28, 2013).

[47] Scott Patterson, et al., *'Wash Trades' Scrutinized*, WALL ST. J., Mar. 17, 2013.

[48] *See, e.g.*, CME GRP., *Risk Management Tools*.

[49] See, e.g., CME GRP., Market Regulation Advisory Notice, Wash Trades Prohibited 1, (Nov. 16, 2016).

[50] Tom Polansek, *CME Group Shelves Update to Rules Barring Wash Trades*, REUTERS (June 28, 2013). Despite offering customers – and regulators – the ability to quickly detect and avoid a wash sale, this feature is still an optional function. See CME GRP., Risk Management Tools.

[51] CME Advisory Notice, CME Group RA1905-5, April 25, 2019, https://www.cmegroup.com/content/dam/cmegroup/notices/market-regulation/2019/04/RA1905-5.pdf.

[52] CME Group, Notice of Disciplinary Action: #CME-18-0883-BC-1 (Dec. 23, 2019), https://www.cmegroup.com/notices/disciplinary/2019/12/CME-18-0883-BC-1-ADRIEN-FROIDURE.html .

[53] CME Group, Notice of Disciplinary Action: #CME 19-1121-BC-2 (Dec. 10, 2020), https://www.cmegroup.com/notices/disciplinary/2020/12/CME-19-1121-BC-Xu-Peng.html.

[54] CME Group, Notice of Disciplinary Action: #CME-20-1265-BC (Feb. 24, 2022), https://www.cmegroup.com/notices/disciplinary/2022/02/CME-20-1265-BC-David-Zubrod.html

[55] For additional examples of the CME's continued focus on wash trading, see CME Group, Notice of Disciplinary Action: # COMEX 16-0569-BC-2 (Nov. 16, 2018), https://www.cmegroup.com/notices/disciplinary/2018/11/COMEX-16-0569-BC-2-THOMAS-POULOSE.html (individual fined $45,000 and was permanently banned from membership of CME Group exchange and access to CME platforms for, among others, executing numerous trades between two proprietary accounts with common beneficial ownership); CME Group, Notice of Disciplinary Action: # CBOT- 17-0634-BC-3 (Oct. 05, 2018), https://www.cmegroup.com/notices/disciplinary/2018/10/cbot-17-0634-bc-3-travis-haymore.html (individual fined $25,000 and had access to CME platforms suspended for 15 business days for entering matching buy and sell orders on the CBOT in U.S. Treasury Bond options and Corn options.).

[56] *See* 7 U.S.C. § 6c(a)(5).

trading algorithm used by a high-frequency trader.[57] Although spoofing only became explicitly illegal under a provision of the Dodd-Frank Act that became effective on July 16, 2011, it has a clear history of prior enforcement by the CFTC[58] and the CME.[59]

Spoofing is specifically prohibited under CME Rule 575.A, which states that ''[n]o person shall enter or cause to be entered an order with the intent, at the time of order entry, to cancel the order before execution or to modify the order to avoid execution.''[60] In addition, spoofing is actionable under CME Rule 432, which contains general prohibitions on conduct that is dishonest and manipulative or otherwise inconsistent with just and equitable principles of trade. On February 16, 2017, the reach of CME Rule 432 was expanded at the request of the CFTC to (i) include ''attempted'' violations of existing exchange rules prohibiting manipulation, false reporting and fraud; and (ii) broaden the requisite scienter standard to encompass ''reckless'' (as opposed to just intentional) violations.[61] At least some industry commentators believe that spoofing is understood to be ''the most immediate and likely target'' of the rules changes, which will give the CME more latitude to pursue traders who engage in such manipulative activity.[62]

The CME has actively pursued cases against both members and non-members for spoofing-like activity over the last few years. Penalties for spoofing range from fines to permanent trading bans for violators. In 2015, for example, the CME permanently banned a group of three traders for spoofing and wash trading activity.[63] The traders were collectively fined $300,000 for their improper conduct.[64] More recently, a non-member was fined $20,000 and suspended for 10 days following a finding that he entered and canceled orders for future contracts that caused opening prices to fluctuate.[65] Interestingly, the CME found that the purpose for the non-member's action was to test the ''connectivity and latency of his front-end trading workstation.''[66] Because the execution caused the underlying fluctuation, however, the non-member was found to have violated Rule 575.A.

In 2020, the CME published 17 disciplinary actions sanctioning activities implicating Rule 575.A violations. For example, in August of 2020, the CME found that a member trader had entered orders the in the U.S. Treasury Note futures markets that were intended to gauge the depth of the order book, rather than execute genuine transactions.[67] As a result of the trader's entry and cancellation of these orders, there were fluctuations in the Indicative Opening Price, which is publicly displayed.[68] In response, the CME issued a $15,000 fine and ordered a 21 day suspension.[69] A month later, in September of 2020, the CME determined that a member trader violated 575.A spoofing prohibitions by entering and cancelling multiple layered orders on one side of the copper futures markets without the intent to trade. The CME issued a $50,000 fine and suspended the trader for four months.[70] The amount of spoofing-related actions brought by the CME in the latest fiscal year indicates that this form of market manipulation remains a regulatory focus moving forward.

c. Exchanges for Related Positions

Exchanges for Related Positions (or ''EFRPs'') are transactions that have their origins in the historic U.S. markets for grain and grain futures, providing flexibility to merchants to complete delivery on their futures contracts at different locations, or even at different quantities, outside of the standardized exchange delivery system. Today, EFRPs are appealing to mar-

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[57] *Id.*

[58] *See, e.g.*, Bunge Global Markets, Inc., CFTC Docket No. 11-10, (Mar. 22, 2011), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfbungeorder032211.pdf. For a further discussion of spoofing and CFTC enforcement activity in this area, *see* 262 SPS § VI-D, *Disruptive Trading Practices*.

[59] *See* Matthew F. Kluchenek & Jacob L. Kahn, *Deterring Disruption in the Derivatives Markets: A Review of the CFTC's New Authority over Disruptive Trading Practices*, 3 Harv. Bus. L. Rev. Online 120 (2013) (citing Michael Wisnefski, CME File No. 11-08127 (Aug. 6, 2012) (conduct at issue occurred before passage of Dodd-Frank)); Gelber Group LLC, CME File No. 09-06442-BC (Nov. 17, 2011) (same)). Spoofing thus ''was clearly on the minds of regulators at the exchange level'' before it was banned outright, as further evidenced by a CME advisory notices issued in 2010 that reminded market participants that ''all orders entered on Globex during the pre-opening are expected to be entered in good faith for the purpose of executing bona fide transactions,'' and threatened disciplinary action in certain instances where orders were entered and cancelled in the pre-opening session. 3 Harv. Bus. L. Rev. Online 120 (citing CME Grp., *Notice: Improper Conduct With Respect to Pre-Opening Orders Entered on CME Globex*, CME Grp. RA1001-5 (Jan. 11, 2010)). *See also* CME Grp., RA1103-5 *Notice: Improper Conduct With Respect to Pre-Opening Orders Entered on CME Globex*, CME Grp. (Sept. 20, 2011).

[60] CME Rule 575.A. This rule took effective in September 2014, and prohibits ''Disruptive Practices.''

[61] *See* CME Group, Special Executive Report: # S-7844, CME Grp. (Feb. 3, 2017), http://www.cmegroup.com/notices/market-regulation/2017/02/SER-7844.pdf (noting that the amended rules include language ''that expressly prohibits attempted fraudulent or bad faith actions, the intentional or reckless use or attempted use of a manipulative device, scheme or artifice to defraud, and the intentional or reckless delivery or attempt to deliver false, misleading or inaccurate information. . . .''); *see also* Letter from Christopher Bowen, managing director and chief regulatory counsel, CME Group, to Christopher J, Kirkpatrick, Office of the Secretariat, Commodity Futures Trading Commission (Feb. 1, 2017), available at http://www.cmegroup.com/market-regulation/rule-filings/2017/02/17-036_1.pdf. The amendments adopt language directly from CFTC's Rule 180.1 concerning abusive trade practices, which has been widely credited for making it easier for the CFTC to bring and win manipulation cases. *Id.* at 1.

[62] Tom Polansek, *CME Group to broaden rules against wrongdoing after CFTC request*, Reuters (Feb. 6, 2017).

[63] *See* Tom Polansek, *CME permanently bans three traders for spoofing, other violations*, Reuters (Oct. 12, 2015, 5:02 PM).

[64] *See id.*

[65] CME Group, Notice of Disciplinary Action: # CME-16-0400-BC (July 28, 2017), http://www.cmegroup.com/notices/disciplinary/2017/07/CME-16-0400-BC.html#pageNumber=1 (fining nonmember $20,000 and suspending him for 10 days).

[66] *Id.*

[67] CME Group, Notice of Disciplinary Action: #CBOT 18-1001-BC (Aug. 14, 2020).

[68] *Id.*

[69] *Id.*

[70] CME Group, Notice of Disciplinary Action: #COMEX 18-0888-BC (Sept. 30, 2020), https://www.cmegroup.com/notices/disciplinary/2020/09/COMEX-18-0888-BC-Brendan-Delovitch.html.

ket participants for the same reasons. In an EFRP, futures contracts are exchanged for an economically offsetting position in a related cash commodity or OTC derivative. EFRPs take several forms, including an exchange for physical or cash commodities (''EFP''), an exchange for swaps (''EFS''), an exchange of over-the-counter (''OTC'') options for exchange-traded options (''EOO''), or an exchange for risk (''EFR'').[71]

Notably, the futures leg of an EFRP is not competitively executed in the Exchange's centralized market, so regulators tend to surveil these transactions more closely to ensure compliance with relevant rules and regulations. Specifically, the CME is one Exchange known to issue routine document requests regarding certain EFRP transactions, which commonly include a list of itemized requests for information related to a given trade. It is therefore important for market participants to keep accurate books and records in connection with any EFRP transactions executed, as well as make sure such records are easily accessible for a timely response. Common risk areas the CME will police, for example, include whether the EFRPs in question were bona fide or had the result of offsetting the related position without the incurrence of material market risk.[72]

In some instances, CME inquiries or investigations into certain EFRPs culminate in enforcement. Recently, for example, George E. Warren Corporation was fined $20,000 for executing two EFP transactions on NYMEX that were contingent upon each other, in order to avoid material market risk associated with the EFP's related position components.[73] In February 2018, Stone Ridge Asset Management LLC also received a $40,000 fine for executing EFRP transactions that were contingent on other transactions, which were immediately offset without incurring material market risk.[74]

Notably, the CME's enforcement of EFRP rules has overlapped with charges under other Exchange provisions, including those governing wash trades. In October 2018, Deutsche Bank AG was fined $75,000 under both Rule 538.C and Rule 534 (prohibiting wash trades) for non-bona fide EFP transactions in the Eurodollar futures market that it executed between two of accounts with common beneficial ownership, thereby avoiding the incurrence of market risk.[75] Three years later, Bank of America was fined $30,000 for nearly identical conduct.[76] In a similar scenario, Ray Carrol County Grain Growers was fined $25,000 for violating prohibitions on wash trading and related position rules when it executed an EFP transaction without the physical exchange of a related cash position, constituting a non-bona fide EFP.[77]

d. Block Trades

A block trade is a privately-negotiated futures, options, or combination transaction that is permitted to be executed apart from the public auction market. CME Rule 526 governs block trading in CME, CBOT, NYMEX, and COMEX products. Block trades are permitted in specified products only and are subject to minimum transaction size requirements, which vary depending on the product, transaction type, and time of execution. Notably, block trades may be executed at any time at a fair and reasonable price, making them appealing to market participants who seek to negotiate trades off-exchange.[78]

Recently, the CME has increased its focus on violations of block trading rules, namely timely reporting. After a block trade is executed it must be submitted to the Exchange via CME Direct or CME ClearPort within 5 or 15 minutes, depending on the product.[79] The reporting time period begins tolling as soon as the trade is executed (i.e., the time that the parties agree to the trade). Thus the reporting of inaccurate execution times may result in disciplinary action. Successful reporting of any block trade requires the provision of trade information across several fields within the specified time rules, making timely reporting a challenge in some instances. This may be especially true at larger institutions where multiple traders and sales personnel are involved in negotiating and executing the transaction in question. In such cases, the individuals respon-

[71] CME Rule 538.C. This rule governs EFRPs and sets forth that 1) the related position component of an EFRP must be the cash commodity underlying the contract or a by product, related product, or OTC derivative instrument that ''has a reasonable degree of price correlation'' to the underlying commodity; 2) there be a ''bona fide transfer of ownership of the underlying asset'' or a ''bona fide, legally binding'' contract for a particular related position transaction, and 3) the execution of an EFRP transaction is ''not [] contingent upon the execution of another EFRP or related position transaction where the transactions result in the offset of the related position'' without incurring material ''market risk.''

[72] Note that CME Rule 538.K permits immediately offsetting FX EFPs because the offsetting physical transaction is not contingent on the EFP in any way.

[73] CME Group, Notice of Disciplinary Action: # NYMEX 18-0950-BC-2 (Nov. 1, 2018), https://www.cmegroup.com/notices/disciplinary/2018/11/NYMEX-18-0950-BC-2-GEORGE-E-WARREN-CORPORATION.html.

[74] CME Group, Notice of Disciplinary Action: # CME-17-0658-BC-2 (Feb. 23, 2018), https://www.cmegroup.com/notices/disciplinary/2018/02/cme-17-0658-bc-2-stone-ridge-asset-management-llc.html.

[75] CME Group, Notice of Disciplinary Action: # CME-17-0729-BC (Oct. 26, 2018), https://www.cmegroup.com/notices/disciplinary/2017/10/cme-17-0729-bc-deutsche-bank-ag.html.

[76] CME Group, Notice of Disciplinary Action: #CBOT 21-1460-BC (Oct. 28, 2021), https://www.cmegroup.com/notices/disciplinary/2021/10/CBOT-21-1460-BC-Bank-of-America-NA.html

[77] CME Group, Notice of Disciplinary Action: # CBOT-17-0685-BC (Aug. 10, 2018), https://www.cmegroup.com/notices/disciplinary/2018/08/cbot-17-0685-bc-ray-carroll-county-grain-growers.html. .

[78] Whether a block trade is executed at a price that is ''fair and reasonable'' includes consideration of (i) the size of the transaction, (ii) the prices and sizes of other transactions in the same contract at the relevant time, (iii) the prices and sizes of transactions in other relevant markets, including, without limitation, the underlying cash market or related futures markets, at the relevant time, and (iv) the circumstances of the markets or the parties to the block trade. The trade price must be consistent with the minimum tick increment for the market in question. Additionally, each outright transaction and each leg of any block eligible spread or combination trade must be executed at a single price. CME Group, Market Regulation Advisory Notice on Block Trades, RA1814-5, Effective Dec. 3, 2018 (November 16, 2018).

[79] Note that block trades negotiated at any other time during which CME Direct or CME ClearPort are closed must be submitted no later than 5 or 15 minutes after the time CME Direct or CME ClearPort reopens, depending on the reporting requirement for the specific product. In addition, block trades may also be reported to the CME ClearPort Facilitation Desk/Global Command Center, which will then submit the trade.

sible for reporting the block trade may not be the same as those directly facilitating execution with the relevant client, thus increasing the risk for delays in reporting.

Other factors contributing to untimely or inaccurate reporting of block trades include instances where a client or firm account is not appropriately set up to accommodate the requisite credit or risk limits, lacks product permissions to execute the trade, or involve a ''fat finger'' (e.g. human error) when inputting trading details into Exchange systems. Firms and individuals may face disciplinary actions for failing to report block trades on time, or for failing to report trading details accurately. For example, in July 2018, a non-member firm was fined $70,000 for failing to supervise its employees who executed multiple block trades that were not reported within the time limit and also misreported the time afterwards.[80] One month earlier, another firm was found liable for $60,000 for misreporting the execution times of their block trades and failing to adequately supervise its brokers.[81] And in August 2020, a member firm was fined $50,000 for executing block trades by having counterparties agree to all of the details of a block trade except for the price.[82] The member firm would then report the block trade later in the day, using a specially calculated market price; this resulted in the incorrect execution, recording, and reporting of the block trades. Also in 2020, a non-member firm was fined $80,000 for submitting inaccurate execution times for block trades it had conducted, and failing to diligently supervise employees to ensure compliance with reporting requirements.[83]

In addition, the CME has been active in policing and enforcing pre-hedging activity in block trades that may actually constitute front running. Principal counterparties to a potential block trade are allowed to engage in pre-hedging, or anticipatory hedging, of the position that they believe will result from the consummation of the block trade. However, intermediaries who facilitate block trades (i.e., on behalf of clients) are not permitted to pre-hedge. The intermediary firm or individual must wait to enter into transactions to offset the position assumed by the block trade until after the block has been consummated.[84] Thus, intermediaries are prohibited from offsetting the position established by the block trade in any account which is owned or controlled by the intermediary until after the trade is executed. The same prohibition applies in these circumstances to proprietary accounts of the intermediary's employer.[85]

The concern with allowing intermediaries facilitating block trades to pre-hedge is front running. It is a violation of Rule 526 for a person to engage in the front running of a block trade when (1) acting on material nonpublic information regarding an impending transaction by another person, (2) acting on nonpublic information obtained through a confidential employee/employer relationship, broker/customer relationship, or (3) in breach of a pre-existing duty. The CME has paid close attention to potential front running violations. For example, in May 2018, Wells Fargo was fined $70,000 and ordered to disgorge approximately $117,187 in profits in connection with pre-hedging block trades. The CME determined that a Wells Fargo trader executed trades on the opposite side of the market in the same products as the block trade in question prior to consummation. The CME further found that Wells Fargo failed to sufficiently supervise and train its traders on prohibited pre-hedging activity.[86] In addition, in February 2018, an individual member settled for $35,000 fine and disgorgement of $61,519 in profits, after NYMEX determined that it engaged in pre-hedging activity after receiving solicitation for, but prior to consummating, a block trade.[87] The actions indicate that CME exchanges are paying close attention to impermissible pre-hedging activity and front running violations.

e. Position Limits

The CME prescribes limits for trade positions and expects market participants to abide by them. Any positions in excess of the limit are deemed position limit violations under Rule 562.[88] Recently, the CME has pursued position limit violations aggressively, leading to ten enforcement action notices in 2018 alone. The CME's strong presence in policing position limits in the latest fiscal year likely means such violations will remain a focus going forward.

Notably, JPMorgan recently settled with the CME for a $125,000 fine in connection with a finding that it exceeded the standard position limit for NG futures contracts (by 82.30% on the first day and 77.30% on the second and third day) for a three-day spot period.[89] Violations occurring across a shorter time span have received no less disciplinary attention from the CME. In September 2018, for example, another firm paid a $40,000 fine for exceeding the position limit for crude oil

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[80] CME Group, Notice of Disciplinary Action: # NYMEX 16-0550-BC (July 13, 2018), https://www.cmegroup.com/notices/disciplinary/2018/07/NYMEX-16-0550-BC-CONTINENTAL-ENERGY-GROUP-LLC.html#pageNumber=1.

[81] CME Group, Notice of Disciplinary Action: # NYMEX 17-0708-BC (June 14, 2018), https://www.cmegroup.com/notices/disciplinary/2018/06/NYMEX-17-0708-BC-EOX-HOLDINGS-LLC.html.

[82] CME Group, Notice of Disciplinary Action: #NYMEX 19-1174-BC (Aug. 17, 2020), https://www.cmegroup.com/notices/disciplinary/2020/08/NYMEX-19-1174-BC-TFS-DERIVATIVES-LTD.html.

[83] CME Group, Notice of Disciplinary Action: #NYMEX 20-1298-BC (Dec. 14, 2020), https://www.cmegroup.com/notices/disciplinary/2020/12/NYMEX-20-1298-BC-MAREX-FINANCIAL.html.

[84] ''. . .prior to the consummation of the block trade, the intermediary is prohibited from offsetting the position established by the block trade in any account which is owned or controlled, or in which an ownership interest is held, or for the proprietary account of the employer of the intermediary. The intermediary may enter into transactions to offset the position only after the block has been consummated.'' CME Group, Market Regulation Advisory Notice on Block Trades, RA1814-5, Effective Dec. 3, 2018 (November 16, 2018).

[85] *Id.*

[86] CME Group, Notice of Disciplinary Action: # CBOT-16-0477-BC (May 25, 2018), https://www.cmegroup.com/notices/disciplinary/2018/05/cbot-16-0477-bc-wells-fargo-securities-llc.html.

[87] CME Group, Notice of Disciplinary Action: # NYMEX 16-0503-BC (Feb. 1, 2018), https://www.cmegroup.com/notices/disciplinary/2018/02/NYMEX-16-0503-BC-PETER-C-MILLER.html.

[88] CME Rule 562.

[89] CME Group, Notice of Disciplinary Action: # NYMEX 17-0716-BC (June 14, 2018), https://www.cmegroup.com/notices/disciplinary/2018/06/NYMEX-17-0716-BC-JP-MORGAN-CHASE-BANK-NA.html.

Figure B: Sample CFE Inquiry Email

Subject: CBOE Compliance: LT Trade Date xx/xx/2013

On trade date xx/xx/2013, [redacted] reported for the April 2013 Volatility Index Total Open Interest ("OI") of 9785x9317 and total Large Trader ("LT") of 9775x9457 for a difference of 10x-140. As LT exceeds OI and NFA noted no adjustments to account for the difference, on behalf of the Exchange, please provide a response as to why LT exceeds OI and how this reporting issue will be resolved.

Please note that per CFE Regulatory Circular RG12-37 (see attachment), all adjustments are to be made at the Options Clearing Corporation no later than 6:30 p.m. (Chicago time) on the applicable trading day.

Please provide a response by xx/xx/13. Thank you for your attention to this matter.

Regards,

[redacted]

Senior Analyst, Market Regulation

futures by 25.20% for only one day.[90] Similarly, another investment company received a $30,000 fine for exceeding the position limit by 95%, again for only one day.[91] Intraday holding has also come under the ambit of the CME's scrutiny. In September 2020, for instance, a firm was fined $20,000 for holding intraday long positions over the single month position limit on several occasions.[92] Market participants should take note of these recent enforcement actions and remain mindful of the CME's position limit rules in order to avoid regulatory scrutiny.

C. CBOE Futures Exchange

1. The investigation

The surveillance, examination, and investigative functions of the CBOE Futures Exchange (CFE or the Exchange) are performed by its Regulatory Services Division (Regulatory Division). The Regulatory Division may initiate an investigation based on information received from a variety of sources, including surveillance reviews; examinations; industry notifications; and external referrals.[93] Anyone may file a complaint to notify the Exchange of a suspected violation of its rules or procedures; the Regulatory Division will investigate the allegations, as long as they are outlined in reasonable detail and signed by the complainant.[94] As soon as an investigation is opened, the CFE issues inquiry letters seeking certain information and/or documents from the entity or individual under review. **Figure B** reflects a sample inquiry email sent by the CFE to a large banking institution.

Based on the response that the CFE receives, it may request more information or make a determination that further investigation is or is not warranted. In the event that an investigation suggests a reasonable basis for finding a violation of an Exchange rule, the Regulatory Division will prepare a written report of the investigation (Investigation Report).[95] This report is submitted to the CRO. Before the Investigation Report is submitted, the Regulatory Division will notify the respondent of the general nature of the violations and the specific rules alleged to have been violated.[96] Generally, the respondent has the opportunity to submit a written and/or videotaped statement to the CRO stating the reasons that disciplinary action is not warranted; this statement must be submitted within 15 days from the date that the respondent is notified of the investigation by the Regulatory Division.[97]

2. Disciplinary proceedings

a. Overview

After the CRO considers the Investigation Report and any information submitted by the respondent, it makes a written determination as to whether probable cause exists to support a violation.[98] In the event that the CRO finds probable cause, it authorizes the Regulatory Division to prepare a written state-

[90] CME Group, Notice of Disciplinary Action: # NYMEX 17-0823-BC (Sept. 10, 2018), https://www.cmegroup.com/notices/disciplinary/2018/09/NYMEX-17-0823-BC-DV-TRADING-LLC.html.

[91] CME Group, Notice of Disciplinary Action: # NYMEX 17-0829-BC (Apr. 2, 2018), https://www.cmegroup.com/notices/disciplinary/2018/04/NYMEX-17-0829-BC-CITY-FINANCIAL-INVESTMENT-COMPANY-LIMITED.html.

[92] CME Group, Notice of Disciplinary Action: #CBOT 19-1112-BC, (Sept. 8, 2020), https://www.cmegroup.com/notices/disciplinary/2020/09/CBOT-19-1112-BC-Eagle-Seven-LLC.html. .

[93] CBOE Futures Exch. (CFE) Rule 702(a).

[94] The Exchange notifies the complainant when an investigation is opened, and thereafter keeps the complainant informed about the status of the inquiry. *See* Chicago Board Options Exchange (CBOE), *Disciplinary Information*, CBOE.COM. CFE Rule 702(a).

[95] CFE Rule 702(d).

[96] CFE Rule 702(e).

[97] CFE Rule 702(e), (f).

[98] CFE Rule 704(b).

ment of charges specifying (i) the allegedly infringing acts, conduct, or practices; (ii) the specific rules alleged to have been violated; (iii) the respondent's right to a hearing on the charges; and (iv) the period within which a hearing on such charges may be requested.[99] After the issuance of formal charges, a respondent has 15 days to submit a written response, which must specifically admit or deny each allegation contained in the statement of charges. Any allegation that is not expressly denied is deemed to be admitted, and the failure to file an answer is considered an admission of the charges.[100]

Once a respondent receives notice of the charges, the respondent may seek to resolve the matter through expedited proceedings rather than a hearing.[101] In such circumstances, the respondent must reach an agreement with the Regulatory Division setting forth a stipulation of the facts and findings regarding the conduct at issue, the rule violations, and a sanction (Letter of Consent).[102] The Letter of Consent is submitted to the BCC Panel for its consideration, and, if accepted, becomes a final decision.[103] In the event that the Letter of Consent is rejected, the matter will proceed as if the respondent never engaged in expedited proceedings.[104]

b. Settlement

Generally, settlement agreements may be entered into within 120 days of the issuance of a statement of charges.[105] The respondent has the opportunity to submit to the BCC Panel two offers of settlement during this period, and may be allowed a third opportunity where the proposed offer of settlement is consistent with the terms recommended by the BCC Panel.[106] The respondent need not admit or deny the allegations contained in the statement of charges in order to settle.[107] In determining whether to accept or reject an offer of settlement, the BCC Panel will review both the offer of settlement and the recommendation of the CFE Division of Enforcement.[108] The BCC Panel may not alter the terms of a settlement offer without the respondent's consent.[109] The respondent may withdraw an offer of settlement at any time before the BCC Panel renders a decision. [110]

If the BCC Panel approves the offer of settlement, it will issue a written decision consistent with the offer's terms, specifying the rule violations at issue; the reasons that the BCC Panel believes that a violation occurred; and any sanctions to be imposed.[111] The BCC Panel may approve an offer of settlement even where the Regulatory Division does not agree with its terms.[112] In the event that the BCC Panel rejects an offer of settlement, it must notify the respondent of its decision, and the matter will proceed as if no offer had been made—neither the offer nor documents related thereto shall become part of the record.[113] The decision by the BCC Panel to accept or reject an offer of settlement is final (i.e., the respondent may not seek further review).[114]

3. Hearing on contested charges

A hearing on contested charges is held before a BCC Panel.[115] All parties—the respondent and the Exchange's regulatory staff—are provided at least 15 days prior notice of the time and place of the hearing.[116] At least five days prior to the hearing, the parties must furnish to the BCC Panel and each other copies of all documentary evidence and a list of witnesses to be presented at the hearing.[117] Where the time and nature of the proceeding permit, the parties will meet for a pre-hearing conference to resolve any disagreements about the authenticity of documents; identify facts not in dispute; and address any other items that may expedite the hearing itself.[118] At the request of any party, the BCC Panel or its Chairperson may hear and decide any outstanding pre-hearing issues.[119]

Formal rules of evidence do not apply to the hearing, and the BCC Panel makes admissibility decisions at its discretion.[120] The respondent must appear personally at the hearing and is entitled to present evidence and produce witnesses.[121] The respondent may be accompanied by legal counsel or an-

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[99] CFE Rule 704(b).

[100] Where the respondent files an answer or admits to any allegations contained in the statement of charges, the BCC may make a summary determination finding liability without a hearing. Notice of any such summary determination, specifying the violation and sanctions, must be served upon the respondent, who then has 10 days from the date of service to request a hearing upon the sanctions. CFE Rule 705, 707.

[101] CFE Rule 703. The respondent has 15 days from receipt of the service of the statement of charges to notify the Exchange of its intention to proceed in an expedited manner.

[102] CFE Rule 703.

[103] CFE Rule 703.

[104] CFE Rule 703.

[105] CFE Rule 708(a). Where a respondent elects to proceed under expedited proceedings, and is unable to reach a settlement agreement with the Regulatory division, the number of days exceeding 30 days spent in expedited proceedings is deducted from the 120-day settlement period. In all cases, however, a respondent will have at least a 14-day settlement period. *Id*.

[106] CFE Rule 708(a), (d).

[107] CFE Rule 708(b).

[108] CFE Rule 708(b).

[109] *Id.*

[110] *Id.*

[111] *Id.*

[112] *Id.*

[113] *Id.*

[114] *Id.*

[115] CFE Rule 706(a).

[116] CFE Rule 706(b). Hearings are generally held in Chicago. However, a BCC Panel may decide to hold the hearing in any other location at its discretion in order to accommodate the parties, witnesses, Exchange staff, or the BCC Panel members.

[117] *Id.*

[118] *Id.*

[119] *Id*. The BCC Panel may agree to interlocutory review where it determines that a particular issue is a controlling issue of rule or policy, and that immediate review by the Board of Directors (Board) would materially advance the ultimate resolution of the matter before the BCC Panel.

[120] CFE Rule 706(c).

[121] *Id.*

other person of its choosing.[122] A transcript is made of every hearing and becomes part of the record.[123]

After the hearing, the BCC Panel must issue a written determination as to whether the respondent has committed a violation and, if applicable, impose any sanctions.[124] Each decision must include: (i) a summary of the allegations contained in the statement of charges; (ii) a summary of the Answer; (iii) a summary of the evidence produced at the hearing; (iv) a statement of the BCC Panel's findings and conclusions with respect to each charge; and, where the BCC Panel concludes that violations were committed, (v) an indication of each rule found to be infringed; and (vi) a declaration of all sanctions, as well as their effective date.[125] A decision is considered final and a copy will be promptly served to the respondent and published.[126]
[127]

Sanctions in disciplinary proceedings may include one or more of the following:

- expulsion;
- suspension;
- censure;
- fine;
- limitation of activities, functions, or operations;
- suspension or bar from trading privileges;
- denial of access to the Exchange, undertakings; or
- any other fitting sanction.[128]

In imposing sanctions, the BCC Panel considers, among other things, the seriousness of the offense, the penalties imposed in like cases, and the respondent's prior disciplinary cases.[129]

4. Enforcement priorities

In recent years, there has been a great increase in enforcement activity by the CFE. There are currently 67 settled matters published on the Exchange's website, the majority of which are from the last six years.[130] This represents a significant increase over the five decisions from 2012 to 2013.[131] These decisions provide insight into the CFE's recent enforcement efforts, and the likely targets of the Exchange's future enforcement efforts.

A large number of the disciplinary decisions brought by the CFE were based on the respondent's alleged non-compliance with ''reportable position'' rules;[132] this is also the subject of the inquiry set forth in Figure B.[133] Pursuant to CFE Rule 412B, those who hold trading privileges (''Trading Privilege Holders'' or ''TPHs''), as well as those without trading privileges (''non-TPHs''), with the CFE must report to the CFE reportable positions and related information related to Exchange Contracts in the form and manner provided for by the Exchange.[134] A position is reportable whenever its ″open interest″ or position—that is, the total number of all of the futures and/or option contracts that is has entered into and not yet offset by a transaction, delivery, or exercise—is expected to exceed or does exceed the applicable threshold levels established for the type of contract being traded. Rule 412B also provides that TPHs and non-TPHs must file concurrently with the Exchange CFTC Forms 102 and 71. CFTC Form 102 is a form used to identify each new account that requires a reportable position, while CFTC Form 71 deals with information regarding volume threshold accounts that are omnibus accounts, to identify the ultimate owner and controller of such accounts.

A frequent issue in these matters is the failure to timely file a CFTC Form 102 for large trader reportable positions to the CFE within three days of establishing the position, or failure to submit reportable position information electronically, via the Securities Industry Automation Corporation.[135] The reportable positions cases have generally been resolved with the respondents submitting to censure and paying fines that range from $10,000 to $25,000.[136] Notably, the CFE has recently held firms liable for failure to report open interest as a result of third party service provider programming errors. For example, in

[122] *Id.*
[123] *Id*.
[124] CFE Rule 709.
[125] *Id.*
[126] CFE Rule 709.
[127] CFE Rule 710.
[128] CFE Rule 711(a).
[129] CFE Rule 711(b).
[130] *See* CBOE Futures Exchange, CFE Disciplinary Decisions, https://www.cboe.com/us/futures/regulation/disciplinary_actions/. These statistics are current as of April 5, 2021. . To date, the CFE's most active years in terms of enforcement activity have been 2015 (with 19 cases) and 2019 and 2016 (with 9 cases each).
[131] *Id*.
[132] *See, e.g.*, Hauck & Aufhauser Privatebankiers KGaA, CFE Docket No. 17-004 (Mar. 30, 2017).
[133] *See* Deutsche Bank Sec. Inc., CFE Docket No. 19-0007 (Jan. 16, 2020); USB Sec. LLC, CFE Docket No. 18-0007 (Jan. 23, 2019: CSC Futures (HK) Ltd., CFE Docket No. 19-0004 (Aug. 26, 2019); RBC Capital Markets, LLC, CFE Docket No. 18-0002 (June 13, 2018); HSBC Trinkaus & Burkhardt AG, CFE Docket No. 17-0007 (Oct. 24, 2017); ABN AMRO Clearing Bank NV, CFE Docket No. 15-0016 (Nov. 17, 2015); Caceis Bank France, CFE Docket No. 15-0010 (Oct. 21, 2015); Banque DeGroof Petercam SA and Banque DeGroof Luxembourg SA, CFE Docket No. 15-0005 (Oct. 21, 2015); Banque Lombard Odier & Cie Sa, CFE Docket No. 15-0015 (Sep. 30, 2015); Credit Suisse Age, CFE Docket No. 15-011 (Sep. 30, 2015); GF Futures (Hong Kong) Co. Ltd., CFE Docket No. 15-009 (Sep. 30, 2015); Daishin Securities Co. Ltd., CFE Docket No. 15-008 (Sep. 30, 2015); RBS Securities Inc. and RBS PLC, CFE Docket No. 15-0007 (Sep. 30, 2015); Macquarie Bank Ltd., CFE Docket No. 15-0013 (Aug. 26, 2015); Phillip Futures PTE Ltd., CFE Docket No. 15-0013 (Aug. 26, 2015); Raiffeisen Bank International AG, CFE Docket. No. 15-0012 (Aug. 26, 2015); Banco Santander SA, CFE Docket No. 15-0006 (Aug. 26, 2015); National Bank Financial Inc., CFE Docket No. 14-0007 (Jan. 27, 2015); Unicredit Bank AG, CFE Docket No. 14-0006 (Dec. 29, 2014); Rosenthal Collins Group LLC, CFE Docket No. 14-0004 (Oct. 6, 2014); Advantage Futures, CFE Docket No. 12-0001 (Oct. 8, 2012).
[134] CFE Rule 412B.
[135] *Id*.
[136] Violation of multiple rules may be fined at a higher amount. *See* RBC Capital Markets, LLC, CFE Docket No. 18-0002 (June 13, 2018), (where the respondent was fined $50,000 for violation of multiple Rules including Rule 412B(a), 410A and 609).

January 2020, the CFE sanctioned a large financial institution $22,500 after finding that the firm failed to properly report open interest, in violation of Rule 410A.[137] The report concluded that this was the result of a systems issue.[138] In another example, in June 2018, the CFE sanctioned a large financial institution $50,000 after finding that the firm reported inaccurate open interest, as well as failed to report large trader positions in VX Weekly contracts, as a result of ''a third party service provider inputting incorrect reportable levels,'' in violation of Rules 410A and 412B(a). The CFE also concluded that the firm failed to follow its own written procedures, possibly amplifying the sanction received.[139]

Another large group of CFE disciplinary actions were focused on Rule 608, which provides that it is an offense to engage in ''any act detrimental to the Exchange, in conduct inconsistent with just and equitable principles of trade or in abusive practices,'' which is defined to include fraudulent, noncompetitive or unfair actions. This catch-all rule has been used to ensnare different types of activity. For example, the CFE has applied Rule 608 to discipline firms that entered orders that were rejected by the Exchange for ''being entered prior to the pre-open,'' based on a determination that the firm ''knew or should have known that the orders would be rejected.''[140] In a different case, unaware of a previous CFE prohibition of such conduct, a trader executed block trades in order to shift risk between two affiliated accounts in violation of Rule 608.[141] This violation resulted in a $60,000 fine for the company.[142] The CFE has also used Rule 608 to target electronic trading malfunctions. To this end, a December 2015 case dealt with the modification of a hedging ratio strategy that inadvertently resulted in the firm's system trading a disproportionate amount of futures contracts in a short period of time, causing price and volume distortions in the contracts, among other issues.[143] A $50,000 fine was issued to settle these charges.

Both of the disciplinary decisions in 2019 that involved charges based on Rule 608 also involved Rule 620, which bans disruptive practices. Broadly, Rule 620 specifically proscribes spoofing, violative bids or offers, intentional or reckless disregard for the orderly execution of transactions during a closing period, and bad-faith market orders. For example, in January 2019, the CFE applied Rules 608 and 620 to discipline a firm that submitted ''strategy orders'' composed of a strip of certain S&P 500 options; the firm did this to increase the likelihood that certain options would be included in the Special Opening Quotation on the Cboe Volatility Index that otherwise would not have been because of a rule excluding options with a zero bid price.[144] The CFE fined the firm $1,275,000 and assessed a total disgorgement of $6,726.[145] In another action that same month, the CFE imposed an $85,000 fine against a firm that violated Rules 608 and 620 by submitting a series of market-price orders using an algorithm that allowed the orders to be submitted just 300 milliseconds before the end of the day's trading session, impacting the daily settlement price between two and four ticks.[146]

Another area of enforcement that has been the source of historical CFE attention relates to certain technical violations. As one example, CFE Rule 303A provides that each Order Entry Operator ID (OEO ID) ''shall represent . . . the natural person . . . entering the order or quote directly or indirectly into a system of or used by a [TPH] that interfaces with the CBOE system.'' In two cases from March and April 2015, violations were found where the companies submitted improper OEO IDs that were not unique and did not represent a natural person or Automated Trading system entering the order.[147] To settle these OEO ID violations, the companies involved agreed to monetary fines ranging from $7,500 to $10,000.[148] In addition to OEO ID violations, the CFE has also focused on Customer Type Indicator (CTI) code violations. These codes are used to identify the type of customer for which a trade is executed, and inform both the transaction fee for the trade as well as the degree of regulatory scrutiny that it will receive.[149] In a 2012 settlement, a respondent agreed to pay a $30,000 fine and submit to censure to settle charges of improper CTI coding.[150]

Several CFE disciplinary decisions have concerned a failure to comply with the Exchange's record-keeping requirements.[151] For example, on August 12, 2013, the CFE settled a matter arising out of a routine audit of a foreign entity authorized to conduct proprietary trading business on the Exchange.

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[137] Deutsche Bank Securities Inc., CFE Docket No. 19-0007 (January 16, 2020).

[138] *Id.*

[139] RBC Capital Markets, LLC, CFE 18-0002 (June 22, 2018).

[140] Virtual Financial BD LLC, CFE Docket No. 06-0005 (Nov. 30, 2016) (imposing $15,000 fine); see also Locust Walk Trading LLC, CFE Docket No. 06-0003 (Nov. 30, 2016) (imposing $25,000 fine).

[141] *See* Barclays Capital Inc., CFE Docket No. 15-0019 (Dec. 14, 2015).

[142] *Id.*

[143] *See* Sun Trading LLC, CFE Docket No. 15-0017 (Dec. 14, 2015); *see also* Clover Light LLC, CFE Docket No. 15-0018 (May 6, 2016) (imposing a $65,000 fine for an automated trading system (ATS) malfunction that resulted in the resubmission of numerous orders to the Exchange that had been cancelled due to risk control parameters).

[144] Akuna Securities LLC, CFE Docket No. 18-0004 (January 23, 2019).

[145] *Id.*

[146] Credit Suisse Securities (USA) LLC, and Credit Suisse International, CFE Docket No. 18-0006 (January 23, 2019).

[147] *See* SG Americas Securities, LLC, CFE Docket No. 15-0001 (Mar. 25, 2015); *see also* JP Morgan Securities LLC, CFE Docket No. 15-0002 (Apr. 22, 2015).

[148] *Id.*

[149] There are four types of CTI Codes: CTI 1 identifies transactions initiated and executed by a person who holds trading privileges for his or her own account, an account he or she controls, or an account in which he or she has an ownership or financial interest; CTI 2 identifies transactions executed for the proprietary account of a clearing member or a person who holds trading privileges; CTI 3 identifies transactions where a person with trading privileges executes for the personal account of another person with trading privileges; and CTI 4 identifies any remaining transactions.

[150] *See* Goldman Sachs Execution & Clearing, L.P., CFE Docket Nos. 12-0002 and 12-0003 (Nov. 7, 2012).

[151] See, e.g., Flow Traders BV, CFE Docket No. 13-0002 (Aug. 12, 2013); Credit Suisse Securities (USA) LLC, CFE Docket No. 13-0003 (Oct. 16, 2013); Credit Suisse Securities (USA), LLC, CFE Docket No. 13-0004 (Feb. 27, 2014); UBS Securities LLC, CFE Docket No. 20-0002 (Nov. 4, 2020). *See also* HTG Capital Partners LLC, CFE Docket No. 16-0001 (March 1, 2016) ($15,000 fine for failure to maintain an audit trail in violation of CFE Rule 403(c)).

The audit encompassed a period of approximately two years and included, among other things, a review of the respondent's audit trail procedures, audit trail records, large trader reporting, and overall firm structure. On numerous trade dates during the review period, the respondent was unable to produce records required by the CFE, in violation of (i) CFE Rule 501 (Books and Records), which requires organizations under the CFE's purview to maintain certain records and produce them upon request to the Exchange; (ii) CFE Rule 502 (Inspection and Delivery), which requires organizations under the CFE's purview to maintain any mandated records for a period of five years; and (iii) CFTC Regulation 17 C.F.R. Part 1.31 (Books and Records), which imposes substantively similar requirements to CFE Rule 502. To settle these violations, the respondent agreed to pay a monetary penalty of $50,000; submit to censure; and provide an Attestation of its compliance with CFE records requirements.[152]

More recently, the CFE has expressed increased concern over wash trades, which are governed by CFE Rule 616. Specifically, Rule 616 prohibits THPs and any related parties from placing or accepting ''buy and sell orders in the same Contract and expiration'' where they ''know[] or reasonably should know that the purpose of the orders is to avoid taking a bona fide market position exposed to market risk.'' Three of the 16 enforcement actions pursued and settled by the CFE during 2019 and 2020 concerned wash trades.

For example, in January 2020, a firm was fined $30,000 based allegations it submitted simultaneous buy and sell orders in the same VX futures contract expiration at the same price for the same account.[153] That same month, another firm was fined $25,000 for executing a wash trade between accounts held by an identical beneficial owner.[154]

As with Rule 608, the CFE has also been using Rule 616 to sanction electronic trading malfunctions. Specifically, in January 2018, a firm was fined $35,000 after its algorithm engaged in multiple self-matches because it ''did not utilize a wash blocker'' and ''a necessary section of code was inadvertently deactivated.''[155] Based on similar allegations, another firm was fined $30,000 for ''engag[ing] in multiple instances of wash trading activity due to running opposing algorithm strategies without utilizing a wash blocker'' in February 2017.[156] These recent cases highlight the CFE's focus on wash trading and its evolution into policing electronic trading mechanisms.

D. National Futures Association

1. The investigation

The National Futures Association (NFA) Compliance Department is responsible for monitoring and investigating member compliance with NFA regulations.[157] In addition to routine audits and examinations, the Compliance Department conducts investigations at the behest of the CFTC or NFA members, or on its own initiative.[158] 262 SPS Practice Tool 4 provides an example of an NFA inquiry conducted on behalf of one if its member firms.

To help execute its enforcement functions, the Compliance Department has the authority to compel testimony and subpoena documents.[159] When the Compliance Department has reason to believe that an NFA requirement is being or is about to be violated, it must submit a written report regarding the matter to the Business Conduct Committee (BCC), summarizing the relevant facts and circumstances and making a recommendation as to whether the BCC should pursue the matter.[160] If the BCC, upon review, determines that there is no reasonable basis that a violation occurred or that prosecution is unwarranted, the BCC shall issue a written closure order and may issue a warning letter to the involved party.[161]

Conversely, if, upon review, the BCC finds reason to believe that an NFA requirement is being, has been, or is about to be violated and should be adjudicated, it will serve a written and dated Complaint to the involved party. Any Complaint must set forth the violations and conduct at issue and alert the respondent of his or her obligation to file an Answer within 30 days.[162] The failure to file an Answer or respond to any allegation in the Complaint is deemed an admission of that allegation and waives respondent's right to a hearing with respect to the charge or charges at issue.[163]

2. Hearing on contested charges

The respondent may address the allegations against him or her at a hearing before a designated panel of the Hearing Committee (Hearing Panel), which is comprised of at least three members and includes a Chairperson.[164] In advance of the hearing, the respondent is entitled to examine all of the relevant evidence in the Compliance Department's possession or control, with the exception of privileged material like the Investigation Report.[165] The Chairperson of the Hearing Panel is tasked with scheduling pre-hearing conferences and deciding all pre-hearing motions concerning discovery, motion deadlines, the location of the hearing, continuances, and requests for telephonic or video testimony.[166] All other motions are decided by the Hearing Panel.

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[152] Flow Traders BV, CFE Docket No. 13-0002 (Aug. 12, 2013).

[153] Danske Bank A/S, CFE Docket No. 19-0006 (Jan. 16, 2020).

[154] Merrill Lynch International, CFE Docket No. 19-0006 (Jan. 16, 2020).

[155] Clear Capital Group LLC, CFE Docket No. 18-0001 (Jan. 24, 2018).

[156] Pacific Liberty SPC, CFE Docket No. 17-0001 (Feb. 28, 2017).

[157] As of March 31, 2021, the NFA had 3,193 members consisting of 109 Swap Dealers; 4 Retail Foreign Exchange Dealers; 61 Futures Commission Merchants; 1,051 Introducing Brokers; 1,247 Commodity Pool Operators; 1,367 Commodity Trading Advisors; and 6 Exchanges. *See* NFA, Membership and Directories (March 31, 2021), https://www.nfa.futures.org/registration-membership/membership-and-directories.html.

[158] NFA Manual Rule 3-1.

[159] *Id.*

[160] NFA Rule 3-2.

[161] *Id.*

[162] NFA Rule 3-4.

[163] *Id.*

[164] NFA Rule 3-7.

[165] NFA Rule 3-8.

[166] *Id.*

During a hearing, the formal rules of evidence do not need to apply.[167] The respondent may appear personally, and is entitled to examine witnesses and present evidence.[168] Following the hearing, the Hearing Panel must issue a written determination as to whether the respondent committed the alleged violations and impose sanctions accordingly.[169] At a May 2013 industry conference, NFA Vice President, General Counsel, and Secretary Thomas W. Sexton III made clear that sanctions should be severe enough to serve as a deterrent to future misconduct.[170] Possible sanctions include:

- expulsion or suspension for a specified period from NFA membership or from being associated with a member;
- censure;
- reprimand;
- a cease and desist order;
- a fine not exceeding $250,000 per violation; or
- any other appropriate penalty or remedial action.[171]

A respondent aggrieved by the decision of a Hearing Panel has the right to appeal the decision to the NFA's Appeals Committee.[172] The Appeals Committee's decision shall be final 30 days after the date of service.[173]

3. Settlement

A respondent may make an offer of settlement, without admitting or denying the charges against him or her, at any time throughout the disciplinary process.[174] Depending on the stage of the proceedings, the settlement is submitted to the BCC (or its designated panel), Hearing Panel, or Appeals Committee for approval.[175] Once a settlement offer is received by the appropriate Committee or Panel, it is considered final and cannot be rescinded by the respondent.[176] The Compliance Department is given an opportunity to express its views on the proposed settlement.[177] A decision accepting or rejecting an offer of settlement must be rendered promptly, and generally becomes final and binding 15 days after the date of the decision.[178] In the event that the offer is rejected by the appropriate Committee or Panel, the offer becomes null and void, and is not deemed to have been an admission of any kind.[179]

4. Enforcement Priorities

In January 2019 and 2020, the NFA issued notices to its members regarding commodity trading advisors (''CTAs'') and commodity pool operators (''CPOs'') claiming an exemption or exclusion from registration pursuant to certain CFTC regulators.[180] The notices reiterated the deadline for affirming any notice of exemption, and asked that NFA members ''take reasonable steps'' to confirm that any CTAs and CPOs with which they do business are in compliance with the NFA's rules regarding exemption status. This reflects the NFA's continued focus on CPOs and CTAs.[181] The NFA recently issued amendments to NFA Compliance Rule 2-29, which require that past performance used in promotional materials be presented net of all commission, fees, and expenses, to allow CTA members that are also SEC registered investment advisors to present past performance to certain eligible contract participants.[182] In addition, in January 2019, the NFA adopted an Interpretive Notice, called NFA Compliance Rule 2-9, that requires CPO members to implement internal an internal controls framework to protect customer funds and provide reasonable assurance that the CPO's books and records are accurate and reliable.[183]

The NFA also turned its focus to swaps in recent years, adopting an Interpretive Notice, entitled NFA Bylaw 301 and Compliance Rule 2-24, to implement swaps proficiency requirements.[184] The NFA amended bylaw 301(l) to clarify which individuals must take and pass the NFA's Swaps Proficiency Requirements and to prohibit an futures commission merchant (FCM), introducing broker (IB), commodity pool operator (CPO) and commodity trading advisor member from having any person conducting CFTC regulated swaps if they have not satisfied the proficiency requirements.[185] Discretionary customer accounts and customer information also received increased attention from the NFA in regard to swaps, with

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[167] NFA Rule 3-9.

[168] *Id.*

[169] NFA Rule 3-10.

[170] 35th Annual Futures Industry Association (FIA) Law & Compliance Division Conference on the Regulator of Futures, Derivatives and OTC Products (May 8-10, 2013).

[171] NFA Rule 3-14.

[172] NFA Rule 3-13.

[173] *Id.*

[174] NFA Rule 3-11(a).

[175] *Id.*

[176] NFA Rule 3-11(c).

[177] NFA Rule 3-11(a).

[178] NFA Rule 3-11(b).

[179] NFA Rule 3-11(c).

[180] See Notice I-19-02: *Member obligations under NFA Bylaw 1101 and Compliance Rule 2-36(d) with respect to CPOs/CTAs exempt from registration*, NAT'L FUTURES ASS'N (Jan. 15, 2019), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5086; Notice I-20-02: *Member obligations under NFA Bylaw 1101 and Compliance Rule 2-36(d) with respect to CPOs/CTAs exempt from registration*, NAT'L FUTURES ASS'N (Jan. 15, 2020), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5192.

[181] In 2017 and 2018, the NFA brought seven enforcement actions against CTAs and CPOs for, among other things, failing to cooperate fully with an NFA examination, misuse of pool funds, failure to distribute disclosure documents to customers, providing materially misleading disclosure documents to the NFA, and failing to adequately supervise the firm's operations. *See, e.g.*, In the Matter of The Stock Mentor LLC and Brian Kelly Johnson, NFA Case No. 18-BCC-002 (May 2, 2018), https://www.nfa.futures.org/news/newsRel.asp?ArticleID=5004; *In the Matter of BCD Forex Investments LLC*, NFA Case. No. 17-BCC-010 (Jan. 8, 2018), https://www.nfa.futures.org/news/newsRel.asp?ArticleID=4981.

[182] Notice I-20-18, *CTA Members: Amendments to NFA Compliance Rule 2-29 and related Interpretive Notice now effective,* NAT'L FUTURES ASS'N, (April 22, 2020), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5223.

[183] Notice I-19-03, *NFA adopts Interpretive Notice entitled NFA Compliance Rule 2-9: CPO Internal Controls System*, NAT'L FUTURES ASS'N, (Jan. 31, 2019), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5088.

[184] Notice I-19-09, *NFA Amends Rules and Adopts Interpretive Notice Implementing Swaps Proficiency Requirements*, NAT'L FUTURES ASS'N, (March 25, 2019), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5105.

[185] *Id.*

amendments related to these issues becoming effective on March 1, 2020.[186] These amendments expanded the NFA's discretionary customer account requirements to apply to discretionary customer accounts trading cleared swaps and clarified the role of futures commission merchants and introducing broker members.[187]

Finally, the NFA has had an increasing focus on cybersecurity, issuing a January 2019 amendment to its information systems security program requirement to provide clarification on training and approval requirements.[188] With regard to training requirements, the new amendments require that members receive annual cybersecurity training on topical areas.[189] The amendments replaced the previous policy which required training upon hiring and periodically after hiring, but did not specify a set time period for how frequently additional training should be provided.[190]

E. ICE Futures U.S., Inc.

1. The investigation

ICE Futures U.S., Inc. (ICE Futures) relies on its Compliance Department to ''initiate and conduct investigations and to prosecute Rule violations.''[191] At the end of the Commission's most recent Exchange rule enforcement review, which covered the target period of March 1, 2014, to February 28, 2015, the Compliance Department consisted of 22 dedicated personnel.[192] This number was updated to 23 as of January 2016.[193] The Compliance Department works closely with the Business Conduct Committee (BCC), which is the primary disciplinary committee of the Exchange. Investigations may be undertaken at the initiative of the Compliance Department or the specific direction of the BCC.[194] **Figure D** provides an example of an inquiry letter sent by ICE Futures to a large financial institution with respect to a potential infraction. At the close of an investigation, the Compliance Department prepares a report summarizing its findings (Investigation Report). The Investigation Report is provided to the respondent, who is given an opportunity to submit written comments before the BCC reviews the matter.[195]

2. Disciplinary proceedings

a. Overview

The BCC executes its disciplinary responsibility through two subcommittees — a subcommittee responsible for charging and the Hearing Panel — made up of BCC members empaneled specifically for the matter at issue.[196] The BCC periodically review Investigation Reports prepared by the Compliance Department to determine whether a rule violation may have occurred.[197] In the event of a possible violation, the subcommittee conducts the relevant review, and Hearing Panels conduct formal hearings on any alleged violations.[198]

The subcommittee is comprised of at least five individuals, including one Public Committee Member who serves as a chair; two ICE Futures members or employees of member firms; and two non-ICE Futures members or non-employees of member firms.[199] The subcommittee is concerned only with determining whether a rule violation has occurred.[200] To answer this question, the subcommittee considers the Investigation Report and any accompanying records; written comments submitted by the respondent; and information provided by Compliance Department staff in attendance.[201] At the time of the initial review of an investigative report, the respondent has an opportunity to appear personally before the subcommittee in an informal proceeding (without a transcript) and may present any relevant evidence.[202] After the respondent has made a presentation, the subcommittee determines whether a rule violation may have occurred.[203] If it answers in the affirmative, the subcommittee may (i) return the matter to the Compliance Department with further instructions; (ii) enter into or approve a settlement with the respondent; or (iii) refer the matter to a formal hearing by the Hearing Panel.[204]

If the matter is referred to a Hearing Panel, the Compliance Department must serve the respondent with a Notice of Charges (Notice) that sets forth, among other things, the conduct and rules at issue.[205] The respondent has 20 days to exercise its right to a formal hearing upon written request.[206] If the respondent fails to file an Answer within 20 days of service, or to expressly deny any allegation contained in the Notice, such failures shall be deemed admissions.[207]

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[186] Notice I-20-04, *Effective date for NFA rule amendments related to discretionary customer accounts, customer information, risk disclosures and bunched orders*, NAT'L FUTURES ASS'N, (Jan. 31, 2020), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5195.

[187] *Id.*

[188] Notice I-19-01, *NFA Amends Interpretive Notice Regarding Information Systems Security Programs—Cybersecurity*, NAT'L FUTURES ASS'N, (Jan. 7, 2019), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5085.

[189] *Id.*

[190] *Id.*

[191] ICE Futures U.S., Inc. (ICE Futures), Disciplinary Rule 21.01.

[192] CFTC, DIV. OF MARKET OVERSIGHT, TRADE PRACTICE RULE ENFORCEMENT REVIEW: ICE FUTURES U.S. 10-11 (Dec. 2, 2016).

[193] *Id.* at 11.

[194] *See* ICE Futures Disciplinary Rule 21.01, 21.02.

[195] ICE Futures Disciplinary Rule 21.02(c).

[196] ICE Futures Disciplinary Rule 21.03, 21.08.

[197] ICE Futures Disciplinary Rule 21.03(c).

[198] ICE Futures Disciplinary Rule 21.08.

[199] ICE Futures Disciplinary Rule 21.03(b).

[200] ICE Futures Disciplinary Rule 21.03(c).

[201] *See* ICE Futures Disciplinary Rule 21.03(c), (d).

[202] ICE Futures Disciplinary Rule 21.03(d).

[203] ICE Futures Disciplinary Rule 21.03(e).

[204] ICE Futures Disciplinary Rule 21.03(e).

[205] ICE Futures Disciplinary Rule 21.05.

[206] ICE Futures Disciplinary Rule 21.05(c).

[207] ICE Futures Disciplinary Rule 21.05. In the event that the respondent fails to Answer, admits the allegations, or does not expressly deny the allegations contained in the Notice, the Hearing Panel may impose a penalty for each violation at issue. The respondent will be promptly notified of the imposition of the penalty and will have 10 days to request a hearing on the penalty. The Compliance Department

Figure D: Sample ICE Futures U.S. Inquiry Letter

Re: Request for Documents

The Compliance Department of ICE Futures U.S. is conducting a trading review of the Cotton ("CT") contract. Staff requests that you produce the following documents by xx/xx/2013:

• Daily account statements Account# [redacted] for trade dates xx/xx/2013.

You may deliver the documents by mail to:

ICE Futures U.S. Compliance Department,

One North End Avenue-8th Floor New York, New York 10282.

If you mail original records, you are advised to keep a receipt of delivery. Or you can email the documents to me at xx.xx@theice.com.

According to the disciplinary rules of the Exchange, you are required to produce documents requested in the course of an investigation. If you have any questions, please contact me at (xxx) xxx-xxxx. Thank you for your prompt attention to this matter.

Sincerely,

Senior Investigator

Compliance Department

File xx xx-xxx

A three-person Hearing Panel is selected by the BCC Chairman from those members of the BCC who did not review the written investigation report. At least one individual on each Hearing Panel must be a member or employee of a member firm, and the chair must be a Public Director.[208]

COMMENT: ICE has a summary fine regime similar to that used by the CME. Pursuant to ICE Rule 21.02(e), ICE may issue summary fines of under $10,000 for several enumerated violations, including recordkeeping violations, abuse of exceptions that allow noncompetitive transfer transactions and pre-execution communications, or failure to comply with certain requirements concerning cross-order entry, marking, and execution; block trade execution and reporting; and audit trail requirements for electronic orders submitted through a firm's direct access or order routing systems. Individuals or institutions who receive a summary fine notice have the opportunity to present evidence to ICE's Market Regulation Department within fifteen days to request that the fine be reduced or rescinded, after which it becomes final. A decision to cancel, modify, or affirm a summary fine imposed in accordance with ICE rules is solely within the power and absolute discretion of the Chief Regulatory Officer or his designees.[209]

b. Settlement

Settlement agreements may be entered into at various stages of ICE Futures' disciplinary process, and do not require a respondent to admit guilt. Before a matter has been referred to a Charging Panel, the Compliance Department may enter into a written settlement including any of the following sanctions: (i) a cease and desist order or reprimand; (ii) fines of up to $100,000 for each rule violation allegation plus the monetary value of any benefit received as a result; (iii) a voluntary suspension of up to three months for each rule violation alleged; (iv) expulsion; and/or (v) as part of a suspension, expulsion, or prohibition against being employed by another member (or, in the case of non-members, an order denying direct and indirect future access to ICE Futures or its markets for a specified amount of time).[210] In cases where the respondent may have violated a rule involving the execution of, or the failure to execute, a customer transaction (Customer Transaction Violation), the Compliance Department must make a specific finding on whether the customer may have incurred any financial harm as a result of the violation, and may enter into a settlement agreement whereby the member agrees to pay restitution to the customer, in addition to other potential sanctions.[211] A settlement agreement with the Compliance Department must be approved by a subcommittee of the BCC or a Hearing Panel, and any penalty included as part of the settle-

is afforded an opportunity to submit a reply within five days of service of the respondent's answer.

[208] ICE Futures Disciplinary Rule 21.08.

[209] ICE Futures Disciplinary Rule 21.02(e).

[210] ICE Futures Disciplinary Rule 21.02(d).

[211] *Id.*

ment agreement becomes final and effective on the date the settlement is approved.[212]

Once a matter has been referred to a Charging Panel, the Charging Panel may enter into written settlement including any of the following sanctions:

- a cease or desist order or reprimand;
- fines of up to $1,000,000 for each rule violation alleged, plus the monetary value of any benefit received as a result;
- a voluntary suspension of up to one year for each rule violation alleged;
- expulsion;
- a prohibition against executing customer orders; and/or
- as part of a suspension or expulsion, a prohibition against being employed by another member as a trading floor employee (or, in the case of non-members, an order denying direct and indirect future access to ICE Futures or its markets for a specified amount of time).[213]

Additionally, the Charging Panel may order restitution, if it finds that the respondent engaged in a Customer Transaction Violation.[214]

3. Hearing on contested charges

The Compliance Department and the respondent must deliver to each other and the Office of the General Counsel a statement listing the witnesses expected to be called and the documents expected to be introduced into evidence at the hearing, together with copies of such documents, by a date prior to the hearing as the Hearing Panel may specify.[215] At the hearing, the respondent is entitled to be represented by counsel or a person of his or her choosing; to present witnesses and documentary evidence; and to cross-examine witnesses.[216] No formal rules of evidence apply, and the Hearing Panel is free to accept or reject any and all evidence as it deems proper.[217]

After the conclusion of the hearing, if the Hearing Panel finds the Respondent guilty of any Rule violation charged, it must issue a written decision that includes: (i) a summary of the allegations contained in the Notice; (ii) a summary of the Answer; (iii) a brief summary of the evidence produced at the hearing; (iv) a statement of its findings and conclusions with respect to each charge (including a finding of financial harm to a customer in the case of a customer transaction violation); and, where it concludes that violations were committed, (v) an order stating the penalty to be imposed.[218]

The possible sanctions that the Hearing Panel may apply are the same as those available to the Charging Panel in the context of settlement.[219] The decision constitutes the final decision of the Exchange and is not appealable.[220] The decision, including any penalty, becomes effective 15 days, or such longer time as the Hearing Panel may specify, after a copy of the written decision has been served on the respondent. In the event of an appeal, the penalties imposed by the Hearing Panel become effective only when the decision of the Appeals Committee concerning the order of expulsion becomes final and effective.[221]

4. Enforcement Priorities

ICE Futures publishes disciplinary notices on its website dating back to 2014.[222] Based on a review of its recent filings, ICE Futures appears to be focused on infractions related to block trading, spoofing, and audit trail requirements for electronic orders. Of the 55 disciplinary notices filed in 2019 and 2020, 11 involved block trading, 15 involved spoofing, and 13 involved audit trail requirement infractions.[223]

a. Block Trades

Block trading is regulated by ICE Futures under Exchange Rule 4.07, which states in part that ''[p]rivately negotiated Transactions may be entered into with respect to Commodity Contracts designated by the Exchange for such purpose (hereinafter referred to as 'Block Trades'),'' subject to the satisfaction of a number of conditions. One such condition requires that''[e]ach buy or sell order underly at Block Trade must state explicitly that it is to be, or may be, executed by means of a Block Trade.'' [224] In November 2019, for example, a respondent was fined $200,000 based on allegations that, among other things, they may have violated this condition.[225]

Like with the CME, ICE Futures block trades must be executed at a price that is fair and reasonable in light of a number of factors, such as the block trade's size, price, and size of other trades in the same contract at the relevant time, as well

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[212] ICE Futures Disciplinary Rule 21.02.

[213] *Id.*

[214] ICE Futures Disciplinary Rule 21.03.

[215] ICE Futures Disciplinary Rule 21.12(c).

[216] ICE Futures Disciplinary Rule 21.12(b).

[217] ICE Futures Disciplinary Rule 21.12(d).

[218] ICE Futures Disciplinary Rule 21.13.

[219] *See* 262 SPS § V-B3, *Hearing on contested charges*.

[220] ICE Futures Disciplinary Rule 21.16.

[221] In certain circumstances, such as where the respondent has consented to the action taken and the timing of its effectiveness, the Hearing Panel may render the decision effective prior to the 15-day period. *Id.*

[222] Notably, in 2015, the CFTC fined ICE Futures $3 million for submitting ''inaccurate and incomplete reports and data'' to the Commission between 2012 and 2014. See Ice Futures U.S., Inc., CFTC Docket No. 15-17 (Mar. 16, 2015), http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enficeorder031615.pdf.

[223] ICE Futures, ICE Futures U.S.: Notices, https://www.theice-.com/futures-us/notices (last visited April 5, 2021).

[224] The full text of Exchange Rule 4.07(a)(ii) follows: Each buy or sell order underlying a Block Trade must: (A) state explicitly that it is to be, or may be, executed by means of a Block Trade; and (B) be for at least the applicable minimum threshold as specified by the Exchange; provided that only a CTA, including without limitation an Exempt Investment Adviser, with total assets under management exceeding US $25 million or a Foreign Adviser with total assets under management exceeding US $50 million, may satisfy this requirement by aggregating orders for different accounts.

[225] Merrill Lynch International, Case No. 2018-033, ICE FUTURES U.S. (Nov. 15, 2019).

as those in other relevant markets. In addition, the trade price must adhere to the minimum tick and price validation requirements of the market in question, and each leg of any blocked spread or combination trade must be done at a single price. It is impermissible under ICE Futures Rules to split the quantity of a particular leg and report different prices for such leg.[226] Depending on the contract, complete block trade details must be reported to ICE Futures within either 5, 10, or 15 minutes after execution. Typically, block trades are submitted directly into ICE Block, an application accessible via WebICE, but may also be reported via email to the Exchange.[227] In order to test reporting and recordkeeping sufficiency at a given institution executing block trades, ICE Futures may issue requests for information in connection with one or several block trades at a time. Although parties to a potential block trade may engage in pre-hedging of the position they believe would result from the consummation of the transaction, intermediaries are prohibited by Rule 4.02(h) from pre-hedging using any accounts they own or control or have proprietary interest.[228] Rule 4.02(h) also prohibits any person from front-running on ''material nonpublic information obtained through a confidential relationship, broker/customer relationship, or in breach of a preexisting duty.''[229]

b. Spoofing

ICE Futures regulates spoofing under Exchange Rule 4.02(l), which prohibits ''manipulative or disruptive trading practices'' as specified by the CEA or CFTC's regulations. This includes a prohibition on entering orders with the intent to ''cancel the order before execution,'' ''disrupt the orderly conduct of trading,'' or ''mislead other market participants,'' as well as knowingly entering bids or offers other than ''for the purpose of bona fide Transactions.''[230] By way of example, in November 2019, a respondent trader violated this provision by using the trader ID of a colleague instead of his own and entering into and cancelling orders during the pre-open period of various markets with no intent to enter into a bona fide trade.[231] More recently, ICE Futures determined that firm violated Rule 4.02(l) when it placed and deleted large-quantity orders on one side of the order book while trading small-quantity orders on the opposite side.[232] The purpose of these actions was not to enter into a genuine trade, but rather to create false depth, put pressure on the market, and mislead market participants.

In another significant example, in 2018, ICE Futures found that a firm violated Rule 4.02(l) when it deployed a semiautomated trading system to enter orders at prices significantly different from the prevailing bid without the intent to execute bona fide transactions, and settled for a $37,500 fine.[233] Notably, violations more severe in nature may face a fine upwards of $100,000. As such was the case for an individual trader who created numerous order book imbalances by entering an undisclosed volume order showing a small quantity, relative to market conditions, to buy or sell on one side of the market, and much larger fully-disclosed orders relative to market conditions on the other.[234] The trader subsequently cancelled the large orders once all or part of the undisclosed volume order had been filled, in violation of ICE Futures spoofing rules.[235]

c. Audit Trail Retention

ICE Futures has also been aggressive in enforcing the audit trail data retention requirements of Rule 4.19, primarily through summary fines. Under Rule 4.19, all members connected to the electronic trading system are required to maintain, and produce upon request, the audit trail record for all orders submitted through its connection, including the date and times of order entry and receipt, as well as other order details such as the Exchange Commodity Contract and expiration month. The members are also responsible for producing upon request such records for all persons authorized by the member to have access to the system. Of the 63 disciplinary actions between 2019 and 2020, 13 notices involve respondents who failed to retain electronic audit trail data corresponding to orders entered into the electronic trading system.[236] The fines imposed ranged from $2,500 to $5,000.

d. Wash Trades

Wash trading is governed in part by Exchange Rule 4.02(c), which states that ''[i]n connection with the placement of any order or execution of any Transaction, it shall be a violation of the Rules for any Person to . . . [e]xecute a wash sale, accommodation Trade, fictitious sale or prearranged trade.'' Like other SROs, ICE Futures has focused more on wash trading activity as the volume of electronic trading has increased. In a 2018 wash trading disciplinary action, for example, a respondent was fined $40,000 and issued a 3-year suspension of access to ICE markets, in connection with 27 instances of wash trades executed between his employer's account and his personal account.[237] ICE Futures found that the purpose of this trading activity was ''to affect the transfer of funds'' between the two accounts.[238] Less recently, in 2015, two affiliated firms were collectively fined $25,000 for 16

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[226] ICE Futures U.S., Block Trade – FAQs (July 20, 2018).

[227] *Id.*

[228] *Id.*

[229] ICE Futures Trading Rule 4.02

[230] *Id.*

[231] Thomas Jendras, Case No. 2017-024, ICE FUTURES U.S. (Nov. 14, 2019), https://www.theice.com/publicdocs/futures_us/disciplinary_notices/ICE_Futures_US_Thomas_Jendras_20191114.pdf.

[232] Yuan Ye, Case No. 2017-014, ICE FUTURES U.S. (April 16, 2020), https://www.theice.com/publicdocs/futures_us/disciplinary_notices/ICE_Futures_US_Yuan_Ye_20200416.pdf,

[233] Uncia Energy LP – Series I, Case No. 2017-047, ICE FUTURES U.S. (Dec. 4, 2018), https://www.theice.com/publicdocs/futures_us/disciplinary_notices/
ICE_Futures_Uncia_Energy_LP_Series_I_201801204.pdf.

[234] Stuart Satullo, Case No. 2016-077, ICE FUTURES U.S. (Feb. 14, 2018), https://www.theice.com/publicdocs/futures_us/disciplinary_notices/ICE_Futures_US_Stuart_Satullo_20180214..pdf

[235] *Id.*

[236] ICE Futures, ICE FUTURES U.S.: Notices, https://www.theice.com/futures-us/notices (last visited April 19, 2021).

[237] Thibault Blehaut, Case No. 2017-058, ICE FUTURES U.S. (Feb. 26, 2018), https://www.theice.com/publicdocs/futures_us/disciplinary_notices/
ICE_Futures_US_THIBAULT_BLEHAUT_20180226.pdf.

[238] *Id.*

instances of wash trades, traded opposite each other.[239] ICE Futures opined that these were also executed ''for the purpose of affecting position transfers.''[240]

e. Position Limits

Finally, in recent years, ICE Futures has taken disciplinary action with respect to position limits. Position limits, governed primarily by Rule 6.13, are levels that may not be exceeded on an intraday or end-of-day basis unless an exemption has been obtained from the ICE Market Regulation Department.[241] If a position limit is exceeded without an exemption, it is considered to be a violation of ICE Exchange rules.[242] By way of example, Exchange rules set forth position limits for cocoa, coffee, cotton, energy and oil, metals, and raw sugar contracts, among others.[243]

In February 2018, a company settled with ICE Futures for a $7,500 fine after holding an intraday position in excess of the applicable spot month position limit.[244] In comparison, a more severe example of sanctions issued in connection with position limits involved a firm that may have caused price movement when reducing a sizeable position at the request of Exchange staff. However, the firm had waited until the final 20 minutes of the trading day to execute a high proportion of trades the day before first notice day, thus possibly resulting in the price fluctuation. In addition, ICE Futures determined that the firm had exceeded the speculative position limit for the relevant contract on a previous date. The firm paid a $200,000 fine to settle the matter, indicating that violation of ICE Futures position limits rules can come at a hefty price.[245]

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[239] Sucres et Desrees S.A., et al., Case No. 2015-038, ICE FUTURES U.S. (Feb. 24, 2015). https://www.theice.com/publicdocs/futures_us/disciplinary_notices/SED_Sucden_Case_No._2015--038.pdf.

[240] *Id*.

[241] ICE FUTURES U.S., Guidance on Position Limits (March 2018).

[242] *Id*. There are limited circumstances when an exemption may be obtained after a position limit is exceeded. Such exemptions are available due to sudden unforeseen increases in bona fide hedging or risk management needs and require that an exemption be requested within one business day (unless the Market Regulation Department has approved a later filing, which may not exceed 5 business days) following the day on which the position limit was exceeded. If the exemption is approved, there is no rule violation.

[243] ICE Futures Regulatory Requirements 6.17-6.28.

[244] National Trading II, LLC, Case No. 2016-076, ICE FUTURES U.S. (Feb. 5, 2018), https://www.theice.com/publicdocs/futures_us/disciplinary_notices/ICE_Futures_US_National%20_Trading_II_LLC20180205.pdf.

[245] Glencore Grain BV, Case No. 2014-072, ICE FUTURES U.S. (Mar. 11, 2015), https://www.theice.com/publicdocs/futures_us/disciplinary_notices/Glencore_Grain_Case_No._2014-072.pdf.

VI.
Recent Developments in CFTC Enforcement

A. Overview of the CFTC's Recent Enforcement Efforts

The CFTC historically has been perceived as a ''toothless regulator'' that has provided only ''gentl[e]'' oversight of those markets under its jurisdiction.[1] However, the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank),[2] as well as the wave of rulemaking it engendered at the Commission, has recalibrated and invigorated the CFTC's enforcement powers in a variety of ways.[3] As discussed at 262 SPS § III-B vs 262 SPS § III-A9, *The CFTC and its enforcement program*, the CFTC has used its ''bigger arsenal of weapons'' aggressively in the dozen years since Dodd-Frank.[4] The Commission has brought a record number of enforcement actions and collected substantially larger civil penalties in the years following the bill's passage.[5] Most recently, in FY 2022, the Commission filed 82 enforcement actions and obtained over $2.5 billion in restitution, disgorgement, and civil monetary penalties.[6] This was the third-highest yearly total in CFTC history for both the number of actions filed and total monetary recovery.[7] The Commission has also continued to expand its public profile through the pursuit of increasingly high-profile targets, its participation in intricate multi-agency and multi-country investigations, and its key oversight role in the emerging cryptocurrency markets. This Chapter discusses those and other developments, as well as the Commission's expected enforcement priorities in the years ahead.

COMMENT: Former CFTC Chairman Giancarlo announced in 2017 that he wanted to focus the Commission on ''(i) fostering economic growth; (ii) enhancing US financial markets; and (iii) right-sizing its regulatory footprint,'' in accordance with former President Trump's regulatory agenda.[8] Under Giancarlo, the Commission moved to streamline existing regulations, limit new regulations, modernize its infrastructure by appointing a Chief Market Intelligence Officer and expanding its use of technology, and stabilize markets. The CFTC also issued a press release and an enforcement advisory regarding foreign corrupt practices, signaling a new area of enforcement for the Commission.[9] And in December 2020, the CFTC filed and settled charges against Vitol Inc., a Swiss-based multinational energy and commodity trading company, in the Commission's first enforcement action involving foreign corruption.[10]

Former Chairman Tarbert succeeded Giancarlo in July 2019 and served as Chairman until January 2021. Tarbert led a major reorganization of the Commission, creating a new Division of Data to more effectively oversee the Commission's data functions and combining several other departments.[11] He also emphasized transparency during his tenure,[12] publishing guidance on the Commission's calculation of civil monetary penalties[13] and the factors used in evaluating compliance programs.[14] Under Tarbert's leadership, the Commission finalized a long-debated rule regarding derivative position limits. Despite a general deregulatory push under President Trump's nominees, the CFTC continued to pursue aggressive enforcement during Tarbert's tenure, bringing 49 actions in 2017, 83 in 2018, 69 in 2019, and 113 in 2020.[15] Even amidst the COVID-

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[1] Ben Protess, *CFTC, Toothless Regulator, Looks to Take a Bite Out of Derivatives*, HUFFINGTON POST (May 25, 2011), https://www.huffpost.com/entry/cftc-toothless-regulator_n_220455.

[2] Pub. L. No. 111-203, § 619, 124 Stat. 1376 (2010).

[3] The CEA is codified at 7 U.S.C. § 1 *et seq.* Because the numbering of the sections of the CEA does not always correspond to the relevant sections of the U.S. Code, the CFTC has provided a conversion chart. *See* CFTC, *Commodity Exchange Act—U.S. Code Conversion Chart*, CFTC.GOV. It may be helpful to refer to this chart throughout this chapter.

[4] Christopher Doering, *CFTC Enforcement Chief Vows to be Aggressive*, REUTERS (May 5, 2011), https://www.reuters.com/article/financial-regulation-cftc-enforcement/new-cftc-enforcement-chief-vows-to-be-aggressive-idUSN059778220110505.

[5] *See* 262 SPS § I, *Introduction* (discussing enforcement actions and civil penalties collected by the CFTC since the passage of Dodd-Frank).

[6] Press Release, CFTC, CFTC Releases Annual Enforcement Results (Oct. 20, 2022), https://www.cftc.gov/PressRoom/PressReleases/8613-22.

[7] *Id.*

[8] CFTC, Remarks of Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL (Mar. 15, 2017), https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20.

[9] Press Release, CFTC, CFTC Division of Enforcement Issues Advisory on Violations of the Commodity Exchange Act Involving Foreign Corrupt Practices (Mar. 6, 2019), https://www.cftc.gov/PressRoom/PressReleases/7884-19.

[10] Press Release, CFTC, CFTC Orders Vitol Inc. to Pay $95.7 Million for Corruption-Based Fraud and Attempted Manipulation (Dec. 3, 2020), https://www.cftc.gov/PressRoom/PressReleases/8326-20.

[11] Press Release, CFTC, CFTC Announces Organizational Changes to Enhance Agency's Operational Effectiveness (Oct. 29, 2020), https://www.cftc.gov/PressRoom/PressReleases/8297-20.

[12] CFTC, Statement of Chairman Heath P. Tarbert Before the December 10, 2019 Open Meeting (Dec. 10, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement121019.

[13] CFTC, CFTC Division of Enforcement Issues Civil Monetary Penalty Guidance (May 20, 2020), https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement121019.

[14] Press Release, CFTC, CFTC Issues Guidance on Factors Used in Evaluating Corporate Compliance Programs in Connection with Enforcement Matters (Sept. 10, 2020), https://www.cftc.gov/PressRoom/PressReleases/8235-20.

[15] Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal year 2017 (Nov. 22, 2017), https://www.cftc.gov/PressRoom/PressReleases/7650-17; Press Release, CFTC, CFTC Division of Enforcement Issues Report on FY 2018 Results (Nov. 15, 2018), https://www.cftc.gov/PressRoom/PressReleases/7841-18; Press Release, CFTC, CFTC Division of Enforcement Issues Annual Report (Dec. 1, 2020), https://www.cftc.gov/PressRoom/PressReleases/8323-20; Press Release, CFTC, CFTC Division of Enforcement Issues Annual Report for FY 2019 (Nov. 25, 2019), https://www.cftc.gov/PressRoom/PressReleases/8085-19; CFTC, AGENCY FINANCIAL REPORT, FISCAL YEAR 2021, at 4 (2021); Press Release, CFTC, CFTC Division of Enforcement Releases Annual Enforcement Results (Oct. 20, 2022), https://www.cftc.gov/PressRoom/PressReleases/8613-22.

19 pandemic, 2020 was among the busiest in the CFTC's history.

In December 2021, former Acting Chairman Rostin Behnam was unanimously confirmed as Chairman of the CFTC.[16] Chairman Behnam, just weeks of taking office, gave a preview of his agenda at an industry conference.[17] He identified, among other issues, cash market oversight, the rise of retail market participants, global regulatory coordination, climate-related financial risk, and the collection, use, analysis, and protection of data as priority topics.[18]

COMMENT: The CFTC's Division of Enforcement released its first public Enforcement Manual in May 2019.[19] In releasing the Manual, the CFTC sought to increase clarity and transparency regarding the policies and practices that guide its work; it does not create any extra rights and is not enforceable in court.[20] The Manual provides general information about the processes the Commission uses in investigating and initiating cases, as well as information about the Commission's internal organization. The most recent version of the Enforcement Manual was released in May 2020.[21]

B. Position Limits

Position limits have long been a focus of the CFTC. The term ''position limit'' refers to the maximum number of futures or options that an individual market participant may hold on an underlying commodity, as determined by the CFTC and/or the exchange where the contract trades.[22] The purposes of position limits are to curb excessive speculation, protect the market from manipulation, reduce price volatility, and ensure sufficient market liquidity for bona fide hedgers.[23] Former CFTC Chairman Gary Gensler has unequivocally stated that ''position limits should be consistently applied and vigorously enforced'' to ensure healthy markets.[24] To this end, the Commission has spoken actively about the importance of position limits in maintaining market integrity—particularly since the Dodd-Frank Act extended its authority to establish such limits in previously unregulated areas of the commodities sector.[25] Given such regulatory scrutiny, it is important to understand how position limits are (i) calculated; (ii) affected by the Dodd-Frank Act; and (iii) enforced.

1. Calculating position limits

The Commission has statutory authority under § 4a(a) of the CEA, 7 U.S.C. § 6a(a), to implement or approve rules establishing position limits.[26] In setting position limits, the CFTC considers three basic elements: (i) the size, or levels, of the limits; (ii) the applicable exemptions from the limits; and (iii) whether and which accounts should be aggregated in applying the limits.[27]

a. Size of position limits

The Commission directly determines position limits with respect to certain core referenced futures contracts across the agricultural, energy, and precious metals industries.[28] The position limits for other commodity futures are set by the exchange on which they are traded, pursuant to specific guidance issued by the CFTC.[29] In general, exchanges establish different position limits for the long and short positions of a given commodity.

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[16] Press Release, CFTC, U.S. Senate Unanimously Confirms Behnam as Chairman (Dec. 16, 2021), https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement121621.

[17] Rostin Behnam, Chairman, CFTC, Keynote Address at the ABA Business Law Section Derivatives & Futures Law Committee Virtual Winter Meeting (Mar. 16, 2022), https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam19.

[18] *Id.*

[19] Press Release, CFTC, CFTC's Division of Enforcement Issues First Public Enforcement Manual (May 8, 2019), https://www.cftc.gov/PressRoom/PressReleases/7925-19.

[20] *Id.*

[21] CFTC, Enforcement Manual (May 20, 2020), https://www.cftc.gov/sites/default/files/2021-05/EnforcementManual.pdf

[22] *See* Int'l Swaps & Derivatives Ass'n v. CFTC, 887 F. Supp. 2d 259, 262 (D.D.C. 2012) (''A position limit caps the maximum number of derivatives contracts to purchase (long) or sell (short) a commodity that an individual trader or group of traders may own during a given period.'') (internal quotation omitted). Position limits are alternatively—and perhaps misleadingly, given their applicability to hedgers—referred to as ''speculative limits'' in industry parlance.

[23] *See* 7 U.S.C. § 6a(a)(3)(B).

[24] John Kemp, *Column: CFTC Signals Zero-Tolerance in Position Limits*, REUTERS (Sept. 28, 2012), https://www.reuters.com/article/column-kemp-cftc-fines/column-cftc-signals-zero-tolerance-on-position-limits-kemp-idUSL5E8KS9ZX20120928 (quoting Gary Gensler).

[25] *See, e.g.*, CFTC, Supporting Statement of Commissioner Brian D. Quintenz Regarding Position Limits for Derivatives (Oct. 15, 2020), https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement101520c.

[26] *See* 7 U.S.C. § 6a(a) (stating that CFTC has authority to proclaim and fix position limits ''from time to time . . . as the Commission finds are necessary to diminish, eliminate, or prevent [excessive speculation],'' and noting that the Commission may fix different ''position limits for different commodities, markets, futures, or delivery months, or for different number of days remaining until the last day of trading in a contract...''). In 1981, the CFTC began requiring exchanges to establish position limits for any commodity that was not already subject to federally mandated limits. *See* 17 C.F.R. § 150.5. The Commission has since relaxed its insistence on position limits in favor of ''position accountability'' provisions that enable exchanges to substitute accountability standards for firm trading caps with respect to certain contracts—*i.e.*, contracts on financial instruments, intangible commodities such as energy, or certain tangible commodities like metal that are supported by large open-interest, high daily trading volume, and liquid cash markets. *See* 17 C.F.R. § 38, App. B. For a historical overview of the CFTC's approach to position limits and position accountability provisions, *see generally* Dan M. Berkovitz, General Counsel, CFTC, Position Limits and the Hedge Exemption, Brief Legislative History, Testimony at Commission Hearing on Speculative Position Limits in Energy Futures Markets (July 28, 2009), https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement072809.

[27] CFTC, Speculative Limits, CFTC.GOV, https://www.cftc.gov/IndustryOversight/MarketSurveillance/SpeculativeLimits/index.htm.

[28] *See* 17 C.F.R. § 150.2(d) (stating the position limits for these commodities).

[29] *See* 17 C.F.R. pt. 38, App. B: Guidance on, and Acceptable Practices in, Compliance with Core Principles (setting out, under Core Principle IV: Position Limitations or Accountability, ''acceptable practices'' for position limitations or accountability adopted by exchanges). For a sampling of exchange rules relating to position limits, *see, e.g.*, CME Group, Rule 559; CBOE Futures Exchange (CFE),

The position limit for a particular futures contract or option is a function of the total deliverable supply of the underlying commodity, as well as the time remaining until the contract expires. This is because the risk of market manipulation is in large part based on the extent to which a single entity or trader can control the deliverable supply, and this risk increases as contracts approach their expiration date.[30] Accordingly, position limits generally decline during the ''spot month'' or ''current delivery month''—*i.e.*, the month in which or immediately preceding the time at which a futures or options contract matures and becomes deliverable—and increase during the ''non-spot month'' or ''single month''—*i.e.*, all of the other contract months of the same commodity. In other words, the closer a contract is to its maturation date, the stricter its position limits. Because the threat of market manipulation is lower in highly-liquid futures and options markets—such as major foreign currency markets—position limits are generally not necessary or applicable.[31]

In addition to spot month or non-spot month limits, the CFTC or exchanges may impose aggregate or ''all-months-combined'' position limits that cap the *total* number of futures contracts that may be held in a given commodity in a certain period.[32] This period may include all contract months of the same commodity, or may be restricted to particular months in a crop year or other production cycle. All-months-combined position limits are not applicable to futures markets where the supply and price of a commodity in a given month are independent of the time of year. Thus, for example, grain—which has a distinct seasonal production pattern and is storable—is subject to an all-months-combined position limit, whereas beef—which is produced continuously and is perishable—is not.[33]

Position limits are calculated by aggregating option and futures contracts into a single number. For purposes of the calculation, options are first converted to ''futures contract equivalents'' through the use of an ''option delta.''[34] The option delta—which reflects the sensitivity of the option price to movement in the underlying asset price—is the amount by which an option contract will change in value, if the price of the underlying futures contract changes by one unit. The futures contract equivalent is calculated by multiplying the number of options contracts in hand with the previous day's option delta (as provided by the relevant exchange).[35] Thus, for example, 20 option contracts with an option delta of 0.1 have a futures contract equivalent of two. The futures contract equivalent and futures positions for the same commodity and contract months are summed to determine the position size.

b. Exemptions from position limits

Although position limits apply equally to both hedging and speculative accounts, non-speculative market participants may apply to the CFTC and/or exchanges for temporary exemptions from position limits. Exemptions are granted on a case-by-case basis, and provide the holder with an individualized and expanded—albeit not unlimited—position limit for a predetermined period of time.

Exemptions may be granted for ''bona fide hedging,'' as defined by CFTC Regulation § 150.1. The rule defines a hedge as ''a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel.''[36] To qualify for an exemption, the hedge must also (i) be economically appropriate to reduce risk for a commercial enterprise and (ii) arise from a change in the value of the hedger's current or anticipated assets or liabilities.[37] The bona fide hedging definition's ''economically appropriate test'' set out in § 150.1 explicitly provides that only hedges that offset price risks can be recognized as bona fide hedging transactions or positions.[38]

Exchanges may also grant exemptions for spreads,[39] straddles,[40] arbitrage positions, or other positions consistent with the purposes of position limit rules. The CFTC periodically reviews the process by which each exchange grants exemptions, monitors compliance with position limits, and enforces against violations. In markets where the CFTC directly sets position limits, hedgers must file a report with the Commission—monthly and upon request—if their futures and/or options positions exceed position limits.[41] The report must also set forth the traders' positions in the cash market. The CFTC then determines whether the cash position is large enough, such that a futures and/or option position in excess of position limits is economically justified to reduce the risk to the trader's cash position.

c. Aggregation requirements

In determining whether a position limit has been exceeded, a person must aggregate all positions for which that person controls the trading decisions with all the positions for which

Rule 412.

[30] As the Seventh Circuit has explained, the possibility of manipulation—and the corresponding need for position limits—arises ''from the potential imbalance between the deliverable supply and investors' contract rights near the expiration date.'' Bd. of Trade of City of Chi. v. SEC, 187 F.3d 713, 724–25 (7th Cir. 1999) (''A person who owns a substantial portion of the long interest near the contract's expiration date also obtains control over the supply that the shorts need to meet their obligations. Then the long demands delivery, and the price of the commodity skyrockets. It takes time and money to bring additional supplies to the delivery point, and the long can exploit these costs to force the shorts to pay through the nose.'').

[31] CFTC, Speculative Limits, CFTC.GOV, https://www.cftc.gov/IndustryOversight/MarketSurveillance/SpeculativeLimits/index.htm.

[32] *See* Paul E. Peterson, *Position Limits, Excessive Speculation and the Dodd-Frank Act*, FARMDOCDAILY. ILLINOIS.EDU (Oct. 17, 2012), https://farmdocdaily.illinois.edu/2012/10/position-limits-excessive-spec.html.

[33] *See id.*

[34] *See id.*

[35] *See id.*

[36] *See* 17 C.F.R. § 150.1.

[37] *Id.*

[38] Position Limits for Derivatives, 86 Fed. Reg. 3423 (Jan. 14, 2021).

[39] A spread is an options position established by purchasing one option and selling another option of the same class (*i.e.*, both calls or both puts) but of a different strike price or expiration date.

[40] A straddle refers to an options strategy where the investor holds a position in both a call and put with the same strike price and expiration date.

[41] *See generally* 17 C.F.R. pt. 19.

that person has at least a 10 percent ownership interest.[42] Contracts held by two or more persons are combined, when these persons are acting pursuant to an express or implied agreement.[43] The intent of such aggregation is to accurately assess the level of market control held by any one party, and to ensure that the spirit and purpose of position limits rules are maintained. In keeping with this purpose, the CFTC applies its aggregation rules broadly. For example, each participant holding at least 10 percent interest in a partnership account must aggregate the entire position of the partnership, rather than the participant's own fractional share. Any position a participant holds separately from the partnership is also aggregated. Similarly, a pool comprised of many traders is treated as a single trader for the purposes of position limits.[44] Exemptions to these aggregation requirements are narrowly tailored to situations where limited partners and pool participants have no knowledge of, or control over, the positions held in common.

The CFTC also imposed an aggregation requirement in 2016.[45] Under this rule, a person must aggregate all positions that it controls in accounts with substantially identical trading strategies, on a pro rata basis, with all positions held or controlled by the person and with all positions that the person is otherwise required to aggregate.[46] The Commission has not defined what would constitute a substantially identical trading strategy, although the adopting release for the rules mention commodity index funds and passively managed index funds in this regard.[47] Notably, this aggregation requirement is not subject to any ownership threshold or aggregation exemptions. In August 2017, however, the Commission granted a period of time-limited, no action relief that effectively confines the ''substantially identical trading strategies'' rule to situations where there is willful circumvention of position limits.[48] On August 10, 2022, the CFTC further extended until the earlier of August 12, 2025 or the effective date of any codifying rulemaking the relief from certain positions it had granted previously in 2017 and extended in 2019.[49] The relief was otherwise set to expire on August 12, 2022.[50]

2. The impact of Dodd-Frank on the CFTC's position limits regime

In addition to reinforcing the Commission's authority to impose position limits on futures and options contracts traded on exchanges, the Dodd-Frank Act also expanded the Commission's authority by allowing it to set position limits on additional instruments. Specifically, § 737 of the Dodd-Frank Act amended § 4a(a) of the CEA to empower—and require—the CFTC to impose position limits on swaps that (i) trade on a regulated futures exchange or Swap Execution Facility (SEF); (ii) are economically equivalent[51] to regulated futures and option contracts with position limits; or (iii) perform a significant price-discovery function.[52] In addition, § 737 of the Dodd-Frank Act mandated that the Commission implement aggregate position limits on futures and swaps on physical commodities.

In response, the Commission proposed new position rules for 28 physical commodity futures contracts—19 agricultural contracts, five metals contracts, and four energy contracts (together, Core Referenced Futures Contracts)—as well as futures and swaps that are economically equivalent to those contracts (together with Core Referenced Futures Contracts, Referenced Contracts).[53] The CFTC sought to impose two types of position limits on these contracts: spot-month limits and non-spot-month limits.[54] The proposed rules would also limit available hedging exemptions and imposed stricter aggregation requirements. Because the CFTC selected the Core Referenced Futures Contracts for having either ''high levels of open interest and significant notional value'' or serving ''as a reference price for a significant number of cash market transactions,'' the

[42] *See* 17 C.F.R. § 150.4(a)(1).

[43] *See id.*

[44] *See* 7 U.S.C. § 6a(a); *see also* CFTC, Speculative Limits, CFTC.GOV, https://www.cftc.gov/IndustryOversight/MarketSurveillance/SpeculativeLimits/index.htm.

[45] This aggregation requirement was approved on December 5, 2016, as part of a series of amended rules for determining compliance with speculative position limits. *See* Press Release, CFTC, CFTC Reproposes Position Limits Rule (Dec. 5, 2016), https://cftc.gov/PressRoom/PressReleases/7495-16.

[46] Aggregation of Positions, 81 Fed. Reg. 242 (Dec. 16, 2016).

[47] *See id.*

[48] Press Release, CFTC, CFTC Staff Grants Relief to Market Participants from Certain Position Aggregation Requirements (Aug. 10, 2017), https://www.cftc.gov/PressRoom/PressReleases/pr7600-17; Press Release, CFTC, CFTC's Division of Market Oversight Extends Time-Limited No-Action Relief from Certain Position Aggregation Requirements (Aug. 1, 2019), https://www.cftc.gov/PressRoom/PressReleases/7989-19.

[49] Press Release, CFTC, CFTC Staff Extends Temporary No-Action Letter Regarding Certain Position Aggregation Requirements (Aug. 10, 2022), https://www.cftc.gov/PressRoom/PressReleases/8570-22.

[50] *Id.*

[51] *See* 7 U.S.C. § 6a(a).

[52] *Id.*

[53] A futures contract, option contract, or swap is considered to be ''economically equivalent'' to a Core Referenced Futures Contract if it is (i) a contract that settles off a Core Referenced Contract either directly or indirectly; (ii) a contract with a reference price based on the combination of one or more Referenced Contract prices and one or more prices in the same or substantially the same commodity as that of the Core Referenced Futures Contract; (iii) an inter-commodity spread contract with two reference price components, at least one of which is based on a Referenced Contract; or (iv) a contract priced at a fixed differential to the price of a Core Referenced Futures Contract or to the price of the same commodity with the same delivery location as the Core Referenced Futures Contract. *See* 76 Fed. Reg. 71,626, 71,630 (Nov. 18, 2011). As explained by the CFTC, the categories of economically equivalent Referenced Contracts were intended to ''capture contracts with prices that are or should be closely correlated to the prices of the Core Referenced Futures Contract.'' *Id.*

[54] The CFTC's proposed rules would set spot-month limits at 25 percent of estimated ''deliverable supply,'' which would represent the maximum combined position a trader could hold in the physical delivery or cash-settled Referenced Contracts. Non-spot-month limits would be set at 10 percent of open interest in the first 25,000 contracts and 2.5 percent thereafter. *Id.*

impact of the proposed rules was expected to resonate widely across markets under the Commission's purview.[55]

On October 18, 2011, the CFTC voted 3–2 to formally adopt these new rules. The division between the Commissioners reflected uncertainty about whether there was any contemporary ''reliable economic analysis to support either the contention that excessive speculation is affecting the market . . . or that position limits will prevent excessive speculation.''[56] Ultimately, the Commission adopted the new rules because it concluded that ''Congress did not give the Commission a choice. Congress directed the Commission to impose position limits and to do so expeditiously.''[57]

The industry generally did not share in the Commission's position that the rules were required by Dodd-Frank. To the contrary, many commentators asserted that the CFTC had failed to provide an adequate statutory and policy justification for imposing new federal position limits. These criticisms formed the basis of a legal challenge to the CFTC's regulations, filed in the U.S. District Court for the District of Columbia on December 2, 2011, by two major industry trade organizations—the International Swaps and Derivatives Association (ISDA) and the Securities Industry and Financial Markets Association (SIFMA, together with ISDA, Plaintiffs).[58]

ISDA and SIFMA asserted, among other things, that the new position rules were unlawful, because the Commission failed to make certain statutorily mandated findings before imposing them. First, Plaintiffs argued that the Commission was required to determine whether the position limits were ''necessary.'' Plaintiffs observed that § 6a(a)(1) of the CEA empowers the Commission to establish position limits ''as the Commission finds are *necessary*'' to ease the burden on interstate commerce caused by excessive speculation.[59] Because the Dodd-Frank amendments expressly stated that position limits shall be established ''[i]n accordance with the standards set forth in paragraph (1) of this subsection,'' Plaintiffs argued that the necessity standard was incorporated in the amendments and could not be circumvented in the rulemaking process.[60] Second, Plaintiffs argued that the Commission failed to make the requisite finding that it was ''appropriate'' to set position limits, in contravention of the plain language of § 6a(a)(2), which states that ''the Commission shall by rule . . . establish limits on the amount of positions, *as appropriate*. . . that may be held by any person.''[61]

The Commission responded to these arguments by agreeing that § 6a was clear and unambiguous in its proscriptions—at least to the extent that it made position limits mandatory and deprived the agency of any discretion not to implement them. In support of its claim, the CFTC referred to Congress' use of the word ''shall'' in the portion of § 6a(2) relied upon by Plaintiffs.[62] Moreover, the Commission contended that § 6a(a)(2)(B)(i), which provides that ''the limits *required* under subparagraph (a) *shall* be established within 270 days'' makes clear that the CFTC was required to act.[63] In any event, the Commission argued that Plaintiffs' interpretation of the Dodd-Frank amendments rendered § 6a entirely meaningless.[64]

In a highly-anticipated decision rendered on November 15, 2012, the court held that the statutory provisions were ambiguous as to whether a position limits rule had to be predicated on a finding by the CFTC that it was ''necessary'' or ''appropriate.'' The statute's use of the word ''may'' in granting the Commission the authority to set position limits was central to the court's analysis. The court vacated the rule and remanded it to the CFTC for reconsideration. In another 3–2 vote, the agency decided to appeal the decision rather than revise the vacated rules. On April 5, 2013, the CFTC filed an appellate brief in the D.C. Circuit.[65]

On October 29, 2013, however, the Commission voluntarily dismissed its appeal and expressed its intent to move forward with a new position limits rule that complies with the district court's decision.[66] The following week, it released a proposal for public comment. The broad contours of the redrafted rule were similar to those of its vacated predecessor, with some key changes: specifically, the proposal lowers the threshold for aggregating positions; narrows the definition of bona fide hedging; and includes legal arguments regarding the necessity of speculative position limits and the Commission's mandate to impose such limits.[67]

On December 5, 2016, the Commission formally adopted a final rule on aggregating positions.[68] The rule modified the method by which a person must aggregate (or can disaggregate) its holdings for purposes of calculating whether it has exceeded

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[55] *See* 76 Fed. Reg. 71,626, 71,629 n.29 (Nov. 18, 2011).

[56] Int'l Swaps & Derivatives Ass'n v. CFTC, 887 F. Supp. 2d 259, 262 (D.D.C. 2012) (citing Transcript of CFTC Open Meeting on Two Final Rule Proposals Under the Dodd–Frank Act, at 13 (Oct. 18, 2011)). Numerous studies conducted in the 1920s and 1930s, which suggested that excessive speculation in the commodities market resulted in large price fluctuations, and thus counseled in favor of position limits. Since then, many studies have refuted a meaningful correlation between speculation and price swings. *See, e.g.*, Managed Funds Association, Comment Letter to the CFTC Regarding Position Limits, at n.1 (Oct. 19, 1998) (citing studies that denounce the necessity of position limits); Plaintiffs' Mem. in Support of Summary Judgment, *Int'l Swaps & Derivatives Ass'n v. CFTC*, No. 11-cv-2146 (RLW), at 7–10 (D.D.C. Mar. 23, 2012) (same). Against this backdrop, there is much contentious industry debate about whether position limits are economically justified and should be statutorily required at all.

[57] 76 Fed. Reg. 71,626, 71,628 (Nov. 18, 2011).

[58] *See* Int'l Swaps & Derivatives Ass'n v. CFTC, 887 F. Supp.2d 259, 262 (D.D.C. 2012).

[59] *Id.* at 266.

[60] *Id*. at 266–67.

[61] *Id.* (citing 7 U.S.C. § 6a(a)(2)).

[62] *Id.* at 267.

[63] *Id.* (emphasis added).

[64] *Id.*

[65] Appellate Brief, *Int'l Swaps & Derivatives Ass'n v. CFTC*, No. 12-5362 (D.C. Cir. Apr. 5, 2013).

[66] Press Release, CFTC, Statement of Commissioner Scott D. O'Malia on the CFTC's Voluntary Dismissal of its Appeal of the 2011 Position Limits Rule (Oct. 29, 2013), http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement102913.

[67] *See* Gina Chon & Gregory Meyer, *CFTC in Fresh Bid to Impose Position Limits*, FT.COM (Nov. 5, 2013), https://www.ft.com/content/ad1a6360-4617-11e3-b495-00144feabdc0.

[68] Press Release, CFTC, CFTC Reproposes Position Limits Rule (Dec. 5, 2016), https://cftc.gov/PressRoom/PressReleases/7495-16. The rule took effect on February 14, 2017.

a position limit. It also created additional exemptions as well as a filing requirement to qualify for certain exemptions.[69]

On the same day, in response to comments on its November 2013 proposal, the Commission re-proposed regulations relating to position limits for 25 core physical commodity futures contracts, bona fide hedging, and reporting requirements.[70] The CFTC formally adopted that rule on October 15, 2020.[71] The rule adds position limits to 16 additional physically settled futures and options contracts in the agriculture, energy, and precious metals markets, in addition to the nine legacy agricultural contracts.[72] It also establishes speculative limits on those 25 core referenced futures contracts, cash-settled futures, and options contracts that are directly or indirectly linked to the core referenced futures contract, and economically equivalent swaps.[73] The rule revises the definition of bona fide hedging to expand the scope of transactions that qualify as hedging.[74] The rule also requires Designated Contracts Merchants (DCMs) and Swap Exchange Facilities (SEFs) to set position limits on the core referenced contracts that are no higher than the federal limits,[75] although the exchanges' enforcement of the swap limits has been delayed two years as the Commission evaluates its ability to surveil the market.[76] The rule featured tiered compliance dates through January 1, 2023, at which point economically equivalent swaps became subject to federal position limits.[77]

Meanwhile, in an attempt to provide exchanges with greater flexibility in setting limits and level the regulatory playing field, on September 19, 2019, the CFTC amended Rule 41.25, which, among other things, addresses the criteria that exchanges must apply when setting position limits on security futures products (SFPs).[78] The amendments increase the default position limit level from 13,500 contracts to 25,000 contracts for equity SFPs and modify the criteria for setting a higher level of position limits and position accountability levels.[79] In addition, the amendments provide discretion to a DCM to apply limits to either a person's net position or a person's position on the same side of the market.[80] The amendments are designed to provide greater liquidity in SFP trading, which may facilitate risk management for entities using SFPs.

3. Enforcing position limits

The CFTC's Division of Market Oversight[81] and the market surveillance groups at each exchange are responsible for monitoring compliance with position limits. In fulfilling this task, the Commission and the exchanges rely on information generated by the exchanges' respective Large Trader Reporting Systems. These reporting systems mandate that positions at or above certain levels be reported daily to the CFTC and the exchange where the contract trades. When a trader or firm holds a position at or near an approaching position limit, the CFTC or the exchange typically notifies the member firm carrying the trader's position, with the expectation that the member firm will promptly alert the trader and take appropriate action for an orderly liquidation of any excess futures contracts. Violations of exchange-set position limits are subject to disciplinary action by the exchange, and—in cases where the Commission has expressly approved exchange-set position limits—the Commission itself.[82] Depending on the circumstances of a violation, either the trader and/or the member firm may be subject to discipline. Possible sanctions include civil and/or criminal penalties, depending on whether the respondent acted willfully.

Traders are strictly liable for violations of position limit rules, as civil liability may be imposed without a showing of either knowledge or intent.[83] Moreover, position limits apply on an intraday as well as end-of-day basis. In other words, as explained by the CFTC, ''a trader whose position exceeds the applicable speculative position limit ***at any time during the day*** is in violation of the CEA and CFTC regulations, ***even if*** the position is subsequently reduced to a level within the applicable

[69] *See* Aggregation of Positions, 81 Fed. Reg. 242 (Dec. 16, 2016).

[70] *See id.*

[71] *See* Position Limits for Derivatives, 86 Fed. Reg. 3236 (Jan. 14, 2021).

[72] *Id.* at 3480–81.

[73] *Id.* at 3239.

[74] *Id.* at 3257, 3264–70.

[75] *Id.* at 3470.

[76] *Id.* at 3296.

[77] *Id*.

[78] Press Release, CFTC, CFTC Unanimously Approves Two Measures in September 16 Open Meeting (Sept. 16, 2019), https://www.cftc.gov/PressRoom/PressReleases/8016-19.

[79] Position Limits and Position Accountability for Security Futures Products, 84 Fed. Reg. 51021 (Sept. 27, 2019).

[80] *Id.* at 51005.

[81] CFTC, Division of Market Oversight, CFTC.GOV, https://www.cftc.gov/About/CFTCOrganization/DMOmission.html.

[82] *See* 7 U.S.C. § 6a(e) (''It shall be a violation of this chapter for any person to violate any . . . rule . . . of any contract market . . . fixing limits on the amount of trading which may be done or positions which may be held by any person under contracts of sale of any commodity for future delivery . . . if such . . . rule . . . has been approved by the Commission.''). For example, on September 23, 2022, the Commission ordered Beijing-based COFCO Corp. and Chinatex Corp., Ltd. to pay a $720,000 civil monetary penalty in part due to position limit violations. *See* Press Release, CFTC, CFTC Orders Two Chinese Companies to Pay $720,000 for Wash Trading, Position Limit Violations, and Reporting Failures (Sept. 23, 2022), https://www.cftc.gov/PressRoom/PressReleases/8592-22.

[83] *See* 7 U.S.C. § 6a(b)(2) (''It shall be unlawful for any person . . . directly or indirectly to hold or control a net long or a net short position in any commodity for future delivery on or subject to the rules of any contract market . . . in excess of any position limit fixed by the Commission for or with respect to such commodity.''); *see also* Newedge USA LLC, CFTC No. 11-07 (Feb. 7, 2011) (''Exceeding position limits rules is sufficient to constitute a violation of Section 4a(e) of the Act; the Commission does not need to establish scienter, or intent to violate position limits, in order to prove a violation.''); Saberi v. CFTC, 488 F.3d 1207, 1212 n.4 (9th Cir. 2007) (noting that the parties' dispute about whether a position limits violation is intentional is ''not relevant to liability'' because § 6a(e)—unlike its criminal counterpart, § 13(a)(5)—''contains no *mens rea* requirement''). In *Saberi*, the Ninth Circuit upheld the CFTC's determination that a trader exceeded the 50-position limit for pork belly futures set by the Chicago Mercantile Exchange (CME) by holding 93 short contracts—which gave him control over about 18 percent of the CME market and yielded a profit of almost $55,000—as well as the CFTC's imposition of a $110,000 civil monetary fine, an order to cease and desist from further violations, and a bar from trading on any exchanges for 30 days. Of particular note is the fact that the CME referred the matter to the CFTC—and the CFTC instituted proceedings—after CME issued a letter of warning, without itself instituting any formal charges.

limit by the close of the market for that day.''[84] For example, in *D.E. Shaw & Co. L.P.*, the Commission pursued an action based on two violations of the single-month position limits imposed by the Chicago Mercantile Exchange (CME) for soybean and corn futures, even though the respondent had recognized and corrected the violations before receiving notification from either the exchange or the CFTC.[85] To settle the matter, the respondent agreed to pay a civil monetary penalty of $140,000 and to comply with a cease and desist order prohibiting future violations of these rules.[86]

There are no clear trends in the Commission's treatment of position limit violations, based on a review of enforcement cases brought by the CFTC since January 1, 2011. In contrast to those issued by the SEC, settlement decisions by SROs and the CFTC tend to provide only the barest details about the allegations underlying an enforcement proceeding. It is clear that, in each instance, the respondent had to pay a civil monetary penalty and submit to a cease and desist order.[87] It is unclear, however, whether disgorgement is mandatory; although respondents were occasionally ordered to pay disgorgement, it is possible that there was simply no profit realized in those cases where respondents were not made to disgorge.[88]

Fines in position limit cases have ranged from approximately $35,000[89] to $3 million per respondent,[90] but the reasons underlying the specific amount imposed are not readily apparent from the record. Given that the Commission's orders often fail to specify the number of contracts by which the position limit was exceeded; the number of position limit violations; and/or the amount of profits earned as a result of the violations, it is difficult to discern the effect, if any, that each of these factors has on the ultimate civil monetary penalty. It is, however, reasonable to presume that the penalty was enhanced, where the respondent failed to implement remedial measures to facilitate compliance with position limits and/or failed to provide proper supervision to prevent the violation.[91]

Nonetheless, while the Commission's methodology in calculating appropriate settlement terms is far from clear in position limits cases, there is no doubt that the Commission has targeted position limit violations in recent years.[92] While the agency pursued just two such cases in the five years between 2006 and 2010, it brought eight cases in the five years between 2016 and 2020, a total of four cases in 2021 alone, and at least one case every year since 2012, including in 2022.[93] The Commission's vigilance with respect to position limits is no doubt at least partly due to the strict liability nature of the offense and, as a corollary, the minimal expenditure required to prosecute and prove such violations. Simply put, such cases bring much bang for the buck.

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[84] CFTC, Advisory Regarding Compliance with Speculative Position Limits, DIV. OF MKT. OVERSIGHT (May 7, 2010), https://www.cftc.gov/sites/default/files/idc/groups/public/@industryoversight/documents/file/specpositionlimitsadvisory0510.pdf (emphasis in original).

[85] D.E. Shaw, CFTC No. 12-09 (Feb. 22, 2012). Specifically, Respondent held short positions that exceeded the soybean futures limit by 3,394 contracts and the corn futures limit by 157 contracts.

[86] *Id.*

[87] The entry of a cease-and-desist order is almost a matter of routine in CFTC settlements. Such orders require respondents to abstain from future misconduct in violation of the CEA and Commission regulations. In the event that respondents later engage in such misconduct, the violation of the cease-and-desist order may be added as an additional independent charge to any complaints or orders issued by the Commission. *See, e.g.*, Compl., CFTC v. Trade Exch. Network Ltd., No. 1:12-cv-01902-RCL (D.D.C. Nov. 26, 2012), ECF No. 1. Moreover, where the Commission has pursued an enforcement case in a federal, rather than administrative, forum, the entry of a cease-and-desist order may subject a respondent to future civil contempt charges, in the event the order is violated.

[88] *Compare CFTC v. Easterday*, No. 4:21-cv-5050 (E.D. Wash. Dec. 17, 2021) (settling position limit violations by paying a $30 million civil monetary penalty and restitution of $263 million), *with* Tyson Foods, Inc., CFTC No. 21-12 (Aug. 13, 2021) (settling position limits violations by paying a $1.5 million civil penalty but not paying restitution). *Compare also* Weidong Ge & Sheenson Invs. Ltd., CFTC No. 12-35 (Sept. 25, 2012) (settling position limit violations by paying a $500,000 civil monetary penalty, disgorging $1 million, and ceasing and desisting from future violations), *with* JP Morgan Chase Bank, NA, CFTC No. 12-37 (Sept. 27, 2012) (settling position limit violations by paying a $600,000 civil monetary penalty and submitting to a cease-and-desist order, but not paying disgorgement).

[89] Daniel Bowman, CFTC No. 15-37 (Sept. 29, 2015).

[90] Olam International, CFTC No. 15-13 (Jan. 20, 2015). In Olam, the CFTC found that Respondents violated § 4a(e) of the CEA by holding aggregated net positions in cocoa futures contracts that exceeded the 1,000-contract spot month position limit established by ICE Futures U.S. Inc. To settle all claims, Respondents agreed to pay a civil monetary penalty of $3 million plus post-judgment interest and enter into a cease-and-desist order. The Commission provided no explanation for the civil monetary penalty imposed.

[91] *See, e.g.*, Eagle Mkt. Makers Inc., CFTC No. 13-05 (Nov. 20, 2012). There, Respondent was charged with holding a net short position in May 2009 corn futures position that exceeded by 278 contracts the spot month position limit established by the Commission. Profits from the contested positions were approximately $3,475. Respondent realized that it had exceeded position limits shortly after the end of trading on the day of the violation, and liquidated the excess position as soon as the next trading session opened. In addition to the position limits violations, Respondent was charged with failure to diligently supervise its traders concerning position limits. Despite two prior warning letters from the Chicago Board of Trade (CBOT) for spot-month position limit violations, Respondent failed to conduct compliance trainings for its traders or create written compliance procedures. The offer of settlement required Respondent to (i) pay a civil monetary penalty of $220,000, plus post-judgment interest; (ii) disgorge the total profits of $3,475; and (iii) cease and desist from further violations.

[92] *See, e.g.*, Press Release, CFTC, CFTC Orders Grain Exporter to Pay a Penalty for Violating Soybeans Futures Speculative Position Limits and for Reporting Violations (Sept. 14, 2018), https://www.cftc.gov/PressRoom/PressReleases/7789-18 (ordering Honourround International Trade Co. Ltd. to pay a $300,000 civil penalty for exceeding the single month and all-month speculative position limits for CBOT soybeans future contracts); Press Release, CFTC, FTC Orders Glencore Agriculture B.V. and Glencore Ltd. to Pay a $2 Million Penalty for Exceeding Cotton Futures Position Limits, Transacting Illegal EFPs, and Submitting Inaccurate Form 304s (Apr. 30, 2018), https://www.cftc.gov/PressRoom/PressReleases/7721-18 (ordering Glencore Agriculture to pay a $2 million civil penalty to settle charges that it held positions in the ICE Futures Cotton No. 2 contracts that exceeded the speculative position limits).

[93] The Commission brought an annual all time high of 7 position limit enforcement actions in 2011. Since then, the Commission has continued to bring at least one position limits action annually: 3 in 2012, 1 in 2013, 3 in 2014, 2 in 2015, 1 in 2016, 1 in 2017, 2 in 2018, 3 in 2019, 1 in 2020, 4 in 2021, and 1 in 2022.

C. Market Manipulation

In 2015, former Chairman Tony Massad stated that the CFTC was ''dedicated to ensuring that the agency has an aggressive enforcement program to protect customers and prevent fraud and manipulation.''[94] Chair Behnam echoed those remarks in 2023, asserting that the CFTC will ''surgically focus their trading analyses for any manipulative, inappropriate or disruptive conduct.''[95] Consistent with these statements, anti-manipulation has been a bedrock enforcement area for the Commission, albeit difficult to enforce. This section discusses the CFTC's anti-manipulation authority and agenda, both before and after Dodd-Frank.

1. The CFTC's anti-manipulation authority before Dodd-Frank

Congress's purpose in enacting the Commodity Exchange Act (CEA) was to prevent, deter, and redress price manipulation of commodity futures and options.[96] Notwithstanding the Commission's specific mandate to protect market participants from manipulative activity, its efforts to police such practices have traditionally been hindered by almost insuperable prosecutorial hurdles. Thus, while the CFTC has settled numerous manipulation and attempted manipulation cases, it successfully prosecuted and won only *one* such case in the 37 years preceding Dodd-Frank.[97]

As a threshold matter, although § 6(c) of the CEA empowers the CFTC to bring anti-manipulation cases, the term ''manipulation'' is not defined in the CEA.[98] In the absence of a statutory definition, the CFTC has established its own four-part test, whereby actionable manipulation is demonstrated by a showing ''(1) that the accused had the ability to influence market prices; (2) that [the accused] specifically intended to do so; (3) that an artificial price existed; and (4) that the accused caused the artificial price.''[99] In practice, however, this four-part test reduces to a two-part test: artificiality and causation, on one hand; and intent, on the other.[100] Even so, as lamented by former CFTC Commissioner Bart Chilton, ''proving manipulation under [this standard] is so onerous as to be almost impossible.''[101]

A primary problem is that the concept of artificial price is a nebulous one. The oft-cited definition of artificial price refers to a price that fails ''[to] reflect [the] basic forces of supply and demand.''[102] Yet, as Judge Easterbrook observed, efforts to ''isolate which 'forces of supply and demand' are 'basic' and which are not is doomed to failure.''[103] Prices fluctuate constantly in response to varying market conditions—particularly in the context of futures markets, where trading activity is in large part informed and spurred by the understanding that commodity prices are highly volatile. As such, there is no single ''non-artificial'' benchmark price against which other price points can reliably be judged. Pinpointing the price a buyer would have paid in the absence of manipulation would require an after-the-fact analysis that isolates the market conditions in effect at that given moment, a complex and impractical task.[104] Or, as Judge Easterbrook explained, ''[p]eople demand what they demand, and never mind the reasons why . . . There is no way to say what demand is real and what is artificial.''[105]

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[94] Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal Year 2015 (Nov. 6, 2015), https://www.cftc.gov/PressRoom/PressReleases/7274-15.

[95] Public Statements & Remarks, CFTC, Remarks of Chairman Rostin Behnam at the Commodity Markets Council 2023 State of the Industry Conference (Jan. 23, 2023), https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam30.

[96] *See* 7 U.S.C. § 5(b); *see also* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 361–64 (1982) (expounding upon the history and purpose of the CEA and the CFTC).

[97] Bart Chilton, then-Commissioner, CFTC, Speech before the Argus Media Summit, (Oct. 21, 2009), https://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-28 (referring to Anthony J. DiPlacido, CFTC No. 01-23 (Nov. 5, 2008)). In an aptly titled law review article, the former Chief Counsel of the CFTC's Enforcement Division observed that ''under present law[,] the crime of manipulation is virtually unprosecutable, and remedies for those injured by price manipulation are difficult to obtain.'' Jerry W. Markham, *Manipulation of Commodity Futures Prices—The Unprosecutable Crime*, 8 YALE J. REG. 281, 282 (1991).

[98] *See* Indiana Farm Bureau Coop. Ass'n, Inc., CFTC No. 74-14 (Dec. 17, 1982) (''Neither manipulation nor attempted manipulation is defined in the Commodity Exchange Act. That task has fallen to case-by-case judicial development.''). *Cf.* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41, 406–07 (July 14, 2011) (''The Commission declines to adopt comments proposing a new economics-based definition of manipulation. Instead, as stated above, all relevant facts and circumstances must be considered in determining whether a violation . . . exists.'').

[99] Decision & Order, Cox, CFTC No. 75-16 (July 15, 1987). To prove attempted manipulation, two elements are required: (1) an intent to affect market prices; and (2) an overt act in furtherance of that intent. *See CFTC v. McGraw-Hill Cos.*, 507 F. Supp. 2d 45, 51 (D.D.C. 2007).

[100] *See, e.g.*, Cargill Inc. v. Hardin, 452 F.2d 1154, 1163 (8th Cir. 1971) (''[T]he test of manipulation must largely be a practical one if the purposes of the [CEA] are to be accomplished . . .The aim must be . . . to discover whether conduct has been intentionally engaged in which has resulted in a price which does not reflect basic forces of supply and demand.'').

[101] Bart Chilton, then-Commissioner, CFTC, Speech before the Argus Media Summit (Oct. 21, 2009), https://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-28.

[102] CFTC v. Gorman III*, No. 21-cv-870, 2023 WL 2632111, at *7 (S.D.N.Y. Mar. 24, 2023) (collecting cases).*

[103] Frank H. Easterbrook, *Monopoly, Manipulation, and the Regulation of Futures Markets*, J. BUS. S103, S117 (1986).

[104] Nonetheless, this is precisely what the CFTC demands: ''[T]o determine whether an artificial price has occurred, one must look at the aggregate forces of supply and demand and search for those factors which are extraneous to the pricing system, are not a legitimate part of the economic pricing of the commodity, or are extrinsic to that commodity market.'' *Mish Int'l Monetary Inc. v. Vega Cap. London, Ltd.*, 596 F. Supp. 3d 1076, 1096 (N.D. Ill. 2022)*(citation omitted).*

[105] Frank H. Easterbrook, *Monopoly, Manipulation, and the Regulation of Futures Markets*, 59 J. BUS. S103, S117 (1986). Even former CFTC Commissioner Chilton has acknowledged that artificial price is ''a point which can certainly be debated by economists.'' Bart Chilton, then-Commissioner, CFTC, Statement at the CFTC Public Meeting On Anti-Manipulation and Disruptive Trade Practices (Oct. 26, 2010), https://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement102610.

Given the uncertainty inherent in assessments of whether a price is, in fact, artificial for purposes of the CEA, it is no surprise that courts have declined to apply liability under the statute. In *United States v. Radley*, a district court in the Eastern District of Texas went further in expressing its distaste for the artificial price inquiry. The court noted that the government could not meet its burden of establishing artificial price because ''the definition of 'artificial' is uncertain and that uncertainty makes application of the manipulation statute unconstitutionally vague as applied to the facts of this case.''[106]

Notwithstanding the difficulties in establishing the artificial price element of the manipulation standard, the Commission's greatest hurdle in enforcing manipulation claims has been the scienter requirement, for two main reasons. First, proof of intent has historically depended on a demonstration that ''the accused acted . . . with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect legitimate forces of supply and demand.''[107] As such, the intent element necessarily incorporates and requires a demonstration of artificial price. Federal courts have confirmed this understanding. In *CFTC v. Wilson & DRW Investments*, for example, a New York district court held that the mere intent to affect prices is not enough to succeed in a market manipulation claim; rather, the CFTC must show that defendants intended to cause artificial prices—''prices that they understood to be unreflective of the forces of supply and demand.''[108] Second, a specific intent requirement is especially demanding in the context of financial law. By contrast, the SEC's 10b-5 rule—the analogous provision for combating manipulation in the securities market—imposes only a general intent requirement that does not rest exclusively on the defendant's state of mind.[109] This is perhaps one reason why the SEC traditionally has been able to exercise its enforcement powers more aggressively than the CFTC.

In the wake of Dodd-Frank, however, the Commission's standards for protecting market integrity have evolved into a more complete and robust regime that facilitates regulation and enforcement of market manipulation.

COMMENT:

On November 30, 2018, a district court judge in the Southern District of New York dismissed the CFTC's lawsuit against investment firm DRW Investments, LLC and its founder Donald Wilson for manipulation and attempted market manipulation of a highly illiquid segment of the interest rate swaps market. In doing so, the court concluded that efforts to drive prices towards their ''true'' value is not tantamount to manipulation and expressly rejected the CFTC's long-held position that proving a defendant's subjective intent to affect the price of commodity could alone satisfy the requisite artificial price element of a market manipulation claim.

The case arose out of charges that the defendants 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 argued that the contracts were undervalued and that they were posting bids to correct a fundamental mispricing, not create an artificial price. The CFTC took the position 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 the CME Group, Commodities Markets Council, Futures Industry Association, Intercontinental Exchange, and Managed Funds Association—filed an amicus brief in favor of the defendant 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.'' Accordingly, they argued that the CFTC's purported link between an attempt to affect price and manipulation would ''upset settled trading expectations and practices, and risk compromising the many public interests that derivatives markets serve—including price discovery, liquidity and hedging.''

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.

This case went to a bench trial before Judge Richard S. Sullivan in December 2016. Two years later, Judge Sullivan ruled against the CFTC. First, with respect to the manipulation claim, the court held that, while there is no question that DRW had the ability to influence market prices, the CFTC failed to provide any evidence supporting the existence of an artificial price so as to support a manipulation claim. Judge Sullivan began by laying out several gaps in the CFTC's evidence: First, there is no evidence that DRW ever made a bid that it thought might be unprofitable. Second, there is no credible evidence that DRW ever made a bid that it thought could not be accepted by a counterparty. Third, the CFTC provided no credible evidence as to what the fair value of the contract actually was at the time DRW was making its bids. Fourth, there is no credible evidence that DRW's bidding practices ever scared off would-be market participants. And finally, there is no evidence that DRW ever made a bid that violated any rule of the exchange—a fact the CFTC conceded in its closing argument.

Judge Sullivan reasoned that these gaps led to the ''inescapable conclusion'' that DRW's bids and consequent settle-

[106] United States v. Radley, 659 F. Supp. 2d 803, 813, 820–21 (S.D. Tex. 2009) (''The court is sympathetic to the government's desire to discourage the types of behavior alleged here, but its ability to do so is currently limited by a confusing and incomplete statutory and common-law regime.'').

[107] Indiana Farm Bureau Coop. Ass'n, Inc., CFTC No. 74-14 (Dec. 17, 1982).

[108] *See CFTC v. Wilson & DRW Investments*, No. 13-cv-7884, 2018 WL 6322024, at *15 (S.D.N.Y. Nov. 30, 2018).

[109] *See* 17 C.F.R. § 240.10b-5; 15 U.S.C. § 78j.

ment prices were the result of free competition. Notably, the court rejected the Commission's argument that any price influenced by defendants' bids was, by definition, artificial because defendants understood and intended that the bids would effect the settlement prices. This argument relied heavily on a CFTC administrative decision, *In re Indiana Farm Bureau Cooperative Association, Inc.*, but, as Judge Sullivan explained, ''dictum in its own thirty-five year-old administrative decision'' cannot support an ''intent-based approach to assessing artificial price . . . , which taken to its logical conclusion would effectively bar market participants with open positions from ever making additional bids to pursue future transactions.'' The court noted that, if taken to its logical conclusion, this theory would effectively bar market participants with open positions from ever making additional bids to pursue future transactions.

With respect to the attempted market manipulation claim—which ''[u]nlike market manipulation, . . . does not require proof of an artificial price—only that Defendants 'acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand' ''—the Court again explained, ''the mere intent to affect prices is not enough; rather, the CFTC must show that Defendants intended to cause *artificial* prices—*i.e.*, prices that they understood to be unreflective of the forces of supply and demand.'' Judge Sullivan determined that the CFTC's evidence actually ran counter to its position and proved ''beyond the shadow of a doubt that [DRW] sincerely believed the fair market value of the [IDCH swaps] was higher than the bids they submitted over the course of the alleged conspiracy.'' As a result, the price increase that DRW was attempting to cause was not artificial and, therefore, did not constitute attempted market manipulation.

2. Benchmark manipulation

The Commission's impressive recovery tallies in recent years have been driven in part by settlements in benchmark manipulation cases. 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—including the valuation of other securities. It can therefore be very profitable if an entity can control or predict the benchmark rates.

The first of the Commission's benchmark manipulation cases involved LIBOR. LIBOR is a short-term interest rate benchmark intended to reflect the borrowing cost of unsecured funds in certain interbank markets. It encompasses rates calculated in 15 currencies for loans of 10 different maturities. Because LIBOR ostensibly indicates the willingness of banks to lend money to one another, lending rates are pegged to LIBOR, on the theory that banks could ensure that the interest rates paid by their clients never fall too far below their own costs of borrowing. As such, LIBOR is supposed to reflect the health of financial markets as a whole and provide an accurate barometer of prevailing interest rates. LIBOR is used to price a variety of global financial products, including U.S.-based swap transactions and futures contracts, as well as home mortgages and commercial and personal consumer loans. Regulators estimate that LIBOR is tied to transactions with a notional value of $500 trillion.[110] Given its import to financial markets worldwide, LIBOR has been referred to as ''the world's most important number.''[111]

For many years, LIBOR was calculated each morning based on information confidentially submitted by 16 banks regarding the rate at which they would be able to borrow funds from other banks.[112] Thomson Reuters, on behalf of the British Banker's Association (BBA), collated and published a daily loan rate based on the average rate of the middle eight valuations submitted by the responding banks. In 2007, however, suspicions began to grow that banks were submitting false rates that did not reflect their actual perceived borrowing costs.[113] Discovery of this manipulation had an immediately devastating psychological and economic impact: LIBOR had ''become such a fixture in credit markets that many people trust[ed] it implicitly,'' such that doubts about its integrity undermined popular trust in the global financial system.[114] Moreover, even a small increase in LIBOR could have massive implications for borrowers. For example, an extra 0.3 percentage points in LIBOR could add a $100 monthly payment to a $500,000 adjustable-rate mortgage, or $300,000 in annual interest costs for a company with $100 million in floating-rate debt.[115]

Given LIBOR's importance, the possibility of its manipulation quickly prompted investigations by regulators all over the world. Together with the U.S. Department of Justice (DOJ) and the U.K. Financial Services Authority (now the Financial Conduct Authority), the CFTC conducted a comprehensive investigation that lasted more than four years. Ultimately, on June 27, 2012, Barclays became the first bank to admit to wrongdoing in connection with LIBOR. Pursuant to a settlement with the DOJ, Barclays acknowledged that it had provided unreliable data to the BBA, in order to benefit specific trading positions and appear more financially sound.[116]

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[110] John Carney, *Libor Rates: A Reader's Guide*, CNBC (July 6, 2012), https://www.cnbc.com/2012/07/06/libor-rates-a-readers-guide-.html.

[111] *Libor: The World's Most Important Number*, MONEYWEEK (Oct. 10, 2008), https://moneyweek.com/32651/libor-the-worlds-most-important-number-13816.

[112] *See* Landon Thomas Jr., *Trade Group for Bankers Regulates a Key Role*, N.Y. TIMES (July 5, 2012), https://www.nytimes.com/2012/07/06/business/global/the-gentlemens-club-that-sets-libor-is-called-into-question.html; Kirstin Ridley, *NYSE Euronext to Take Over Scandal-Hit Libor*, REUTERS (July 9, 2013), https://www.reuters.com/article/uk-libor-nyse/nyse-euronext-to-take-over-scandal-hit-libor-idUKBRE9680G420130709. NYSE Euronext, the U.S. owner of the NYSE, took over the running of LIBOR on July 9, 2013.

[113] Carrick Mollenkamp, *Bankers Cast Doubts on Key Rate Amid Crisis*,WALL ST. J. (Apr. 16, 2008), https://www.wsj.com/articles/SB120831164167818299.

[114] *Id.*

[115] *Id.*

[116] Press Release, DOJ, Barclays Bank PLC Admits Misconduct Related to Submissions for the London Interbank Offered Rate and the Euro Interbank Offered Rate and Agrees to Pay $160 Million Penalty (June 27, 2012), https://www.justice.gov/opa/pr/barclays-bank-plc-admits-misconduct-related-submissions-london-interbank-offered-rate-and. Barclays also agreed to pay $160 million settlement and to continue cooperating in ongoing DOJ investigations. In exchange, the DOJ agreed not to pursue criminal charges against Barclays.

On the same day, the CFTC entered and simultaneously settled an Order Instituting Proceedings (OIP) against Barclays,[117] under which Barclays agreed to pay a civil penalty of $200 million; submit to a cease and desist order; and implement certain compliance measures going forward.[118]

In the wake of the Barclays settlement, three other banks—the Royal Bank of Scotland (RBS), UBS, and Coonullperatieve Centrale Raiffeisen-Boerenleenbank B.A. (Rabobank)—admitted that their employees had also manipulated worldwide interest rates through LIBOR. The resolution of claims against these banks followed a similar pattern to that of the Barclays settlement; the banks entered into settlements with the DOJ, in which they admitted wrongdoing and on the same day, the CFTC filed and simultaneously settled an OIP with respect to these institutions based on charges of attempted manipulation.[119] The CFTC obtained a $700 million settlement from UBS, $325 million from the RBS, and $475 million from Rabobank. All three banks also agreed to implement remedial measures to safeguard against future violations, and to submit to cease and desist orders. Two years later, in April 2015, Deutsche Bank paid $800 million to resolve charges of manipulation of LIBOR and a similar benchmark, EURIBOR.[120]

Since the revelation of the LIBOR scandal, 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.[121] The foreign exchange benchmarks are set by independent bodies that survey the market at specific times of day and report the price at that time. A multi-agency investigation revealed that traders from competing banks shared their strategies in chat rooms and discussed what foreign exchange rates would benefit these traders. The traders would then time currency trades around the benchmark setting periods with the intent of affecting the benchmark rates to their advantage or the advantage of co-conspirators at other banks.[122] The size and scope of the investigation and ensuing settlements highlighted the CFTC's increasingly sophisticated enforcement capabilities as well as its extensive cooperation with domestic and foreign regulators.

From 2015 to 2018, the Commission brought nine enforcement actions involving manipulative conduct in connection with the ISDAFIX benchmark, which is used to value the cash settlement of options on interest rate swaps and other products.[123] In 2018 alone, the CFTC brought four actions, totaling $215 million and signaling the Commission's continued focus on anti-manipulation.[124] These actions resulted in numerous settlements with notable banks, with fines ranging from $30 million to $250 million.[125] These settlements brought the total amount of penalties that the Commission has imposed in connection with benchmark manipulation to $5.32 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.

In December 2020, the CFTC filed and settled charges against Vitol Inc., a Swiss-based multinational energy and commodity trading company, for attempted manipulation of two S&P Global Platts physical oil benchmarks, as well as foreign corrupt practices.[126] Vitol was alleged to have entered trades at various times to push the benchmark up or down, depending on its exposure.[127] Vitol agreed to pay over $95 million to settle the charges, and its cooperation in the investigation helped to

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[117] Barclays PLC, Barclays Bank PLC, & Barclays Capital Inc., CFTC No. 12-25 (June 27, 2012).

[118] *Id.*

[119] *See* UBS AG & UBS Sec. Japan Co., Ltd., CFTC No. 13-09 (Dec. 19, 2012); The Royal Bank of Scotland plc and RBS Sec. Japan Ltd., CFTC No. 13-14 (Feb. 6, 2013); Coonullperatieve Centrale Raiffeisen-Boerenleenbank B.A., CFTC No. 14-02 (Oct. 29, 2013).

[120] *See* 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; Erika Kelton, *CFTC Will Flex Dodd-Frank Muscle in 2014*, FORBES.COM (Feb. 19, 2014), https://www.forbes.com/sites/erikakelton/2014/02/19/cftc-enforcement-efforts-will-get-a-boost-in-2014/?sh=7bbe60b94658. In addition to the CFTC's settlements with the banks discussed above, the Commission obtained a $65 million settlement with an interdealer broker firm. *See* ICAP Europe Ltd., CFTC No. 13-38 (Sept. 25, 2013).

[121] 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), https://www.cftc.gov/PressRoom/PressReleases/7056-14.

[122] *See id.*

[123] Press Release, CFTC, CFTC Orders Bank of America, N.A. to Pay $30 Million Penalty for Attempted Manipulation and False Reporting of U.S. Dollar ISDAFIX Benchmark Swap Rates (Sept. 19, 2018), https://www.cftc.gov/PressRoom/PressReleases/7794-18. In the wake of the ninth case brought by the CFTC, then-Director of Enforcement James McDonald stated that "the Commission will continue to work vigilantly to ensure the integrity of critical financial benchmarks and hold all wrongdoers accountable, no matter how widespread the misconduct." *Id.*

[124] Press Release, CFTC, CFTC Orders Bank of America, N.A. to Pay $30 Million Penalty for Attempted Manipulation and False Reporting of U.S. Dollar ISDAFIX Benchmark Swap Rates (Sept. 19, 2018), https://www.cftc.gov/PressRoom/PressReleases/7794-18; Press Release, CFTC, CFTC Orders ICAP Capital Markets LLC to Pay $50 Million Penalty for Aiding and Abetting Attempted Manipulation of U.S. Dollar ISDAFIX Benchmark Swap Rates (Sept. 18, 2018), https://www.cftc.gov/PressRoom/PressReleases/7793-18; Press Release, CFTC, CFTC Orders JPMorgan Chase Bank, N.A. to Pay $65 Million Penalty for Attempted Manipulation of U.S. Dollar ISDAFIX Benchmark Swap Rates (June 18, 2018), https://www.cftc.gov/PressRoom/PressReleases/7742-18; Press Release, CFTC, CFTC Orders Deutsche Bank Securities Inc. to Pay $70 Million Penalty for Attempted Manipulation of U.S. Dollar ISDAFIX Benchmark Swap Rates (Feb. 1, 2018), https://www.cftc.gov/PressRoom/PressReleases/pr7692-18. In these cases, the CFTC found that, for at least a five-year period, the banks—or in ICAP's case, on behalf of its bank clients—attempted to manipulate the USD ISDAFIX benchmark by bidding, offering, or executing transactions in targeted interest rate products, including swap spreads and U.S. Treasuries, around 11:00 a.m. to affect rates and thereby increase or decrease the Swaps Broker's reference rates and spreads, or the ICAP's print, and influence the final published ISDAFIX.

[125] *See id.*

[126] Press Release, CFTC, CFTC Orders Vitol Inc. to Pay $95.7 Million for Corruption-Based Fraud and Attempted Manipulation (Dec. 3, 2020), https://www.cftc.gov/PressRoom/PressReleases/8326-20. The DOJ also entered a Deferred Prosecution Agreement with Vitol Inc., deferring charges under the Foreign Corrupt Practices Act. *Id.*

[127] Vitol Inc., CFTC No. 21-01 (Dec. 3, 2020).

reduce the fine.[128] Vitol also entered a deferred prosecution agreement with the DOJ.[129]

Most recently, in May 2022, in its largest benchmark manipulation case to date, the CFTC alleged that Glencore International A.G. of Switzerland, Glencore Ltd. of New York, and Chemoil Corporation of New York (collectively, Glencore), an energy and commodities trading firm, manipulated four widely distributed physical oil benchmarks and made corrupt payments to persons associated with state-owned entities in exchange for confidential information regarding traders or physical contracts.[130] The settlement in that case resulted in the highest civil monetary penalty and disgorgement amount ordered in the history of the Commission—a total combined amount of ***$1.186 billion***.[131]

Given how lucrative (and high profile) these types of cases have proven to be, benchmark manipulation is likely to remain a Commission priority going forward. Indeed, as a former Director of the Enforcement Division James McDonald once noted, ''there is no reason to be sanguine or confident that there aren't a host of other benchmarks that haven't been corrupted.''[132]

3. The Impact of Dodd-Frank on the CFTC's Manipulation Regime

The Dodd-Frank Act substantially expanded the Commission's authority to combat fraudulent and manipulative behavior by amending § 6(c) of the CEA in several ways. Perhaps most importantly, Dodd-Frank enacted a new sub-section prohibiting fraud-based manipulation schemes that contravene Commission rules.[133] Specifically, § 6(c)(1) bars the use or employment, as well as the attempted use or employment, ''in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, [of] any manipulative or deceptive device or contrivance.''[134] This language is modeled upon § 10(b) of the Exchange Act, and has been interpreted by the CFTC as a ''broad, catch-all provision reaching fraud in all its forms.''[135]

In July 2011, the CFTC promulgated Rule 180.1 to implement § 6(c)(1)'s antifraud provision. Rule 180.1 broadly prohibits fraud-based manipulation, including attempts thereof, with respect to derivatives by any person acting intentionally or recklessly.[136] Rule 180.1 is an incredibly potent tool with respect to the Commission's enforcement of manipulative activity in the commodity futures, options, and swaps markets, for two primary reasons.

First, although Rule 180.1 is intended to be the functional equivalent of Rule 10b-5 of the Exchange Act—which prohibits trading on the basis of material nonpublic information obtained through fraud or deceit or in breach of a pre-existing duty[137]—it actually extends well beyond the SEC provision on which it was modeled.[138] For example, while Rule 10b-5 bars certain conduct only in connection with an actual transaction involving the purchase or sale of a security, Rule 180.1 extends to *all* activities involving the futures or swaps contracts at issue.[139]

Second, Rule 180.1 has disarmed the primary hindrances to the CFTC's successful prosecution of manipulation claims.[140] Specifically, to the extent that a manipulation encompasses some measure of fraud, even *attempts* to engage in

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[128] Press Release, CFTC, CFTC Orders Vitol Inc. to Pay $95.7 Million for Corruption-Based Fraud and Attempted Manipulation (Dec. 3, 2020), https://www.cftc.gov/PressRoom/PressReleases/8326-20.

[129] *Id.*

[130] Press Release, CFTC, CFTC Orders Glencore to Pay $1.186 Billion for Manipulation and Corruption (May 24, 2022), https://www.cftc.gov/PressRoom/PressReleases/8534-22.

[131] *Id.*

[132] Peter Rawlings, CFTC, Prosecutors Eye Obstruction Cases, COMPLIANCE REP., Vol. XXI, No. 26, Dec. 29, 2014 (quoting Aitan Goelman). Goelman also opined that ''There is little as damaging to the integrity of our markets, or the perception of the integrity of our markets, as benchmark manipulation.'' *Id.*

[133] Dodd-Frank also expanded § 6(c)(2)'s prohibition against false statements made in registration applications or reports filed with the Commission to include any statement of material fact made to the Commission in any context. *See* 7 U.S.C. § 9(2) (2012). In addition, Dodd-Frank amended the general prohibition of price manipulation or attempted price manipulation in § 6(c)(3) to encompass swaps, rather than just futures contracts and commodities. *See* 7 U.S.C. § 9(3).

[134] 7 U.S.C. § 9(1).

[135] 75 Fed. Reg. 67,657, 67,658–59 (Nov. 3, 2010). The CFTC has stated that it will be ''guide[d], but not control[led],'' by regulatory and judicial precedent related to Rule 10b-5. *See generally* CFTC, ANTI-MANIPULATION Q & A (2013), https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/antimanipulation_qa.pdf.

[136] Specifically, Rule 180.1 makes it unlawful to (i) use or employ, or attempt to use or employ, any manipulative device, scheme or artifice to defraud; (ii) make, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading; or (iii) engage, or attempt to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person. *See* 76 Fed. Reg. 41,398 (July 14, 2011); *see also* DiPlacido v. CFTC, 364 F. App'x 657, 661 (2d Cir. 2009) (discussing pre-Dodd-Frank anti-manipulation standard). In any case of manipulation or attempted manipulation in violation of CEA § § 6(c) or 9(a)(2), Dodd-Frank § 753 provides for a civil penalty of up to the greater of $1,000,000 or triple the monetary gain to the person for each violation. Dodd-Frank also requires restitution to customers of damages proximately caused by the violations. *See* CFTC, ANTI-MANIPULATION Q & A (2013), https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/antimanipulation_qa.pdf.

[137] *See*17 C.F.R. § 180.1; *see also* 17 C.F.R. § 180.2 (codifying the CFTC's authority to prohibit price manipulation).

[138] *See generally* Zachary S. Brez & Jon Daniels, *The New Financial Sheriff: CFTC Anti-Fraud Authority After Dodd-Frank*, 44 SEC. REG. & L. REP. 1209 (2012) (discussing the parameters, significance, and history of the Commission's anti-manipulation authority).

[139] *Id.* Thus, for example, the Commission may apply Rule 180.1 to prosecute fraudulent conduct in connection with any payments due under a futures or swaps contract. Rule 10b-5 does not cover such conduct.

[140] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,410 (July 14, 2011) (noting that Dodd-Frank—and the new Commission regulations it enabled—

such activity may be actionable. In this context, although the Commission's four-part manipulation test remains viable,[141] liability may now attach irrespective of whether such manipulation created or was intended to create an artificial price.[142] Moreover, Rule 180.1 lowers the scienter standard for fraud-based manipulations: rather than proving that a defendant specifically intended to manipulate the derivative's price, the Commission need only demonstrate that the defendant acted recklessly.[143]

> The CFTC has since used its authority under Rule 180.1 to prosecute trading on material nonpublic information, [144] misstatements to exchanges and futures commission merchants, [145] misappropriation of customer funds, [146] spoofing, [147] wash trading, [148] and even foreign corrupt practices, [149] several of which are discussed in further detail below.

a. Insider Trading

The Commission has made clear that Rule 180.1 will be interpreted broadly—*i.e.*, ''not technically and restrictively, but flexibly to effectuate its remedial purposes.''[150] Consistent with that interpretation, the Commission has extended Rule 180.1's reach to insider trading done in breach of a pre-existing duty or on the basis of material non-public information that was obtained through fraud. It may surprise securities law practitioners that, in contrast to the federal securities laws, the CEA does not contain a broad ban against trading on non-public information. Instead, proscriptions against the misuse of inside information traditionally targeted government and exchange officials.[151] This is at least partly due to the nature of futures markets. The original idea behind futures contracts—hedging market exposure—meant that both parties entered the trade in possession of information that was undisclosed to either their counterparty or the market at large. Indeed, the Commission has expressly ''recognize[d] that unlike securities markets, derivatives markets have long operated in a way that allows for market participants to trade on the basis of lawfully obtained material nonpublic information.''[152] Accordingly, and notwithstanding the influence of Rule 10b-5 on Rule 180.1, parties who obtain non-public information in the ordinary course of business may continue to trade on the basis of that information in the commodity futures markets.[153] But, as recent enforcement actions illustrate, trading on material non-public information and in breach of a pre-existing duty may constitute a violation of the CFTC's anti-manipulation rule.

> Indeed, the Commission has brought several insider trading cases since the passage of Rule 180.1, each of which has been based on the alleged misappropriation of material non-public information (as opposed to the act of trading on such information). First, in December 2015, the CFTC filed and simultaneously settled charges against a futures trader Arya Motazedi based on allegations that he misused proprietary and confidential information about his employer's intended trades in oil and gas futures to benefit his personal trading accounts.[154] Specifically, the Commission alleged that Motazedi (i) placed trades between his personal accounts and the company's accounts to generate profits for himself at the expense of his employer and (ii) entered into successive buy orders and sell orders on his personal accounts to front-run the company's orders. Pursuant to the settlement, Motazedi agreed to pay a civil monetary penalty of $100,000 and restitution in the amount of $216,955.80. He was also subject to a permanent ban on trading and registering as a futures professional in any capacity.[155]
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> Notably, the Commission could have prosecuted Motazedi pursuant to its traditional authority to prevent fictitious or pre-arranged sales. However, it specifically chose to invoke Rule 180.1 and reaffirm its intent to construe its authority under CEA § 6(c)(1) broadly to reach all types of fraudulent conduct. The CFTC explained that Motazedi ''shared a relationship of trust and confidence [with his employer] that gave rise to a duty of confidentiality'' and ''breached his duties'' by misusing material non-public information ''to trade in personal trading accounts and by failing to disclose such trading to his employer.''[156] The CFTC further explained that, ''[u]nder the misappropria-

''close[] a significant gap, as it will broaden the types of cases [the CFTC] can pursue and improve the chances of prevailing over wrongdoers'').

[141] *See* CFTC, ANTIMANIPULATION Q & A (2013), https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/antimanipulation_qa.pdf.

[142] For example, Rule 180.1 does not require proof of a market or price effect, and applies ''where the fraud or manipulation has the *potential* to affect cash commodity, futures, or swaps markets or participants in these markets'' (emphasis added). 76 Fed. Reg. at 41,401.

[143] Zachary S. Brez & Jon Daniels, *The New Financial Sheriff: CFTC Anti-Fraud Authority After Dodd-Frank*, 44 SEC. REG. & L. REP. 1209 (2012); Kenneth W. McCracken & Christine Schleepegrell, *The CFTC's Manipulative and Disruptive Trading Authority in an Algorithmic World*, DECHERT (Apr. 2015), https://www.dechert.com/content/dam/dechert%20files/knowledge/publication/2015/4/Derivatives%20Law%20Report%20Publication%20April%202015.pdf.

[144] *See, e.g.*, *CFTC v. Clark*, No. 4:22-cv-00365 (S.D. Tex. 2022); Mathew Webb, CFTC No. 21-09 (2021); Marcus Schultz, CFTC No. 20-76 (2020).

[145] *See, e.g.*, *CFTC v. Easterday*, No 4:21-cv-5050 (E.D. Wash. 2021); Aron Seidenfeld, CFTC No. 19-51 (2019).

[146] *See CFTC v. Uduakobong*, No. 1:21-cv-11615 (D. Mass. Sept. 30, 2021); *CFTC v. McAllister*, No. 1:18-cv-0346 (W.D. Tex. Apr. 26, 2018).

[147] JPMorgan Chase, CFTC No. 20-69 (Sept. 29, 2020).

[148] Coinbase, CFTC No. 21-03 (Mar. 29, 2021).

[149] Vitol Inc., CFTC No. 21-01 (Dec. 3, 2020).

[150] 76 Fed. Reg. 41,401.

[151] *See* 7 U.S.C. § § 13(d)-(e).

[152] 76 Fed. Reg. 41,403.

[153] *Id.*

[154] Press Release, CFTC, CFTC Orders Arya Motazedi 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), https://www.cftc.gov/PressRoom/PressReleases/7286-15.

[155] *Id.*

[156] Arya Motazedi, CFTC No. 16-02 (Dec. 2, 2015), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcemen-

> tion theory, of misuse of material, non-public information, deception occurs because the source of the information (principal) is entitled to the exclusive use of the information.''[157] Although the Commission did not use the term ''insider trading,'' it referred to and borrowed language from the SEC's seminal insider trading case, *United States v. O'Hagan*, 521 U.S. 642 (1997), in its legal analysis—thereby suggesting that it will proceed in a manner consistent with SEC precedent and embrace insider trading law even as it eschews the term itself.

In September 2016, the Commission brought its second enforcement action for insider trading, again avoiding the term ''insider trading'' and relying on the same misappropriation theory. Specifically, the CFTC alleged that Jon Ruggles, a former executive at Delta Airlines, breached a duty of confidentiality to his employer by using material non-public information gained through his job trading energy contracts on the New York Mercantile Exchange to make personal trades.[158] Ruggles was ordered to pay a $3.5 million civil monetary penalty and $1.75 million in disgorgement and was permanently banned from trading.[159]

In September 2019, the CFTC filed and settled charges in another insider trading case against broker Classic Energy LLC (Classic) and its owner, Matthew Webb.[160] The CFTC accused Webb of misusing material, non-public block trade information from Classic's customers by taking the other sides of his customers' trades.[161] In doing so, the Commission alleged, Webb breached the duties he owed to his customers as an affiliated person of a registered broker.[162] The CFTC further alleged that Webb and Classic breached their duty to supervise by failing to have appropriate systems in place to prevent the misappropriation of material, non-public information.[163] Webb and Classic agreed to disgorge over $400,000 and pay a $1.5 million civil penalty; Webb also received a two-year trading ban.[164]

In September 2020, the CFTC filed and settled charges against Marcus Schultz, a natural gas trader, for allegedly misappropriating confidential information from his employer and making fictitious trades.[165] Schultz allegedly disclosed information about his employer's trades to an unnamed broker, ''Person A,'' who would either trade on the information personally or pass the information along to others to trade.[166] Schultz also allegedly coordinated with Person A and others to place fictitious trades that profited outsiders, to Schultz's employer's detriment.[167] According to the CFTC, Schultz's misappropriation of the insider information obtained from his employer breached his fiduciary duties owed to his employer.[168] As part of the settlement, Schultz agreed to pay a monetary penalty of $669,750 and disgorge $427,067.45.[169]

Most recently, on August 16, 2022, a Southern District of Texas jury awarded a $7.49 million verdict in favor of the CFTC against Andrew Gizienski and EOX Holdings, LLC (EOX) for taking opposing positions from those of EOX's clients without consent and disclosing customer confidential information.[170] In addition to the monetary penalties, the judge imposed a 120-day trading and registration ban on Gizienski and ordered EOX to implement adequate policies and procedures within 60 days to prevent future violations. The initial filing of this case had coincided with the creation of the CFTC's Insider Trading and Information Protection Task Force (Task Force).[171] The CFTC had alleged that Gizienski had provided information about his other clients' nonpublic trades to a client-friend approximately twenty times over the course of two years in order to develop the relationship with the hope of future business.[172] Additionally, Gizienski took opposing positions on trades to those of his clients approximately 100 times without disclosure to the clients.[173] This verdict marks a clear victory for the CFTC's Task Force and may lead to more CFTC enforcement actions against insider trading.

b. Virtual Currency

Seeking to expand its anti-fraud footprint into high-tech, cutting-edge corners of the industry, the Commission became one of the first federal agencies to address digital assets. In December 2014, then-CFTC Chairman Timothy Massad stated that virtual currency derivatives ''represent one area within [the Commission's] responsibilities,'' shortly before the CFTC began to gain notoriety as a virtual currency regulator through a handful of enforcement actions.[174]

On September 17, 2015, the CFTC brought an enforcement action against an unregistered trading platform, Coinflip,

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tactions/documents/legalpleading/enfmotazediorder120215.pdf.

[157] *Id.*

[158] Press Release, CFTC, CFTC Orders Jon P. Ruggles to Disgorge More than $3.5 Million in Trading Profits and Pay a $1.75 Million Penalty for His Illegal Futures and Options Trading (Sept. 29, 2016), https://www.cftc.gov/PressRoom/PressReleases/7459-16.

[159] *Id.*

[160] Press Release, CFTC, CFTC Orders Energy Broker and Its Owner to Pay Over $1.5 Million for Misappropriating Confidential Customer Information and Other Violations (Oct. 1, 2019), https://www.cftc.gov/PressRoom/PressReleases/8030-19.

[161] *Id.*

[162] Classic Energy LLC & Matthew D. Web, CFTC No. 19-50 (Sept. 30, 2019).

[163] *Id.*

[164] Press Release, CFTC, CFTC Orders Energy Broker and Its Owner to Pay Over $1.5 Million for Misappropriating Confidential Customer Information and Other Violations (Oct. 1, 2019), https://www.cftc.gov/PressRoom/PressReleases/8030-19.

[165] Press Release, CFTC, CFTC Orders Texas Man to Pay Over $1 Million for Misappropriating Confidential Information, Fictitious Trading, and False Statements (Sept. 30, 2020), https://www.cftc.gov/PressRoom/PressReleases/8266-20.

[166] Marcus Schultz, CFTC No. 20-76 (Sept. 30, 2020).

[167] *Id.*

[168] *Id.*

[169] *Id.*

[170] *CFTC v. EOX Holdings LLC et al.*, No. 19-2901 (S.D. Tex. Aug. 15, 2022).

[171] Press Release, CFTC, CFTC Charges Block Trade Broker with Insider Trading (Sept. 28, 2018), https://www.cftc.gov/PressRoom/PressReleases/7811-18.

[172] *Id.*

[173] *Id.*

[174] Testimony of CFTC Chairman Timothy Massad before the U.S. Senate Committee on Agriculture, Nutrition and Forestry (Dec. 10, 2014), http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-6.

Inc., that allowed users to buy and sell bitcoin options.[175] There, the CFTC determined that Bitcoin and other digital assets are within the definition of a ''commodity'' within Section 1a(9) of the CEA and therefore under its purview.[176] It has since found that Ethereum, Litecoin, and at least several stablecoins are also commodities and has brought nearly fifty crypto-related enforcement actions and levied fines and disgorgements in such actions totaling nearly $900 million.[177] Notably, the share of all CFTC enforcement that has been crypto-related since 2020 has skyrocketed from 6 to 22 percent.[178] Just seven of the Commission's 113 total enforcement actions were crypto-related in FY 2020; in 2022, 18 of their 82 actions were.[179] By comparison, the SEC's crypto-related enforcement actually fell as a share of its total activity from FY 2020 to FY 2022.[180]

Many of the CFTC's recent crypto-related actions have been brought against entities that have allegedly failed to register as designated contract markets (DCMs)[181] or futures commission merchants (FCMs).[182] In these matters, the CFTC also often finds that the defendant or respondent failed to comply with other regulations, such as applicable Know-Your-Customer (KYC) or Bank Secrecy Act requirements. The CFTC has also brought several actions involving alleged fraud[183] or manipulation involving crypto assets.[184] This included allegations against one of the largest Bitcoin fraudulent schemes to date, involving over $1.7 billion in allegedly misappropriated assets.[185]

The extent of the CFTC's future role in regulating digital assets will largely depend on statutory changes. As Chairman Benham has asserted, enforcement ''cannot be viewed as a viable substitute for a functional regulatory oversight regime for the cash digital asset market.''[186] He further observed that this will only come about legislatively by granting enhanced authority to regulate spot digital asset markets to a federal financial regulator.[187]

Although there have been several legislative proposals, the Digital Commodities Consumer Protection Act (DCCPA), co-sponsored by the Senate Agriculture Committee Chairwoman Debbie Stabenow (D-MI) and Ranking Member John Boozman (R-AR), has attracted the most attention.[188] Among other things, the DCCPA would require all digital commodity platforms, digital commodity brokers, dealers, and custodians to register with the Commission.[189] On September 15, 2022, Chairman Behnam testified before the Senate Agriculture Committee, championing the proposed DCCPA and stated:

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[175] Coinflip, Inc., CFTC No. 15-29 (Sept. 17, 2015), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliprorder09172015.pdf.

[176] *Id.*

[177] *2023 Crypto Enforcement Trends: SEC & CFTC Set Records as States Take the Lead*, SOLIDAS LABS RES. (2023), https://www.soliduslabs.com/research/2023-crypto-enforcement-trends.

[178] *Id.*

[179] *Id.*

[180] *Id.*

[181] On October 3, 2022, the CFTC filed a complaint against Adam Todd and four companies he controlled—Digitex LLC, Digitex Limited, Digitex Software Limited, and Blockster Holdings Limited Corporation (collectively, ''Digitex Futures'')—alleging that he and Digitex Futures operated an unregistered commodity exchange. *CFTC v. Todd et al.*, No. 22-cv-23174 (S.D. Fla. 2022).

[182] The CFTC also charged that because Digitex Futures met the statutory definition of an FCM, it was required to comply with the applicable provisions of the Bank Secrecy Act, including requirements to implement effective KYC procedures and a customer information program (CIP). The CFTC alleged that Digitex Futures did not have effective KYC procedures and did not implement an effective CIP, thus violating 17 C.F.R. § 42.2. CFTC, Statement of Commissioner Kristin N. Johnson Regarding Unregistered Crypto Futures Platform, Price Manipulation, and Failure to Comply with AML/KYC/CIP Obligations (Oct. 3, 2022), https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement100322.

[183] On May 19, 2022, the CFTC filed a civil enforcement action against Sam Ikkurty, Ravishankar Avadhanam, and Jafia LLC for fraudulently soliciting participation interest in an income fund that invested in digital assets and other instruments. Compl., CFTC v. Ikkurty, No 1:22-cv-02465 (N.D. Il. May 10, 2022), ECF No. 1. According to the complaint, the defendants solicited more than $44 million from at least 170 individuals to purchase, hold, and trade digital assets, commodities, derivatives, swaps, and commodity futures contracts. *Id.* However, the defendants allegedly did not invest the pooled funds as represented, instead the funds were transferred to other accounts under defendants' control for their sole benefit. The CFTC seeks restitution for defrauded investors, disgorgement of ill-gotten gains, civil monetary penalties, permanent trading and registration bans, and a permanent injunction.

[184] The CFTC's first enforcement action involving a digital asset manipulation scheme was brought on March 5, 2021, when it filed a complaint in the Southern District of New York against John McAfee and his former employee, Jimmy Gale Watson for allegedly engaging in a pump-and-dump scheme in a variety of digital currencies. Compl., CFTC v. McAfee, No. 1:21-cv-01919 (S.D.N.Y. Mar. 5, 2021), ECF No. 1. On July 18, 2022, after McAfee's death, the court entered a Consent Order against Watson that found Watson engaged in price manipulation in violation of Sections 6(c)(3) and 9(a)(2) of the Act and Regulation 180.1, requiring Watson to disgorge $144,736 in ill-gotten gains, and pay a civil monetary penalty of the same amount. Consent Order, CFTC v. McAfee, No. 1:21-cv-01919 (S.D.N.Y. July 14, 2022), ECF No. 38. In addition, the Commission in the Digitex case alleged that the respondent attempted to manipulate the price of the Digitex exchange's native currency, DGTX, by engaging in non-economic trading activity on third-party digital asset trading platforms with the intent to artificially inflate the price of DGTX and increase the value of the DGTX. Specifically, the CFTC alleged Todd pumped the price of DGTX by developing a ''bot'' that purchased and sold DGTX on third-party exchanges but was designed to always buy more than it sold, and by filling large over-the-counter orders to purchase DGTX from third-party exchanges rather than Digitex's reserves, which owned hundreds of millions of DGTX tokens. Press Release, CFTC, CFTC Charges Digital Asset Derivatives Platform and Miami Resident with Facilitating Unlawful Futures Transactions, Failing to Register, and Attempted Manipulation of Native Token (Oct. 3, 2022), https://www.cftc.gov/PressRoom/PressReleases/8605-22.

[185] Compl., CFTC v. Mirror Trading Int'l Proprietary Ltd., No. 1:22-cv-00635 (W.D. Tex. June 30, 2022), ECF No. 1.

[186] Examining Digital Assets: Risks, Regulation, and Innovation: Full Committee Hearing Before S. Comm. on Agric., Nutrition, & Forestry (Feb. 9, 2022), https://www.agriculture.senate.gov/imo/media/doc/Testimony_Behnam_020920225.pdf (testimony of Rostin Behnam, Chairman, CFTC).

[187] *Id.*

[188] Digital Commodities Consumer Protection Act of 2022, S.4760, 117th Cong. (2022).

[189] *Id.*

> The DCCPA leverages the historical strength of the CFTC as a market regulator by requiring registration and supervision of digital commodity platforms and digital commodity intermediaries as is required in CFTC-regulated derivatives markets. . . . . Critically, all digital commodity platforms must maintain adequate financial, operational, and managerial resources, segregate customer funds, and comply with Commission requirements for the treatment of customer assets. These tools have proven effective in preserving customer funds and market operations in times of instability, uncertainty, or market misconduct.[190]

In the wake of the collapse of the FTX Trading, Ltd. (FTX) crypto exchange and resulting bankruptcy filing in November 2022, Chairman Behnam returned to testify before the Senate Agriculture Committee to reiterate that the ''CFTC does not have direct statutory authority to comprehensively regulate cash digital commodity markets'' and that lack of authority will leave consumers of digital assets largely unprotected.[191] During his testimony, Chairman Behnam noted that the CFTC-regulated affiliate of FTX (LedgerX, LLC) did not share in the customer losses suffered by FTX, demonstrating the value and strength of the CFTC regulatory framework.[192]

The DCCPA, however, has faced scrutiny in the wake of FTX's collapse. Senators Elizabeth Warren (D-MA) and Roger Marshall (R-KS) introduced the Digital Asset Anti-Money Laundering Act,[193] and Senator Cynthia Lummis (R-WY) stated that she plans to reintroduce the Responsible Financial Innovation Act.[194] In the House of Representatives, House Agriculture Committee Ranking Member (now Chairman) Glenn Thompson (R-PA) will likely seek to build on his bill, the Digital Commodity Exchange Act of 2022.[195] Meanwhile, SEC Chairman Gensler described the DCCPA as ''too light touch.''[196] While Senators Stabenow and Boozman remain committed to advancing a final version of the DCCPA, it remains unclear whether other legislators will ultimately support this bill.

D. Disruptive Trading Practices

Prior to the passage of the Dodd-Frank Act, CFTC officials commented that ''they regularly find cases of disruptive trading practices that negatively impact prices but did not rise to the level of legal manipulation, leaving the agency handcuffed by the law over how to prosecute the cases.''[197] The Dodd-Frank Act solved this problem by creating a new category for offenses that formerly were classified as manipulation claims, but are now prosecutable on their own and freed from the stringent scienter requirements of manipulation claims. Specifically, Dodd-Frank amended § 4c(a) of the CEA to prohibit three types of transactions as ''disruptive of fair and equitable trading''—namely, trading that (i) ''violates bids or offers''; (ii) ''demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period''; or (iii) ''is of the character of, or is commonly known to the trade as 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution).''[198]

Even before Dodd-Frank made these trading activities explicitly illegal, the CFTC brought manipulation-based enforcement actions involving these types of transactions. The Commission has signaled that these trading practices will continue to be subject to heightened regulatory scrutiny in the years ahead.

1. Violation of bids and offers

The Commission interprets the CEA's prohibition on violating bids and offers, 7 U.S.C. § 6c(a)(5)(A), as precluding ''a person from buying a contract on a registered entity at a price that is higher than the lowest available price offered for such contract or selling a contract on a registered entity at a price that is lower than the highest available price bid for such contract.''[199]

The Commission brought its only enforcement action based on a violation of bids and offers in the pre-Dodd-Frank era, under the stringent specific intent standards of its general anti-manipulation powers. But this action—*In the Matter of Anthony DiPlacido*—is also the one anti-manipulation case that the Commission ever successfully litigated to final judg-

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[190] Legislative Hearing to Review S.4760, the Digital Commodities Consumer Protection Act: Full Committee Hearing Before S. Comm. on Agric., Nutrition, & Forestry (Sept. 15, 2022), https://www.agriculture.senate.gov/download/farm-bill/testimony-of-rostin-behnam (testimony of Rostin Behnam, Chairman, CFTC).

[191] Why Congress Needs to Act: Lessons Learned From the FTX Collapse: Full Committee Hearing Before S. Comm. on Agric., Nutrition, & Forestry (Dec. 1, 2022), https://www.agriculture.senate.gov/imo/media/doc/The%20Honorable%20Rostin%20Behnam%20Testimony.pdf ((testimony of Rostin Behnam, Chairman, CFTC).

[192] *Id.*

[193] Press Release, Elizabeth Warren, Senator, Warren, Marshall Introduce Bipartisan Legislation to Crack Down on Cryptocurrency Money Laundering, Financing of Terrorists and Rogue Nations (Dec. 14, 2022); https://www.warren.senate.gov/newsroom/press-releases/warren-marshall-introduce-bipartisan-legislation-tocrack-down-on-cryptocurrency-money-laundering-financing-of-terrorists-and-rogue-nations

[194] Crypto Crash: Why the FTX Bubble Burst and the Harm to Consumers: Full Committee Hearing Before S. Comm. on Banking, Hous., & Urban Affairs (Dec. 14, 2022), https://www.banking.senate.gov/hearings/crypto-crash-why-the-ftx-bubble-burst-and-the-harm-to-consumers.

[195] Digital Commodity Exchange Act of 2022, H.R.761, 117th Cong. (2022).

[196] Paul Kiernan, *FTX Collapse Sets Back Crypto Agenda in Washington*, WALL. ST. J. (Nov. 14, 2022), https://www.agriculture.senate.gov/newsroom/dem/press/release/chairwoman-stabenow-opening-statement-at-hearing-on-lessons-learned-from-the-ftx-collapse-and-the-need-for-congressional-action.

[197] Christopher Doering, *Analysis: CFTC Eager to Target Manipulation with New Tools*, REUTERS (July 29, 2010), https://www.reuters.com/article/uk-financial-regulation-cftc-analysis-idUKTRE66S5EH20100729.

[198] 7 U.S.C. § 6c(a)(5). *See generally* Antidisruptive Practices Authority, 76 Fed. Reg. 14,943 (Mar. 18, 2011).

[199] CFTC, INTERPRETIVE GUIDANCE AND POL'Y STMT. ON DISRUPTIVE PRACTICES (2013).

ment.[200] There, the Commission issued an opinion and order finding a trader liable for manipulation and attempted manipulation based on his trading activity during the closing period, during which he either offered at prices below the prevailing bid price in the pit (*i.e.*, violated bids) or bid at prices higher than the prevailing offer prices (*i.e.*, violated offers). The trader asserted that there was a legitimate purpose for his conduct—that he was acting quickly to help his client unwind hedge positions in other markets. The Commission rejected this argument and held, among other things, that the defendant acted with manipulative intent, because there could be no rational economic motive for his conduct, and that the trader produced artificial prices by overpaying for contracts. The trader appealed to the Second Circuit, which reduced the sanctions imposed by the CFTC from $1 million to $680,000 but otherwise affirmed the agency's decision.[201]

The express prohibition on violating bids and offers, as enacted by Dodd-Frank, takes such claims outside of the manipulation context. Intent is no longer relevant for purposes of establishing a violation. Instead, a violation is established when a trader has control of the bids and offers he sends—*i.e.*, they are not entered into an electronic trading platform that uses automated order-matching software—and ''buy[s] a contract at a price that is higher than the lowest available offer price and/or sell[s] a contract at a price that is lower than the highest available bid price'' in a manner that contravenes the rules of a given exchange.[202] This provision mostly affects traders in over-the-counter (OTC) markets.[203]

2. Disruptive practices prior to close

As mentioned above, 7 U.S.C. § 6c(a)(5)(B) prohibits conduct that ''demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period.'' The Commission has not explicitly defined the phrase ''orderly execution of transactions,'' thus leaving open the types of conduct that could potentially constitute an actionable disruption of such executions. Despite the provision's broad applicability, however, it is likely be applied with the most vigor to so-called ''banging the close'' violations.[204] Banging the close refers to a manipulative tactic whereby a trader acquires a substantial position in futures contracts leading up to the closing period (*i.e.*, when the futures settlement price is determined), and then takes an even larger offsetting cash-settled position before the end of trading on the same day, in order to push prices in favor of the larger position. This is a strategy that can be employed in any market with derivative financial products, including securities options. The Commission pursued such activity under the general category of manipulation before it was expressly outlawed in Dodd-Frank. In fact, banging the close cases made up a substantial percentage of the agency's total manipulation-related enforcement efforts in the years immediately prior to 2011. Somewhat surprisingly, although Dodd-Frank has obviated the need to demonstrate specific intent for purposes of establishing a banging the close violation, the CFTC has not brought any related enforcement actions in recent years.

Any banging the close cases postdating Dodd-Frank have been brought under the CFTC's older manipulation authority—presumably because the underlying conduct predated the implementation of the new disruptive trade practice rules. In June 2015, for example, the CFTC entered into a consent order to settle banging the close allegations based on conduct that took place from June 2006 to May 2008.[205] The CFTC alleged that, while working as a broker at MF Global, Inc., trader Joseph Welsh received orders to buy palladium and platinum futures contracts from a portfolio manager, Christopher Louis Pia, of Moore Capital Management, LLC (Moore) with instructions to exert upward pressures on prices. According to the Commission, Welsh waited to enter these large buy orders until the last five or 10 seconds of the closing periods with the intent to manipulate the prices of those futures contracts, including the settlement prices. To settle the allegations, Welsh agreed to pay a civil monetary penalty of $500,000 and submit to a trading ban and compliance trading.[206]

This settlement represented the latest chapter of a long-standing banging the close matter that had already generated $26 million in fines.[207] The CFTC had previously filed and simultaneously settled charges against both Moore and Pia. On April 29, 2010, the Commission and Moore entered into a settlement regarding charges of attempted manipulation and failure to supervise in connection with the challenged transactions.[208] Moore paid a $25 million penalty, and was subject to restrictions on its trading activity—specifically, Moore was barred from (i) trading within 15 minutes of and during the closing period of the palladium and platinum futures markets for two years, and (ii) registering with the Commission for three years. On July 25, 2011, the Commission and Pia entered into a settlement, whereby Pia had to pay a $1 million fine. In addition, the settlement permanently barred Pia from trading during the closing periods for all CFTC-regulated products and from trading any CFTC-regulated products in palladium and platinum. The settlement also required Pia to (i) distribute a copy of the order/settlement to current investors as well as current and future employees, principals, and officers; and (ii)

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[200] Anthony DiPlacido, CFTC No. 01-23 (Nov. 5, 2008).

[201] DiPlacido v. CFTC, 364 F. App'x 657 (2d Cir. 2009), *cert. denied*, 559 U.S. 1025 (2010); *see also* Press Release, CFTC, Federal Appeals Court Affirms CFTC's Finding of Manipulation by Anthony J. DiPlacido and Modifies Civil Monetary Penalty (Oct. 21, 2009), https://www.cftc.gov/PressRoom/PressReleases/5740-09.

[202] Matthew F. Kluchenek & Jacob L. Kahn, *Deterring Disruption in the Derivatives Markets: A Review of the CFTC's New Authority over Disruptive Trading Practices*, 3 HARV. BUS. L. REV. ONLINE 120 (2013) (citations omitted).

[203] *Id*.

[204] Christopher Doering, Analysis: CFTC Eager to Target Manipulation with New Tools, REUTERS (July 29, 2010), https://www.reuters.com/article/uk-financial-regulation-cftc-analysis-idUKTRE66S5EH20100729.

[205] Consent Order, *CFTC v. Welsh*, No. 1:12-cv-01873 (S.D.N.Y. June 17, 2015).

[206] *Id.*

[207] Compl., *CFTC v. Welsh*, No. 12-cv-01873 (S.D.N.Y. Mar. 14, 2012), ECF No. 1.

[208] Press Release, CFTC, Hedge Fund Moore Capital Management, LP, and Its Affiliates Moore Capital Advisors, LLC and Moore Advisors, Ltd., Ordered to Pay a $25 Million Penalty to Settle CFTC Charges of Attempted Manipulation of Platinum and Palladium Futures Settlement Prices (Apr. 29, 2010), https://www.cftc.gov/PressRoom/PressReleases/5815-10.

provide a disclosure document setting out the Commission action to existing and prospective clients. Finally, Pia had to provide the CFTC with access to his books and records so that the Commission could review his trading activity and monitor his compliance with the settlement for any five-year period.[209]

3. Spoofing

The CFTC has 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 in order 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 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.[210] ''Quote stuffing'' involves a trader repeatedly placing and canceling large orders in order to overwhelm a market's quotation system or to slow and confuse competitors' analysis of the market.[211]

Spoofing is expressly prohibited in amended § 4c(a) of the CEA.[212] Prior to that Dodd-Frank amendment, the CFTC could only charge spoofers under the generic manipulation provision—the same rule that prompted former Commissioner Chilton to bemoan the difficulty of bringing such claims. Now, a spoofing charge only requires the intent to cancel the bid or offer before it is filled. In 2013, the Commission finalized its interpretive guidance on how the new rules would be enforced.[213]

The first case involving the Commission's explicit power to prohibit spoofing came on July 22, 2013, with the filing and simultaneous settlement of charges against a high frequency trading firm, Panther Energy Trading LLC, and its sole owner, Michael Coscia (collectively, Panther), for using a computer algorithm designed to illegally place and quickly cancel bids and offers in futures contracts.[214] According to the CFTC, Panther would place a relatively small order to sell futures contracts that they actually wanted to execute, followed by several large buy orders at successively higher prices that they intended to cancel. In doing so, Panther allegedly intended to give the market the impression that there was significant buying interest, thus making its small order more valuable.

Specifically, 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 it wanted to execute. For example, if the highest bid for a contract was $0.97 and the lowest offer was $1.00, the algorithm would place a small bid at $0.98. The algorithm would then place several large sell orders at $1.01, then $1.00, and then $0.99. Other traders or trading algorithms, seeing this increase in supply and decreasing offer price, would predict that the price would drop and sell for the highest available price—the algorithm's own $0.98 bid. Once the algorithm bought at $0.98, it would cancel the large offers before they could be executed. It would then enter a small sell order at $0.99 and proceed to place large buy orders at $0.96, then $0.97, then $0.98, repeating the process in the other direction. Panther's algorithm would make a very small profit on each transaction, sometimes buying and selling the same commodity hundreds of times in a day.[215]

This scheme allegedly took place over four exchanges in 18 different futures contracts. To settle the civil case, Panther agreed to (i) pay a $1.4 million civil monetary penalty; (ii) disgorge $1.4 million in trading profits; and (iii) submit to a trading ban on any CFTC-registered entity for a period of one year.[216] Significantly, the CFTC cooperated on this case with the Department of Justice, which filed charges against Coscia in the first criminal prosecution for spoofing.[217]

> **COMMENT:** The criminal case against Coscia ultimately proceeded to trial. On November 3, 2015, a Chicago jury took less than two hours to return a guilty verdict on six counts of commodities fraud and six counts of spoofing. Facing up to ten years in prison, Coscia filed a motion for a new trial, arguing among other things that the spoofing charges were unconstitutionally vague and threaten to upend the entire industry. The court denied Coscia's motion on April 6, 2016, finding that the statutory language of § 6c(a)(5)(C), which provides that spoofing involves ''bidding or offering with the intent to cancel before execution,'' clearly defined spoofing and provided sufficient notice as to what conduct would be actionable.[218] Coscia appealed, and in a long-awaited decision issued in August 2017, the Seventh Circuit similarly rejected his constitu-

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[209] Christopher Louis Pia, CFTC No. 11-17 (July 25, 2011).

[210] Indictment Highlights Increased Scrutiny of Futures and Derivative Market Participants' Trading Practices, SIDLEY AUSTIN (Dec. 2, 2014).

[211] Roberta Rampton, ''Quote Stuffing'' a Focus in Flash Crash Probe, REUTERS (Sept. 2, 2010), https://jp.reuters.com/article/us-sec-trades/quote-stuffing-a-focus-in-flash-crash-probe-idUSTRE6812ZS20100902.

[212] 7 U.S.C. § 6c(a).

[213] Antidisruptive Practices Authority, 78 Fed. Reg. 31,890 (May 28, 2013).

[214] 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 (July 22, 2013), https://www.cftc.gov/PressRoom/PressReleases/6649-13.

[215] Scott Patterson & Jamila Trindle, CFTC Charges High-Speed Trader Under New Powers, WALL ST. J. (July 22, 2013), http://www.wsj.com/articles/SB10001424127887324783204578621631102187340.

[216] 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 (July 22, 2013), https://www.cftc.gov/PressRoom/PressReleases/6649-13.

[217] Press Release, DOJ, High-Frequency Trader Indicted For Manipulating Commodities Futures Markets In First Federal Prosecution For ''Spoofing'' (Oct. 2, 2014), https://www.justice.gov/usao-ndil/pr/high-frequency-trader-indicted-manipulating-commodities-futures-markets-first-federal.

[218] 7 U.S.C. § 6c(a)(5)(C).

tional argument.[219] The Supreme Court then denied Coscia's petition for writ of certiorari in May 2018.

The case against Panther was only the tip of the iceberg for spoofing-related enforcement activity. 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.[220] In April 2015, the Commission filed a complaint against Navinder Singh Sarao for spoofing and manipulation that contributed to the ''flash crash'' in 2010 ''when the Dow Jones industrial average fell 600 points in a matter of minutes before bouncing back.''[221] Sarao allegedly used an algorithm similar to that used by Panther to implement a repetitive layering scheme. Notably, the CFTC cooperated with the DOJ and kept its own complaint sealed until Sarao was arrested and criminally charged with substantively the same misconduct.[222]

In May 2015, the CFTC filed another spoofing action against Heet Khara and Nasim Salim, two traders based in the United Arab Emirates, alleging that the two ''regularly placed larger aggregate orders for gold and silver futures contracts . . . opposite smaller orders and cancelled the larger orders after the smaller orders were executed.''[223] That action settled on March 31, 2016, with defendants agreeing to pay a combined penalty of $2.69 million.[224]

In October 2015, after a multi-year spoofing investigation,[225] the CFTC brought a case against trading company 3Red and trader Igor Oystacher, alleging that Oystacher and his company, 3Red, ''intentionally and repeatedly engaged in a manipulative and deceptive spoofing scheme while placing orders for and trading futures contracts . . . on multiple registered entities.''[226] That action settled in December 2016, with defendants agreeing to pay a combined penalty of $2.6 million.[227]

While these cases are significant, no more than two spoofing actions were initiated by the CFTC in any year prior to 2017.[228] 2017 saw a notable increase, with the CFTC bringing nine disruptive trading actions involving spoofing.[229] For example, in July 2017, the Commission levied a $635,000 civil penalty against Simon Posen, a New York-based individual who traded from his home account, to settle charges related to thousands of incidents of spoofing in gold, silver, copper, and crude oil futures contracts over a three-year period.[230] Posen was also banned permanently from trading in CFTC-regulated markets.

Then, in January 2018, the Commission, in conjunction with the DOJ, announced a wave of coordinated spoofing cases. In connection with its new Spoofing Task Force, the CFTC filed eight anti-spoofing enforcement actions on January 29, 2018, including three settlements with financial institutions, and five complaints in federal district court against six individuals and one corporation.[231] On the same day, the DOJ announced criminal charges against seven individuals for spoofing, including the six individuals in the CFTC actions.[232] Previously, only three individuals had been publicly charged with criminal spoofing.[233]

Over the next two years, the CFTC doubled down on its anti-spoofing enforcement efforts. The agency brought 16 cases involving spoofing or manipulative conduct in both 2019 and 2020.[234] The CFTC also settled over a dozen high-profile spoofing cases during that time. In late 2019, for example, the

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[219] *See generally*, United States v. Coscia, 866 F.3d 782, 785 (7th Cir. 2017), *cert. denied*, 138 S. Ct. 1989 (2018).

[220] 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), https://www.cftc.gov/PressRoom/PressReleases/7026-14.

[221] Press Release, CFTC, CFTC Charges U.K. Resident Navinder Singh Sarao and His Company Nav Sarao Futures Limited PLC with Price Manipulation and Spoofing (Apr. 21, 2015), https://www.cftc.gov/PressRoom/PressReleases/7156-15.

[222] Ben Rooney, *UK Trader Arrested for Causing 2010 Stock Market 'Flash Crash'*, CNN MONEY (Apr. 21, 2015), https://money.cnn.com/2015/04/21/investing/flash-crash-uk-trader-arrested.

[223] 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.

[224] Consent Order, U.S. v. Khara and Salim, No. 15-cv-03497 (JPO) (S.D.N.Y. Mar. 31, 2016).

[225] 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 ST. J. (Feb. 22, 2015).

[226] Compl., *CFTC v. Oystacher et al*., No. 15-cv-09196 (N.D. Ill. Oct. 19, 2015).

[227] Press Release, CFTC, Federal Court Orders Chicago Trader Igor B. Oystacher and 3Red Trading LLC to Pay $2.5 Million Penalty for Spoofing and Employment of a Manipulative and Deceptive Device, while Trading Futures Contracts on Multiple Futures Exchanges (Dec. 20, 2016), https://www.cftc.gov/PressRoom/PressReleases/7504-16.

[228] Gregory S. Kaufman et al., *CFTC Enforcement Actions 2017: "Ye[a]r So Bad? Not The Best Year They've Ever Had"*, BLOOMBERG (Mar. 15, 2018).

[229] Press Release, CFTC, CFTC Releases Annual Enforcement Results for Fiscal Year 2017 (Nov. 22, 2017), https://www.cftc.gov/PressRoom/PressReleases/7650-17.

[230] Press Release, CFTC, CFTC Orders New York Trader Simon Posen to Pay a $635,000 Civil Monetary Penalty and Permanently Bans Him from Trading in CFTC-Regulated Markets for Spoofing in the Gold, Silver, Copper, and Crude Oil Futures Markets (July 26, 2017), https://www.cftc.gov/PressRoom/PressReleases/7594-17.

[231] Press Release, CFTC, CFTC Files Eight Anti-Spoofing Enforcement Actions against Three Banks (Deutsche Bank, HSBC & UBS) & Six Individuals (Jan. 29, 2018), https://www.cftc.gov/PressRoom/PressReleases/pr7681-18. The CFTC settled with Deutsche Bank for $30 million, UBS for $15 million, and HSBC for $1.6 million. While announcing the actions, then-Director of Enforcement James McDonald emphasized that ''[t]hese cases should send a strong signal that we at the CFTC are committed to identifying individuals responsible for unlawful activity and holding them accountable.'' *Id.*

[232] Press Release, DOJ, Eight Individuals Charged with Deceptive Trading Practices Executed on U.S. Commodities Markets (Jan. 29, 2018), https://www.justice.gov/opa/pr/eight-individuals-charged-deceptive-trading-practices-executed-us-commodities-markets.

[233] *Id.*

[234] CFTC, FY 2020 DOE ANN. REP. (Dec. 2020), https://www.cftc.gov/PressRoom/PressReleases/8323-20; CFTC, FY2019

CFTC ordered Tower Capital LLC to pay $67.4 million in total recovery—a record at the time—based on allegations that three of Tower's traders, for the benefit of Tower and using Tower's accounts, engaged in the spoofing of E-Mini S&P 500, E-Mini NASDAQ 100 and E-Mini Dow futures contracts.[235] The order settled allegations that the traders employed an elaborate scheme, sometimes using an order splitter to place several smaller, randomly-sized orders, concealing the spoofing from the market. The monetary penalty reflected the severity of the spoofing—which caused market losses of over $32 million—on the one hand, and Tower's cooperation, on the other.

In 2020, the CFTC smashed its previous record for its largest fine—not just in the spoofing context, but across all areas of enforcement—when it settled with J.P. Morgan and affiliated entities (JPM) for $920 million in connection with hundreds of thousands of alleged spoofing orders placed between 2008 and 2016.[236] The scheme allegedly involved numerous traders at JPM's precious metals and Treasuries trading desks, including the heads of both desks, and a variety of futures, such as futures in silver, gold, and Treasury Bonds. Faced with internal surveillance alerts, internal allegations of misconduct by a trader, and inquiries by an exchange and the CFTC, JPM allegedly failed to diligently supervise its employees and flag the rampant misconduct. This settlement highlights the CFTC's increasingly aggressive stance on supervisory liability. Indeed, in the agency's press release, former CFTC Chairman Heath Tarbert warned: ''Spoofing is illegal—pure and simple. This record-setting enforcement action demonstrates the CFTC's commitment to being tough on those who intentionally break our [spoofing] rules , no matter who they are.''[237]

During this anti-spoofing push in 2018 through 2020, a record-breaking 16 CFTC actions were pursued in tandem with criminal authorities, many of which were anti-spoofing cases.[238] The DOJ has the authority to prosecute any individual or company that violates anti-spoofing laws,[239] and it often does so in parallel with civil actions brought by the CFTC. As former CFTC Director of Enforcement James McDonald explained: ''We know that twenty-first century bad actors do not conform their misconduct to the technical boundaries of our respective jurisdictions, nor do they pause as their conduct crosses international borders. So, we in the enforcement community must work together to meet the challenges presented by this sort of wrongdoing.''[240] When such parallel actions are brought, the civil action is typically stayed until the criminal case is resolved.

Despite its increased activity in anti-spoofing enforcement in the years following Dodd-Frank, the CFTC's spoofing efforts have been met with significant criticism from industry participants and practitioners. Commenters have characterized the Commission's guidance on the issue as vague and failing to consider 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 that the language of the regulation is so broad that it encompasses some of these entirely appropriate trades.[241] 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.[242]

Traders have also complained that ''it can be difficult to distinguish between illegal market manipulation and savvy tactics to conceal the size of an intended trade.''[243] The CFTC has identified four ''non-exclusive'' examples of spoofing,[244] but otherwise appears to have adopted an ambiguous ''we know it when we see it'' approach when it comes to spoofing. To this end, the CFTC explained that, ''[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.''[245] Defense counsel have also criticized the vagueness of the spoofing rules and CFTC oversight in this area, emphasizing that ''regulators have provided market participants with minimal guidance

DOE ANN. REP. (Nov. 2019), https://www.cftc.gov/PressRoom/PressReleases/8085-19.

[235] Press Release, CFTC, CFTC Orders Proprietary Trading Firm to Pay Record $67.4 Million for Engaging in a Manipulative and Deceptive Scheme and Spoofing (Nov. 7, 2019), https://www.cftc.gov/PressRoom/PressReleases/8074-19. Interestingly, then-Commissioners Behnam and Berkovitz wrote separate opinions, concurring and dissenting, respectively. Both disagreed with the Commission's conclusory decision not to disqualify Tower as a ''bad actor'' under SEC Rule 506. They argued that disqualification was either supported or required by Tower's unprecedented level of spoofing. CFTC, Statement of Commissioner Rostin Behnam Regarding Tower Research Capital LLC (Nov. 7, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement110719; CFTC, Dissenting Statement of Commissioner Dan M. Berkovitz (Nov. 7, 2019), https://bit.ly/3wTgBJM.

[236] Press Release, CFTC, CFTC Orders JPMorgan to Pay Record $920 Million for Spoofing and Manipulation (Sept. 29, 2020), https://www.cftc.gov/PressRoom/PressReleases/8260-20.

[237] *Id.*

[238] CFTC, FY 2020 DOE ANN. REP. 9 (Dec. 2020), https://www.cftc.gov/PressRoom/PressReleases/8323-20.

[239] 7 U.S.C. § 13(a)(2).

[240] Remarks Of CFTC Director Of Enforcement James McDonald The American Bar Association's National Institute On White Collar Crime, Mondovisione (June 3, 2019), https://mondovisione.com/media-and-resources/news/remarks-of-cftc-director-of-enforcement-james-m-mcdonald-at-the-american-bar-as.

[241] Letter from Futures Industry Association and Securities Industry and Financial Markets Association regarding Antidisruptive 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.'').

[242] John D. Arnold, Spoofers Keep Markets Honest, BLOOMBERG VIEW (Jan. 23, 2015).

[243] Bradley Hope, As ''Spoof'' Trading Persists, Regulators Clamp Down, WALL ST. J. (Feb. 22, 2015), http://www.wsj.com/articles/how-spoofing-traders-dupe-markets-1424662202.

[244] The CFTC's examples consist of submitting or cancelling bids or offers for the purpose of (i) overloading a quotation system (ii) delaying another person's trades, (iii) creating the appearance of market depth, and (iv) creating artificial price movements.

[245] Antidisruptive Practices Authority, 78 Fed. Reg. 31,890, 31,896 (May 28, 2013).

around the definition of spoofing'' and that ''it is unclear of what elements the criminal offense of spoofing consists.''[246]

The past two years have seen a relative decrease in the number of spoofing cases, which is likely explained by market participants being increasingly able to prevent such activity through their own surveillance and compliance programs.[247] Despite this downward trend, the Commission nonetheless brought five spoofing actions in 2022.[248] The creation of the Spoofing Task Force further signals that spoofing will continue to be a priority for the Commission. The CFTC has also taken steps to ensure that the Self-Regulatory Organizations (SROs) that it oversees are also taking spoofing seriously. In a November 2014 report, for example, the CFTC instructed the Chicago Mercantile Exchange (CME), the operator of the world's largest futures market, to develop better detection strategies for spoofing and to improve and increase self-regulation and enforcement of this form of manipulation.[249] Recent SRO enforcement activity, as discussed in greater detail in 262 SPS Chapter V: *Other Regulatory Enforcement Actions*, indicates that SROs have also received the CFTC's anti-spoofing message.

COMMENT: The CME Group, CBOE Futures Exchange, and ICE Futures are three SROs that have actively pursued cases against market players for spoofing-like activity in recent years. In 2018 alone, for example, the CME published 46 disciplinary actions sanctioning activities implicating spoofing rule violations, constituting over one-third of all CME enforcement actions in fiscal year 2018. Separately, in 2018, the CFE resolved an action involving spoofing conduct from 2014, issuing a fine of $20,000 and compelling disgorgement of $19,500, as well as holding the trader and his firm jointly and severally liable.[250] Further, ICE Futures determined in December 2018 that a firm violated ICE spoofing rules when it deployed a semi-automated trading system to enter orders at prices significantly different from the prevailing bid without the intent to execute bona fide transaction. The firm settled with ICE Futures for a $37,500 fine.[251]

E. False Statements

At a 2016 industry conference, Manal Sultan, Deputy Director of the Division of Enforcement, indicated that the provision of false information to the CFTC would be a key enforcement priority in the years ahead.[252] Historically, the CFTC lacked statutory authority to pursue many, if not most, false statements made in the course of a Commission investigation or enforcement proceeding. Dodd-Frank expanded the CFTC's mandate to pursue charges for false statements in two important ways. First, the Commission may now go after 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. The Commission could previously address only false statements made in certain formal documents or in materials required to be submitted to the Commission or regulated entities.[253]

Second, while only ''knowing'' misstatements or ''willful'' falsifications were actionable before Dodd-Frank, the CFTC now has authority to pursue charges based on recklessness where the speaker ''knew, or *reasonably should have known*, the statement to be false or misleading.''[254] Relying on this authority, then-Acting Director of the Division of Enforcement Gretchen L. Lowe stated that if witnesses in CFTC investigations do not tell the truth, ''the CFTC will not hesitate to take action to enforce the Dodd-Frank's prohibition against providing false or misleading information and impose sanctions.''[255] Then-Director of Enforcement Goelman bluntly articulated the CFTC's interest in false statement cases at a December 2014 conference, noting that ''[w]here it's possible to prove false statements, you have to bring those cases.''[256]

Consistent with these remarks, the Commission has brought at least 29 false statement actions between 2014 and

[246] Martindale, *First* Criminal Prosecution for Spoofing: High Frequency Trading Firm Owner Indicted in Northern District of Illinois, *Clients and Friends Memo*, CADWALADER, WICKERSHAM & TAFT LLP (Oct. 7, 2014), https://www.martindale.com/legal-news/article_cadwalader-wickersham-taft-llp_2181084.htm.

[247] Paul Architzel & Matt Beville, CFTC 2022 Enforcement and Regulatory Developments and a Look Forward, WILMER HALE (Feb. 2, 2023), https://www.wilmerhale.com/en/insights/client-alerts/20230202-cftc-2022-enforcement-and-regulatory-developments-and-a-look-forward.

[248] Compl., CFTC v Skudder, No. 1:22-cv-01925 (N.D. Ill. Apr. 14, 2022), ECF No. 1; Compl., CFTC v Shak, No. 2:22-cv-01258 (D. Nev. Aug. 5, 2022), ECF No. 1; In re Schwartz, CFTC No. 22-22, 2022 WL 3656396 (Aug. 24, 2022); In re Tanius Tech., LLC, CFTC No. 22-34, 2022 WL 4597775 (Sept. 26, 2022); In re Chen, CFTC No. 22-35, 2022 WL 4597774 (Sept. 26, 2022).

[249] CFTC DIV. OF MKT. OVERSIGHT, Trade Practice Rule Enforcement Review: The New York Mercantile Exchange and the Commodity Exchange (Nov. 21, 2014), https://cftc.gov/sites/default/files/idc/groups/public/@iodcms/documents/file/rertradepractice112114.pdf.

[250] *See* David Lambert & DBF GP LLC, CFE No. 17-0006 (Apr. 11, 2018). The current Rule 620 has 620(a)(iii) noted as the spoofing provision; since the infringing activities took place in 2014, this case used the pre-amendment sectioning.

[251] Uncia Energy LP – Series I, ICE No. 2017-047 (Dec. 4, 2018).

[252] Susan L. Harper, *Regulators Preview 2017 Priorities at SIFMA's 2016 New York Regional Conference*, BATES GROUP (Nov. 9, 2016), https://www.batesgroup.com/news/regulators-preview-2017-priorities-at-sifmas-2016-new-york-regional-confere.

[253] Specifically, statements made in applications, reports, or other documents required to be filed with the Commission, contained in applications for membership in or association with a member of an exchange or futures association, or made to an exchange or futures association acting in furtherance of its official duties. *See* 7 U.S.C. § 13(a)(3)–(4).

[254] *See, e.g.*, Press Release, CFTC, CFTC Charges Introducing Broker eFloorTrade, LLC and its Principal John Moore with Recordkeeping and Supervision Failures and Charges Moore for his False and Misleading Statements to the CFTC (Sept. 28, 2016), https://www.cftc.gov/PressRoom/PressReleases/7458-16 (alleging that principal knew or reasonably should have known that certain of his sworn statements to CFTC regarding his firm's supervision and recordkeeping practices were false and misleading).

[255] Press Release, CFTC, FTC 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), https://www.cftc.gov/PressRoom/PressReleases/6815-14.

[256] Peter Rawlings, *CFTC, Prosecutors Eye Obstruction Cases*, XXI COMPLIANCE REP. 26 (Dec. 29, 2014).

2022 under its expanded authority.[257] These cases focused on false statements and omissions made in a variety of contexts, including, for example, false statements made to the National Futures Association (NFA) in connection with an NFA investigation, misstatements and omissions in the submission of required risk manuals to the CFTC, and false or misleading statements made to the CFTC staff while testifying under oath.

In some cases, the false statement charge has stood on its own without parallel charges of other misconduct. In 2014, for example, 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.[258] In 2022, the CFTC charged a crypto-trading platform that was seeking registration as a DCM for allegedly making false statements to the CFTC in connection with the self-certification of a Bitcoin futures contract.[259] The CFTC alleged that the trading platform falsely stated that its contract was not readily susceptible to manipulation—a requirement for listing—because it required customers to completely pre-fund positions, without disclosing that the firm had allegedly given certain customers loans or advances to help increase trading volumes. The trading platform also allegedly overstated the effectiveness of its self-trading prevention controls and allegedly failed to disclose that a significant portion of the volume during the auction process involved a single participant trading with itself.

More frequently, false statement charges have been brought alongside other charges. In many such cases, the addition of a false statement charge has increased the size of settlement. In September 2016, for example, the Commission ordered the defendants to pay a $1.5 million civil monetary penalty for making inaccurate statements in required CFTC filings, as well as for failing to comply with supervision and risk management obligations.[260] In 2018, a defendant was ordered to pay more than $1.9 million in civil monetary penalties and disgorgement after a two-day bench trial found him guilty of false statements to the CFTC and fraudulent solicitation.[261] In 2019, the CFTC obtained a settlement order against Korea's sole securities exchange operator, Korea Exchange, Inc. (KRX), based on its submission of a false annual certification.[262] Because KRX was granted certain registration exemptions, the CFTC required KRX to annually certify that it adhered to the Principles of Financial Market Infrastructure (PMSIs). The PMSIs mandated that KRX perform daily tests to ensure financial stability in the event of an extreme market event. In addition, KRX was obligated to adjust its policies and resources in accordance with those test results. The order found that: (i) KRX learned its policies diverged from the PMSIs in October 2017; (ii) KRX failed to change its policies until December 2017; but (iii) KRX nevertheless certified to the CFTC in February 2018 that it had complied with the PMSIs on a daily basis over the previous year. KRX agreed to pay $150,000 for this purportedly false and incomplete statement.

False statements were also among the misconduct alleged in the CFTC's $127 million settlement with Bank of Nova Scotia (BNS) in 2020, an action that produced multiple orders and alleged misconduct ranging from spoofing to supervision violations to swap dealer compliance.[263] One order found that BNS made false or misleading statements to the CFTC regarding its audio retention and supervision. Another order found that BNS made false statements to the CFTC during an earlier spoofing investigation causing the CFTC to misjudge the scope and severity of BNS's misconduct. As a result, the CFTC ordered BNS to pay a much larger penalty in the 2020 case to reflect the true scale of the spoofing, which involved thousands of illegal orders in gold and silver futures. Additionally, the CFTC ordered a record-setting penalty for the related false statements of $17 million.

Finally, in October 2022, the CFTC entered a consent order imposing monetary penalties against CTAX Partners, LLC, a CFTC-registered commodity pool operator and CFTC Partners, LLC, a CFTC-registered introducing broker (collectively, CTAX), as well as its associated person, Purvesh Mankad, based on allegations of fraudulent solicitation, misappropriation of pool participant funds, and making false statements to the NFA regarding the fraud. Specifically, the order alleges that, from July 2014 to March 2019, Mankad and CTAX (1) represented to pool participants that only experienced commodity trading advisors (CTAs) would trade funds in the CTAX pool, when in reality Mankad, who was not a CTA and had limited, unsuccessful experience trading futures, engaged in much and eventually all trading in the CTAX pool; (2) misrepresented and omitted material facts regarding brokerage commissions that would be charged to the CTAX pool, when in fact Mankad and CTAX Partners misappropriated pool funds by extracting excessive commissions triggered by Mankad's own unauthorized trading; (3) beginning in July 2018, recklessly traded the CTAX pool's assets in a manner that resulted in a loss of approximately 89 percent of the CTAX pool's assets, resulting in significant losses to pool participants; (4) concealed those losses from pool participants by intentionally delaying the provision of monthly account statements to pool participants; and (5) submitted false emails to the NFA, in connection with

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[257] CFTC Enforcement Press Releases related to False Statements, https://www.cftc.gov/PressRoom/PressReleases?combine=false+statement&field_press_release_types_value=Enforcement&field_release_number_value=&prtid=All&year=all.

[258] Artem Obolensky, CFTC No. 14-05 (Jan. 2, 2014).

[259] Compl., CFTC v. Gemini Tr. Co., 1:22-cv-04563 (S.D.N.Y. June 2, 2022), ECF No. 1.

[260] Press Release, CFTC, CFTC Orders Chicago-based Advantage Futures LLC, its CEO Joseph Guinan, and Former Chief Risk Officer William Steele Jointly to Pay a $1.5 Million Civil Monetary Penalty for Supervision, Risk Management Failures, and Making Inaccurate Statements in Required Filings with the CFTC (Sept. 21, 2016), https://www.cftc.gov/PressRoom/PressReleases/7449-16.

[261] Press Release, CFTC, CFTC Wins Trial against Fraudster in Futures Markets (Oct. 3, 2018), https://www.cftc.gov/PressRoom/PressReleases/7821-18. As then-Director of Enforcement James McDonald remarked, ''[t]he CFTC's case and this court's decision make clear that recidivists will be caught and punished and that lying to the CFTC is a grave offense meriting a serious penalty.'' *Id.*

[262] Press Release, CFTC, CFTC Issues Order Finding that Korea Exchange, Inc. Made a False and Misleading Certification to the CFTC (July 12, 2019), https://bit.ly/3ppN2wI.

[263] Press Release, CFTC, CFTC Orders The Bank of Nova Scotia to Pay $127.4 Million for Spoofing, False Statements, Compliance and Supervision Violations (Aug. 19, 2020), https://www.cftc.gov/PressRoom/PressReleases/8220-20.

an NFA audit of CTAX Series and CTAX Partners, to make it appear that the defendants provided timely account statements to all pool participants. As a result of this conduct, pool participants lost more than $1.9 million.[264] The order requires the defendants to pay $1,631,072.29 in restitution to victims and to pay a $727,588.91 civil monetary penalty.[265]

COMMENT: In addition to bringing false statement charges directly, the CFTC has also brought failure to supervise charges against institutions based on false statements made by employees. For example, on September 22, 2017, the CFTC settled charges with Merrill, Lynch, Pierce, Fenner & Smith (Merrill Lynch) for, among other things, failing to supervise its response to CME inquiries into futures block trade execution and recordkeeping practices of the swaps desk at Bank of America, N.A. (BANA), a Merrill Lynch affiliate. The CME interviewed certain traders on the swaps desk, who made misleading statements and failed to acknowledge that they did in fact trade ahead of futures block trades in some instances. As part of the settlement order, the CFTC noted that Merrill Lynch relied on the operations business support group at BANA to gather information for Merrill Lynch's response to the CME's inquiries, but exercised only minimal oversight over the work of this group and failed to stay adequately informed of the group's findings. As a result, the CFTC concluded that Merrill Lynch's lack of diligence in supervising the work of this group contributed to its failure to detect trading ahead by certain traders on the swaps desk before these traders misled the CME during their interviews. For example, members of the business operations support group prepared a trading analysis that showed that certain members of the swaps desk traded ahead of futures block trades but did not share this information with Merrill Lynch compliance and legal staff.[266] This case serves as a reminder that the CFTC expects in-house counsel to stay directly apprised of any activity relating to ongoing regulatory investigations and will hold companies liable for failure to exercise reasonable diligence to ensure that employees tell the truth.

On September 26, 2018, the CFTC similarly settled charges with Kooima & Kaemingk Commodities, Inc. (K&K) and its principals for, among other things, defrauding customers by unauthorized trading, making false statements to the CME, and failing to supervise employee misconduct. Specifically, the CFTC found that K&K, through its principals, failed to supervise a former employee's handling of customer accounts. Even though the principals knew the employee was engaged in unauthorized trading, they initially did nothing to stop him. Further, when the CME opened an investigation into the former employee's violation, K&K made misleading statements and engaged in a cover-up to conceal the scope of the unauthorized trading. As a result, the defendants were ordered to pay $11.9 million in restitution and $1.25 million in civil monetary penalties.[267] This case shows that the CFTC expects brokers to respond truthfully and completely to the CME and other exchanges when misconduct is being investigated, and will hold companies liable for their failure to do so.[268]

F. Automated and Algorithmic Trading

Technological advances have led to an increase in automated trading, with nearly all trading on CFTC markets now done electronically. In response to these changes, on November 24, 2015, the CFTC proposed ''Regulation Automated Trading,'' or ''Regulation AT.'' The proposed regulation sought to reduce the risk associated with automated and algorithmic trading on U.S.-designated markets. The proposal ''represent[ed] a series of risk controls, transparency measures, and other safeguards to enhance the U.S. regulatory regime for automated trading.''[269] It reflected a principles-based approach and set forth only general requirements, leaving the details to market participants, as the CFTC believed they ''[were] the ones who should determine those specifics.''[270] These rules would apply to trading firms, clearing members, and exchanges engaging in automated trading, and impose registration, reporting, and recordkeeping obligations, among others.[271]

Once operative, these rules were expected to have a significant impact on the algorithmic and automated trading industry—as well as CFTC enforcement in these areas—because they created a new and independent basis for charges. Regulation AT would also have given the CFTC the authority to bring enforcement actions against automated traders for failure to comply with the rules. Enforcement actions brought on this basis would not have required evidence of fraud, manipulation,

[264] *Id.*

[265] *Id.*

[266] Press Release, CFTC, CFTC Orders Merrill, Lynch, Pierce, Fenner & Smith Incorporated to Pay $2.5 Million to Settle Charges of Supervision Failures and Recordkeeping Violations (Sept. 22, 2017), https://www.cftc.gov/PressRoom/PressReleases/7615-17.

[267] Press Release, CFTC, CFTC Orders an Iowa Introducing Broker and Its Principals to Pay $11.9 Million in Restitution to Farmers and a $1.25 Million Civil Monetary Penalty for Fraud, Unauthorized Trading, and False Statements to the CME, Among Other Violations (Sept. 26, 2018), https://www.cftc.gov/PressRoom/PressReleases/7803-18.

[268] As then-Director of Enforcement James McDonald noted, ''[b]rokers are also expected to respond truthfully and completely to CME and other exchanges when misconduct is being investigated. When brokers defraud their customers and then seek to cover it up—as in this case—the Commission will vigorously pursue them.'' *Id.*

[269] Press Release, CFTC, CFTC Unanimously Approves Proposed Rule on Automated Trading (Nov. 24, 2015), http://www.cftc.gov/PressRoom/PressReleases/7283-15.

[270] CFTC, Remarks of Chairman Timothy Massad Before the ABA Derivatives and Futures Law Committee, 2016 Winter Meeting (Jan. 22, 2016), https://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-37. Such an approach is similar to the standards used by FINRA to regulate algorithmic trading. *See* FINRA, Regulatory Notice 15-09, Equity Trading Initiatives: Supervision and Control Practices for Algorithmic Trading Strategies (March 2015), http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-09.pdf.

[271] Press Release, CFTC, CFTC Unanimously Approves Proposed Rule on Automated Trading (Nov. 24, 2015), http://www.cftc.gov/PressRoom/PressReleases/7283-15.

or other similar misconduct; instead, the fact of a rule violation would be sufficient.[272]

One of the most controversial pieces of Regulation AT was its requirement that algorithmic trading source code be preserved and made available to the Commission when necessary. Industry commentators expressed concern that this requirement may implicate trade secrets and core intellectual and property rights.[273] In response, the CFTC made certain changes to the proposed rule, including limiting the Commission's access to algorithmic trading source code only via a subpoena or special call approved by the Commission itself.[274] This revised proposal did not alleviate industry concerns. For example, in a comment letter submitted by Walt Lukken, president and CEO of the Futures Industry Association, on behalf of his organization as well as FIA Principal Traders Group, he noted that the new intellectual property safeguards still fell short because the special call process ''[did] not provide the protections available to market participants when a subpoena is required.''[275]

In June 2020, after nearly four years of uncertainty about Regulation AT, the Commission voted 3–2 to withdraw it.[276] The same day, the Commission proposed a new electronic trading rule for public comment, which was largely incorporated into the December 2020 Final Rule approved by the Commission in a 4–1 vote.[277] The Final Rule embodies former Chairman Tarbert's ''principles-based approach,'' setting forth three ''risk principles'' to guide designated contract markets (DCMs) in self-regulating electronic and algorithmic trading.[278] The Final Rule requires DCMs to adopt rules that (i) prevent, detect, and mitigate market disruptions and system anomalies associated with electronic trading; (ii) establish pre-trade risk controls for all electronic orders; and (iii) provide prompt notification to Commission staff of any significant market disruptions on their electronic trading platforms.[279] Former Commissioner Tarbert had hoped this approach would offer the DCMs flexibility, simplicity, and opportunities for innovation, while equipping the CFTC with an objective, adaptable, and efficient framework for enforcement.[280] Meanwhile, then-Commissioner Behnam, the sole dissenter, expressed fear that the Final Rule was too reactive, failing to incorporate data from recent volatility events and anticipate external market stressors such as climate change and the pandemic.[281]

G. Cybersecurity

The CFTC has taken steps to increase its focus on the regulation of cybersecurity. Former Chairman Timothy Massad observed that ''[t]he risk of cyberattack probably represents the single greatest threat to the stability and integrity of our markets today.''[282] On September 8, 2016, the Commission unanimously approved final rules designed to enhance cybersecurity protection and ensure that firms are ''doing adequate evaluation of cybersecurity risks and testing of their own cybersecurity and operational risk protections.''[283] These rules apply to designated contract markets, swap execution facilities, swap data repositories, and derivatives clearing organizations.

The rules establish principles-based testing guidelines to ensure that companies are following the industry's best practices in evaluating cybersecurity risks and testing their own cybersecurity and operational risk protections. They require at least five types of testing ''essential to a sound system safeguards program'': controls testing, vulnerability testing, security incident response plan testing, penetration testing, and enterprise-wide assessment of technology risk.[284] These tests

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[272] *Id.*

[273] Then-Chairman Giancarlo voted against Regulation AT as Commissioner, noting that ''any public good achieved by the rule is undone by the now notorious source code repository requirement.'' CFTC, Statement of Dissent by Commissioner J. Christopher Giancarlo Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading (Nov. 4, 2016), https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110416. He further explained: ''I am unaware of any other industry where the federal government has such easy access to a firm's intellectual property and future business strategies . . . Do other agencies in the federal government have ready access to businesses' intellectual property and business strategies? . . . [Regulation AT] is unlike any other rule proposal that I have seen in my time of service. What should be a step forward by the agency in its mission to oversee twenty-first century digital markets is squandered by its giant stumble backwards in undoing Americans' legal and Constitutional rights.'' *Id.*

[274] This revised proposal was relayed in a supplemental notice of proposed rulemaking that was published in the Federal Register on November 25, 2016 with a 90-day comment period, which was then extended until May 1, 2017. *See* Press Release, CFTC, CFTC Extends Public Comment Period for the Supplemental Proposal for Regulation Automated Trading (Jan. 23, 2017), https://www.cftc.gov/PressRoom/PressReleases/7520-17.

[275] Letter from Walt Lukken, Pres. & CEO, Futures Indust. Ass'n & FIA Principal Traders Grp., to Christopher Kirkpatrick, Sec'y, CFTC (May 1, 2017) (on file with fia.org).

[276] Press Release, CFTC, CFTC Approves Two Final Rules and Two Proposed Rules at June 25 Open Meeting (June 25, 2020), https://www.cftc.gov/PressRoom/PressReleases/8188-20.

[277] Electronic Trading Risk Principles, 86 Fed. Reg. 2,048 (Jan. 11, 2021).

[278] *CFTC Adopts Final Rule on Electronic Trading Risk Principles* SULLIVAN & CROMWELL LLP (Dec. 16, 2020).

[279] Press Release, CFTC, CFTC Approves Two Final Rules at December 8 Open Meeting (Dec. 8 2020), https://www.cftc.gov/PressRoom/PressReleases/8331-20.

[280] CFTC, Statement of Chairman Heath P. Tarbert in Support of the Final Rule on Electronic Trading Risk Principles (Dec. 8, 2020), https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement120820.

[281] CFTC, Dissenting Statement of Commissioner Rostin Behnam Regarding Electronic Trading Risk Principles (Dec. 8, 2020), https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement120820.

[282] CFTC, Statement of Chairman Timothy Massad on the System Safeguards Testing Final Rules (Sept. 8, 2016), https://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement090816b.

[283] 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.

[284] CFTC, Fact Sheet – Final Rules on System Safeguards Testing Requirements (Sept 8. 2016), https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/syssafeguard_factsheet090816.pdf. Certain registrants may be subject

are designed to ''detect, contain, respond to, and recover from a cyberattack or other type of operational problem.''[285]

Notably, ''being hacked, by itself, cannot be considered a rule violation subject to enforcement.''[286] It appears from these statements that compliance with the new CFTC cybersecurity rules may protect market participants from enforcement actions in the event of a cyber attack. Nonetheless, it remains to be seen how the CFTC will apply and enforce its new rules.

Since the adoption of these rules, the CFTC has brought two enforcement actions premised on a cybersecurity failure at a CFTC-registered entity. On February 12, 2018, the Commission issued an order filing and simultaneously settling charges against AMP Global Clearing LLC, a registered futures commission merchant, for its failure to diligently supervise the implementation of critical provisions in AMP's information systems security program. This failure left customer records and information unprotected for nearly ten months. As a result, a third party accessed AMP's information technology network and copied approximately 97,000 files, which included customers' records and personally identifiable information. The vulnerability in AMP's network went undetected by three successive quarterly network risk assessments. In fact, AMP did not learn about the breach of its systems until directly contacted by the third party, at which time it cooperated with the CFTC to remediate the issue. Because of its failure to supervise, the CFTC ordered AMP to pay a $100,000 civil monetary penalty, as well as provide written follow-up reports verifying AMP's ongoing efforts to maintain and strengthen the security of its network and its compliance with its security program requirements.[287]

In 2019, the CFTC settled charges with Philip Capital, Inc. (PCI), a registered Futures Commission Merchant, arising out of an incident in which cyber criminals hacked into PCI's email system, obtained customer information, and then fraudulently convinced an employee to wire $1 million in PCI's customer funds.[288] The settlement order found that PCI failed to diligently supervise its employees with regards to its cybersecurity policy, written IT systems security policy, and customer disbursements. Moreover, it failed to timely disclose the breach to customers. For these alleged lapses, PCI agreed to pay $1.5 million in monetary sanctions. These cases illustrate the CFTC's commitment to ensuring that regulated entities work diligently to protect the sensitive information entrusted to them.

<BB.BOOKMARK NAME=″_cp_change_256″>In November 2022, the CFTC announced that it was considering expanding requirements for clearing house notifications to the CFTC of cybersecurity incidents and clearing system malfunctions.[289] Such requirements were informed by approximately 120 recent reportable events, in addition to certain clearing houses who had not reported cybersecurity incidents and clearing system malfunctions as required.[290] CFTC Commissioner Christy Goldsmith Romero commented that these additional notifications will help address cybersecurity threats as they happen, rather than after the fact, ''when most of the damage has been done and when a useful, coordinated response may be too late.''[291]

H. Registration Violations

Another area of enforcement focus for the CFTC has been the failure to register properly with the Commission for certain trades or other actions. Recently, these violations have appeared often (but not always) to coincide with charges of fraud.[292] In July 2018, the Commission settled charges against an Estonian company and a Nevada company for their failure to register properly with the Commission, as well as for their fraudulent solicitation of United States customers to trade leveraged foreign currencies.[293] Respondents agreed to pay nearly $10.3 million in restitution to defrauded customers and civil monetary penalties totaling more than $760,000.[294] In February 2019, the Commission secured a default judgment 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, resulting in a civil mon-

to additional testing requirements.

[285] CFTC, Remarks of Chairman Timothy Massad Before the ABA Derivatives and Futures Law Committee, 2016 Winter Meeting (Jan. 22, 2016), https://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-37.

[286] CFTC, Statement of Commissioner J. Christopher Giancarlo Regarding System Safeguards Testing Requirements for Derivatives Clearing Organizations (Sept. 8, 2016), https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement121615a. When the rules were first proposed, Commissioner Giancarlo suggested that those who comply with 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.''

[287] Press Release, CFTC, CFTC Orders AMP Global Clearing LLC to Pay $100,000 for Supervision Failures Related to Cybersecurity of its Customers' Records and Information (Feb. 12, 2018), https://www.cftc.gov/PressRoom/PressReleases/pr7693-18. The CFTC charged AMP under Regulation 166.3, which requires that every CFTC registrant ''diligently supervise the handling [of confidential information] by its partners, officers, employees and agents,'' and Regulation 160.30, which requires registrants to ''adopt policies and procedures that address administrative, technical and physical safeguards for the protection of customer records and information.'' *CFTC Brings Cybersecurity Enforcement Action*, HUNTON ANDREWS KURTH: PRIVACY & INFO. SEC. L. BLOG (Feb. 14, 2018), https://www.huntonprivacyblog.com/2018/02/14/cftc-brings-cybersecurity-enforcement-action/.

[288] Press Release, CFTC, CFTC Orders Registrant to Pay $1.5 Million for Violations Related to Cyber Breach (Sept. 12, 2019), https://www.cftc.gov/PressRoom/PressReleases/8008-19.

[289] Public Remarks and Statements, Statement of Commissioner Christy Goldsmith Romero on Proposed Rule on Cybersecurity Incident Reporting (Nov. 10, 2022), https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement111022#_ftn9.

[290] *Id.*

[291] *Id.*

[292] *See* Paul M. Architzel & Dan M. Berkovitz, *CFTC Year in Review and a Look Forward*, HARVARD L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 4, 2017), https://corpgov.law.harvard.edu/2017/02/04/cftc-year-in-review-and-a-look-forward.

[293] Press Release, CFTC, Tallinex Ltd. Ordered to Pay nearly $10.3 Million in Restitution to Defrauded Customers and Defendants Ordered to Pay Civil Monetary Penalties Totaling More than $760,000 (July 19, 2018), https://www.cftc.gov/PressRoom/PressReleases/7757-18.

[294] *Id.*

etary penalty of $2.3 million.[295] In recent years, the Commission has brought numerous other cases involving both the failure to register and a fraudulent scheme.[296]

Although many of these actions have involved fraud of some kind, the Commission has also enforced its registration requirements without alleging fraudulent conduct. In February 2017, it found that Oden Capital Management acted as a Commodity Pool Operator without properly registering and improperly operated its pools pursuant to regulatory requirements.[297] For these violations, the Commission imposed a $100,000 civil monetary penalty and a five-year ban from engaging in activities requiring registration with the CFTC. A month later, it ordered a dairy and food ingredient company to pay a $150,000 civil monetary penalty for failing to register as a Futures Commission Merchant while accepting orders from milk suppliers for the purchase and sale of milk futures contracts.[298] In September 2018, the CFTC charged eight unregistered entities and eight unregistered individuals for illegally pedaling apps, websites, and social media to retail customers for trading in forex and binary options. Respondents were ordered to pay civil monetary penalties ranging from $75,000 to $150,000.[299]

2020 was a particularly active year for registration enforcement. The CFTC filed eight actions alleging off-exchange contracts or a failure to register.[300] Notably, the CFTC's first case policing COVID-19 pandemic-related fraud included a failure to register claim.[301] In July 2020, the CFTC filed a complaint against James Frederick Walsh in the Western District of Texas alleging that the defendant solicited funds from consumers by falsely marketing himself as a foreign currency trader on social media. According to the complaint, the defendant claimed that he could deliver higher forex returns due to the pandemic and his ''legal, inside information'' about the trajectory of forex markets. The CFTC also charged the defendant with failing to register as a commodity trading advisor—a fact emphasized throughout the complaint.[302] In June 2021, the court entered an order for default judgment against Walsh, ordering him to pay a civil monetary penalty of $55,726.[303]

Enforcing the registration requirements against unregistered trading platforms remains an important customer protection element of the Commission's enforcement program, given the possibility that unregistered entities might fail to provide their customers with protections that follow from adherence to the registration requirements.[304] To that end, The Commission brought twelve actions in 2022 for illegal off-exchange contracts or failure to register.[305] Among those actions, the CFTC charged five entities with operating as unregistered futures commission merchants.[306] Then-Acting Director of Enforcement Gretchen Lowe said in the Commission's press release accompanying the complaint: ''Today's actions reflect the CFTC's on-going efforts to enforce the registration requirements in the Commodity Exchange Act, which safeguard market participants and maintain market integrity.''[307]

I. Book and Recordkeeping Rules

CFTC Regulation 1.31 (Rule 1.31 or the Recordkeeping Rule) contains specific criteria applicable to all CFTC-registered entities and any other persons required under the CEA to maintain and produce firm records.[308] The Commission recently modernized Rule 1.31, which, prior to the CFTC's unanimous approval of proposed amendments in May 2017, was last updated in 1999 and contained many provisions that industry groups argued were outdated in light of innovative technological advances. Specifically, the old Rule 1.31 required that entities store paper and electronic records in their native form, and that electronic records were further preserved in ''write once, read-many'' (WORM) formats. Under the old rule, firms suffered foregoing the opportunity to use inventive storage systems, which were arguably key to stifling cybersecurity threats. Additionally, the former Rule 1.31 required that record keepers who use only electronic media to retain records hire third-party technical consultants to store and produce files to the CFTC upon request; this significantly burdened firms that used, or sought to use, their own in-house information technology departments.

Revised Rule 1.31 thus aims to tackle industry concerns and modernize compliance under the CFTC's record and book

[295] CFTC Secures Default Judgment Against Operators of Profit Management, FIN. FEEDS (Feb. 1, 2019), https://financefeeds.com/cftc-secures-default-judgment-operators-profit-management.

[296] *See, e.g.*, Press Release, CFTC, CFTC Charges 14 Entities for Failing to Register as FCMs or Falsely Claiming to be Registered (Sept. 29, 2021), https://www.cftc.gov/PressRoom/PressReleases/8434-21.

[297] Press Release, CFTC, CFTC Orders John B. Oden and His Company, Oden Capital Management, LLC, to Pay a $100,000 Penalty for Failure to Register with the CFTC and Failure to Comply with Certain Pool Operator Requirements (Feb. 9, 2017), https://www.cftc.gov/PressRoom/PressReleases/7530-17.

[298] Press Release, CFTC, Davisco Foods International, Inc. Ordered to Pay $150,000 Penalty for Acting as a Futures Commission Merchant without Registering with the CFTC (Mar. 27, 2017), https://www.cftc.gov/PressRoom/PressReleases/7539-17.

[299] Press Release, CFTC, CFTC Charges Multiple Forex and Binary Options Dealers with Registration Violations (Sept. 14, 2018), https://www.cftc.gov/PressRoom/PressReleases/7785-18.

[300] CFTC, FY 2020 DOE ANN. REP. 4, 8–9 (Dec. 2020), https://www.cftc.gov/PressRoom/PressReleases/8323-20.

[301] Press Release, CFTC, CFTC Charges Florida Man for Attempting to Fraudulently Profit From COVID-19 (July 8, 2020), https://www.cftc.gov/PressRoom/PressReleases/8195-20.

[302] *CFTC v. James Frederick Walsh*, No. 1:20-cv-00725 (W.D. Tex. July 7, 2020).

[303] Press Release, CFTC, CFTC Wins Its First Enforcement Action Targeting Misconduct Directly Tied to COVID-19 (June 3, 2021), https://www.cftc.gov/PressRoom/PressReleases/8393-21.

[304] Paul Architzel & Matt Beville, CFTC 2022 Enforcement and Regulatory Developments and a Look Forward, WILMER HALE (Feb. 2, 2023), https://www.wilmerhale.com/en/insights/client-alerts/20230202-cftc-2022-enforcement-and-regulatory-developments-and-a-look-forward.

[305] CFTC, Addendum A: FY 2022 Enforcement Actions (Oct. 20, 2022), https://www.cftc.gov/media/7861/DOE_ResultsFY22_AddendumA100722/download.

[306] *Id.*

[307] Press Release, CFTC, CFTC Charges Five Entities for Failing to Register as FCMs (Sept. 22, 2022), https://www.cftc.gov/PressRoom/PressReleases/8589-22.

[308] 17 C.F.R. 1.31 (2017).

keeping regime.[309] The Commission's revisions, effective since August 28, 2017, eliminate the native file and WORM format requirements, and now allow market participants to develop and use programs best tailored to their unique technical needs.[310] Also notable is the new Rule 1.31's elimination of the requirement that firms hire a technical consultant—this acknowledges that market insiders often cultivate in-house technical staff to monitor and comply with record keeping standards.[311] Another significant revision in Rule 1.31 is the amendment to retention periods for pre-trade swaps and forwards communications required under CFTC Rules 23.202(a)(1) and (b)(1)-(3). Under the old Rule 1.31, these records had to be maintained for the life of the transaction, plus five years; now, they need only be kept for five years from the date of creation.[312] Finally, the CFTC also amended Rule 1.31's definitions to encompass all relevant electronic data, and deleted the ''chain of custody'' elements governing electronic record keeping systems—although ''the practical requirement that records entities maintain a comprehensive audit trail for all electronic regulatory records'' still exists.[313]

The CFTC noted its belief that the new Rule 1.31 does not impose any new recordkeeping mandates on any records entities—nor does it overrule other record keeping methods that are acceptable under CFTC regulations.[314] This means that record entities are still permitted to use their current retention practices, even if these techniques are those technology sources contemplated by the old Rule 1.31, as long as they are practices allowed by the CEA, CFTC regulations, or existing Commission guidance.[315]

Under the new rules, the CFTC has continued to enforce its recordkeeping requirements, bringing eighteen actions against market participants for recordkeeping violations in FY 2022, fifteen of which also involved a failure to supervise charge.[316] Most notably, the CFTC conducted an investigative sweep against the swap dealer and FCM affiliates of eleven financial institutions for recordkeeping and communication failures related to external and internal employee communications via unapproved communication methods, such as personal texts or messaging applications.[317] The civil monetary penalties in the sweep ranged from $6 million to $100 million, with the most common penalty being $75 million.[318] In total, the firms paid over $710 million in civil monetary penalties.[319]

J. Administrative Proceedings

Prior to 2014, the Commission brought contested cases only in federal courts.[320] In a November 2014 speech, former Director of Enforcement 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.[321] Goelman said the move was necessary for the Commission to ''present a credible trial threat'' with its limited resources.[322] In explaining the need for a move to the administrative forum, Goelman cited the heavy costs of discovery and expert witnesses that can be imposed by ''scorched earth'' defense tactics in federal court.[323] At one point, because the CFTC had no administrative law judges of its own, it sought to ''borrow'' them from other agencies.[324]

By 2015, however, the CFTC had not litigated any cases in an administrative tribunal,[325] which Goelman blamed on the ''sturm und drang'' surrounding a similar move by the CFTC's sister regulator, the SEC.[326] Starting in 2013, the SEC drastically increased the number of cases it brought before administrative courts and even added two new administrative law judges to its staff.[327] Data showed that while the SEC used administrative proceedings for about 64 percent of enforcement actions in the years 2010 through 2012, that proportion jumped to over 80 percent in 2014 and 2015.[328] The results in these ''in-house'' courts were striking: the *Wall Street Journal* reported that in the 12 months from September 2013 to September 2014, the SEC had a 100 percent success rate before

[309] *See* Revised Rule 1.31, 82 Fed. Reg. at 24479-24480, 24485.

[310] *See* Proposed Revisions to Rule 1.31, 82 Fed. Reg. at 6358; *see also* Final Revisions to Rule 1.31, 82 Fed. Reg. at 24485.

[311] See Proposed Revisions to Rule 1.31, 82 Fed. Reg. at 6358.

[312] *See* Final Revisions at 82 Fed. Reg. at 24486.

[313] *See* Final Revisions to Rule 1.31, 82 Fed. Reg. at 24483.

[314] *See* Revised Rule 1.31, 82 Fed. Reg. at 24480.

[315] *Id.*

[316] CFTC, Addendum A: FY 2022 Enforcement Actions (Oct. 20, 2022), https://www.cftc.gov/media/7861/DOE_ResultsFY22_AddendumA100722/download.

[317] Press Release, CFTC, CFTC Orders 11 Financial Institutions to Pay Over $710 Million for Recordkeeping and Supervision Failures for Widespread Use of Unapproved Communication Methods, CFTC Press Release No. 8599-22 (Sept. 27, 2022), https://www.cftc.gov/PressRoom/PressReleases/8599-22.

[318] *Id.*

[319] *Id.*

[320] Sarah N. Lynch, *U.S. CFTC Enforcement Chief to Revive Use of In-House Courts*, REUTERS (Mar.12, 2015), https://www.reuters.com/article/cftc-enforcement-court/u-s-cftc-enforcement-chief-to-revive-use-of-in-house-courts-idUKL1N0WE1LD20150312.

[321] Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, N.Y. TIMES (Oct. 5, 2013), https://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html.

[322] Jean Eaglesham, *CFTC Turns Toward Administrative Judges*, WALL ST. J. (Nov. 9, 2014), https://tinyurl.com/mpwx4989.

[323] *Id.*

[324] *Id.*

[325] The CFTC had settled, but not fully litigated, cases, including the *Motazedi* insider trading case, administratively.

[326] Ed Beeson, *CFTC Enforcement Chief Bemoans Lack of In-House Judges*, LAW360 (Oct. 16, 2015), https://www.law360.com/articles/715444/cftc-enforcement-chief-bemoans-lack-of-in-house-judges.

[327] Sarah N. Lynch, *U.S. SEC Beefs Up Administrative Court to Meet Rising Demand*, REUTERS (June 30, 2014), https://www.reuters.com/article/sec-court-hires/u-s-sec-beefs-up-administrative-court-to-meet-rising-demand-idUSL2N0PB18H20140630.

[328] Sara Gilley, Heather Lazur & Alberto Vargas, *SEC Focus on Administrative Proceedings: Midyear Checkup*, LAW360 (May 27, 2015), https://www.law360.com/articles/659945/sec-focus-on-administrative-proceedings-midyear-checkup.

administrative judges and only 61 percent in federal court.[329] In March 2015, the SEC finally lost a proceeding before an administrative law judge, after winning 22 of the prior 23 cases.[330] However, as former Director of Enforcement Goelman noted, the SEC's shift to administrative proceedings had been the subject of much controversy and criticism. For instance, prominent federal judge Jed Rakoff of the Southern District of New York 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.[331] Moreover, recent court rulings have thrown the constitutionality of these proceedings into question. In *Bandimere v. SEC*, [332] for example, the Tenth Circuit held that the SEC's administrative law judges were ''inferior officers'' who must be appointed under the Appointments Clause of the Constitution. Because they were not appointed in accordance with that clause, the court deemed the proceeding unconstitutional and set aside the SEC's order imposing sanctions in that case. While the D.C. Circuit held that those same proceedings were constitutional in *Raymond J. Lucia Companies, Inc. v. SEC*, [333] upon rehearing en banc, the D.C. Circuit judges split evenly.[334]

In light of these rulings and the increased risk of bringing cases administratively, the SEC has lessened its use of administrative proceedings.[335] Additionally, the SEC adopted amendments to the Rules of Practice governing its in-house administrative courts on July 13, 2016.[336] According to the SEC, these amendments ''are intended to update the rules and introduce additional flexibility into administrative proceedings, while continuing to promote the fair and timely resolution of the proceedings.''[337] While commentators generally agree that these changes were a step in the right direction, they also agree that the amendments do not do enough to alleviate the due process and fairness concerns with the administrative process.[338]

Despite the SEC's efforts, the split among circuits and judges ushered the Supreme Court's guidance. On June 21, 2018, the Supreme Court resolved the controversy in *Lucia v. SEC*, ruling that the SEC's administrative law judges were ''inferior officers'' for purposes of the Constitution's Appointments Clause, and that the SEC had failed to properly appoint its administrative law judges.[339] After several years of filing contested proceedings administratively rather than in federal district court, this decision throws a wrench in the Enforcement Division's plans. While it remains unclear how the SEC will handle pending cases, it faces the prospect of retrying cases that were tried before improperly-appointed administrative law judges.

The impact of *Lucia* will continue to reverberate beyond the SEC and into the administrative state of other federal agencies. In April 2018, the CFTC attempted to address the potential effects of *Lucia* by issuing its own order ratifying the appointment of its Judgment Officer, and ordered reconsideration of all its pending cases.[340] However, the CFTC's order is not definitive proof of the Judgment Officer's status under the Appointments Clause, and throughout much of 2018, practitioners debated whether the continued appointment of a Judgement Officer squared with *Lucia*.[341] For now, it appears that those concerns have not born out; Kavita Kumar Puri continues to adjudicate cases as the CFTC's sole Administrative Judge.

K. Whistleblower Awards

The CFTC's Whistleblower Program was established in 2011 under the Dodd-Frank Act.[342] Under the Program, the CFTC pays monetary awards to eligible whistleblowers who voluntarily provide the CFTC with original information about CEA violations that leads the CFTC to bring a successful enforcement action resulting in monetary sanctions exceeding $1 million.[343] The CFTC can also pay awards based on monetary sanctions collected by other authorities in actions that are related to a successful CFTC action and are based on information provided by a CFTC whistleblower.[344] The total amount of an award for an eligible enforcement action is between 10 and 30 percent of the amount of monetary sanctions collected.[345]

The Whistleblower Program has recently seen significant advancement and growth. The number of tips received by the

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[329] Jean Eaglesham, *CFTC Turns Toward Administrative Judges*, WALL ST. J. (Nov. 9, 2014), https://tinyurl.com/mpwx4989.

[330] Mark Curriden, *Judge Rejects Most SEC Claims Against Dallas-Area Financial Execs*, DALLAS MORNING NEWS (Mar. 20, 2015), https://www.dallasnews.com/business/2015/03/21/judge-rejects-most-sec-claims-against-dallas-area-financial-execs

[331] Nate Raymond, *U.S. Judge Criticizes SEC Use of In-House Court for Fraud Cases*, REUTERS (Nov. 5, 2014), https://www.reuters.com/article/us-sec-fraud-rakoff/u-s-judge-criticizes-sec-use-of-in-house-court-for-fraud-cases-idUSKBN0IP2EG20141105.

[332] 844 F.3d 1168 (10th Cir. 2016).

[333] 832 F.3d 277 (D.C. Cir. 2016).

[334] Raymond J. Lucia Companies, Inc. v. SEC, 868 F.3d 1021 (D.C. Cir. 2017) (en banc).

[335] Kurt Wolfe, *The Case for Voluntary SEC Administrative Proceedings*, LAW360 (June 14, 2017), https://www.law360.com/articles/934735/the-case-for-voluntary-sec-administrative-proceedings.

[336] Press Release, SEC, SEC Adopts Amendments to Rules of Practice for Administrative Proceedings (July 13, 2016), https://www.sec.gov/news/pressrelease/2016-142.html.

[337] *Id.*

[338] Carmen Germaine, *SEC Faces Long Road Ahead on Admin Court Reforms*, LAW360 (July 13, 2016), https://www.law360.com/articles/816979/sec-faces-long-road-ahead-on-admin-court-reforms.

[339] Lucia v. SEC, 138 S. Ct. 2044 (2018).

[340] Ratification and Reconsideration Order, *In re: Pending Administrative Proceedings* (Apr. 9, 2018).

[341] *The Effects of the Supreme Court's Lucia v. SEC Decision across Administrative Agencies*, PAUL HASTINGS (2018), https://webstorage.paulhastings.com/Documents/Default%20Library/infrastructure-lucia-article-(final).pdf (discussing the CFTC's reappointment of the Judgment Officer and the options available to the CFTC regarding existing cases if she was found to be an officer for constitutional purposes).

[342] *See* Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub L. No. 111-203, tit. VII, § 748, 124 Stat. 1376, 1739 (July 21, 2010) (codified at 7 U.S.C. § 23); Whistleblower Incentives & Protection, 76 Fed. Reg. 53171 (Aug. 25, 2011).

[343] CFTC Whistleblower Program, *Program Overview*, WHISTLEBLOWER.GOV.

[344] *Id.* By law, the CFTC protects the confidentiality of whistleblowers and does not disclose information that might directly or indirectly reveal a whistleblower's identity. *Id.*

[345] *Id.* All whistleblower awards are paid from the CFTC Customer Protection Fund established by Congress and financed entirely through monetary sanctions paid to the CFTC by violators of the CEA. *Id.*

CFTC has increased almost every year since the whistleblower program's inception, including a 70 percent increase from fiscal year 2016 to fiscal year 2017, which the CFTC attributed at least in part to its ongoing outreach efforts aimed at educating stakeholders about the program.[346] In addition, in May 2017, the Commission unanimously approved amendments to the whistleblower rules that strengthen protections for whistleblowers who come forward, as well as enhance the process for reviewing whistleblower claims.[347] In fortifying whistleblower protections, the Commission hopes to increase both the quantity and quality of information available to it regarding potential misconduct in the markets.

Further, the Commission has incentivized whistleblowers to come forward through an increased bank of award money. Prior to 2018, the Commission had issued a total of four whistleblower awards.[348] In comparison, in 2018, the Commission issued five such awards, which totaled more than $75 million, including what was, at the time, the CFTC's largest-ever award of approximately $30 million, announced in July 2018.[349] The year 2022 resulted in an even higher number of whistleblower awards issued by the CFTC: 10 individuals received a total of more than $200 million, with one whistleblower receiving a record-breaking award of nearly $200 million—the largest single award in Dodd-Frank history.[350] The CFTC has also reported receiving a record 1,506 tips and complaints in 2022, representing a more than 50 percent increase over the year prior.[351] These trends—along with the CFTC's estimate that 30 to 40 percent of its cases originate from whistleblower tips—suggest that the CFTC will continue to rely upon, and even seek to expand, the Whistleblower Program as part of its effort to protect customers and promote market integrity.[352]

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[346] CFTC, 2017 ANN. REP. on the Whistleblower Program & Customer EDUC. Initiatives 4 (2017), https://www.whistleblower.gov/sites/whistleblower/files/Reports/wb_fy2017reporttocongress.pdf.

[347] *See* 17 C.F.R. § § 165.19–20 (2018). Under the amendments, the CFTC or the whistleblower may now bring an action against an employer for retaliation against a whistleblower. Employers are also prohibited from taking steps to impede a would-be whistleblower from communicating directly with CFTC staff about a possible violation of the CEA by using a confidentiality, pre-dispute arbitration, or a similar agreement. *See* Press Release, CFTC, CFTC Strengthens Anti-Retaliation Protections for Whistleblowers and Enhances the Award Claims Review Process (May 22, 2017), https://www.cftc.gov/PressRoom/PressReleases/7559-17.

[348] CFTC, 2018 DOE ANN. REP. 14 (2018), https://www.cftc.gov/sites/default/files/2018-11/ENFAnnualReport111418_0.pdf.

[349] *See id.*; *see also* Press Release, CFTC, CFTC Announces Its Largest Ever Whistleblower Award of Approximately $30 Million (July 12, 2018), https://www.cftc.gov/PressRoom/PressReleases/7753-18 (noting that then-Chairman Giancarlo hopes "that an award of this magnitude will incentivize whistleblowers to come forward with valuable information and provide notice to market participants that individuals are reporting quality information about violations of the [CEA]."). Previously, the highest award was approximately $10 million in March 2016. *Id.*

[350] CFTC, WHISTLEBLOWER PROGRAM & CUSTOMER EDUC. INITIATIVE: 2022 ANN. REP. 2 (Oct. 2022), https://www.whistleblower.gov/sites/whistleblower/files/2022-10/FY22%20Customer%20Protection%20Fund%20Annual%20Report%20to%20Congress.pdf.

[351] *Id*. at 5.

[352] *Commodity Futures Trading Commission 2019 Enforcement and Regulatory Developments and a Look Forward*, WILMER HALE (Feb. 3, 2020), https://www.wilmerhale.com/en/insights/client-alerts/20200203-cftc-2019-in-review.

Key Terms/ Glossary

There are certain concepts and terms that arise frequently in the context of commodities-related inquiries, and of which practitioners should be aware. These are discussed in detail below:[1]

Artificial Price: A futures price that has been affected by manipulation and is thus higher or lower than it would have been if it reflected the forces of supply and demand.

At-the-Market: An order to buy or sell a futures contract at whatever price is obtainable when the order reaches the trading facility.

At-the-Money: When an option's strike price is the same as the current trading price of the underlying commodity.

Basis Grade: The quality standard a deliverable commodity must meet under the terms of a futures contract.

Commodity Exchange Act: The 1936 body of law which, as amended, 7 U.S.C. § 1, et seq., provides for the federal regulation of commodity futures and options trading.

Cover: (1) Purchasing futures to offset a short position; (2) to have in hand the physical commodity when a short futures sale is made, or to acquire the commodity that might be deliverable on a short sale.

Delivery Instrument: A document used to effect delivery on a futures contract, such as a warehouse receipt or shipping certificate.

Designated Contract Market: A board of trade or exchange designated by the CFTC to trade futures or options under the CEA. A contract market can allow both institutional and retail participants and can list for trading futures contracts on any commodity, provided that each contract is not readily susceptible to manipulation.

Designated Self-Regulatory Organization: Self-regulatory organizations (i.e., the commodity exchanges and registered futures associations) must enforce minimum financial and reporting requirements for their members, among other responsibilities outlined in the CFTC's regulations. When a futures commission merchant (FCM) is a member of more than one SRO, the SROs may decide among themselves which of them will assume primary responsibility for these regulatory duties. Upon approval of the plan by the Commission, that SRO is appointed as the ''designated self-regulatory organization'' for the FCM.

Derivatives Transaction Execution Facility: CFTC-registered board of trade that is subject to fewer regulatory requirements than a contract market. To qualify as a DTEF, an exchange can trade only certain commodities (including excluded commodities and other commodities with very high levels of deliverable supply) and generally must exclude retail participants (retail participants may trade on DTEFs through futures commission merchants with adjusted net capital of at least $20 million or registered commodity trading advisors that direct trading for accounts containing total assets of at least $25 million).

[1] These definitions, and many more, may be found at the CFTC's online glossary.

Eligible Contract Participant: An entity, such as a financial institution, insurance company, or commodity pool, that is classified by the CEA as an eligible contract participant based upon its regulated status or amount of assets. This classification permits these persons to engage in transactions (such as trading on a derivatives transaction execution facility) not generally available to non-eligible contract participants, i.e., retail customers.

Expiry/Expiration Date: The date on which an option contract automatically expires; the last day an option may be exercised.

Ex-Pit: A futures transaction that does not occur on the trading floor.

Floor Broker: A person with exchange trading privileges who, in any pit, ring, post, or other place provided by an exchange for the meeting of persons similarly engaged, executes for another person any orders for the purchase or sale of any commodity for future delivery.

Floor Trader: A person with exchange trading privileges who executes his own trades by being personally present in the pit or ring for futures trading.

Futures Commission Merchant: Individuals, associations, partnerships, corporations, and trusts that solicit or accept orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any exchange and that accept payment from or extend credit to those whose orders are accepted.

Instrument: A tradable asset such as a commodity, security, or derivative, or an index or value that underlies a derivative or could underlie a derivative.

Intermediary: A person who acts on behalf of another person in connection with futures trading, such as a futures commission merchant, introducing broker, commodity pool operator, commodity trading advisor, or associated person.

In-The-Money: A term used to describe an option contract that has a positive value if exercised. A call with a strike price of $1100 on gold trading at $1150 is in-the-money by $50.

Large Trader: A person or entity who holds or controls a position in any one future or in any one option expiration series of a commodity on any one exchange equaling or exceeding the exchange or CFTC-specified reporting level – namely, a position size at or above which commodity traders or brokers who carry these accounts must make daily reports identifying the size of the position by commodity and delivery month, as well as whether the position is controlled by a commercial or non-commercial trader.

Margin: The amount of money or collateral deposited by a customer with his broker, by a broker with a clearing member, or by a clearing member with a clearing organization. Initial margin is the amount of margin required by the broker when a futures position is opened; Maintenance margin is an amount that must be maintained on deposit at all times. If the equity in a customer's account drops to or below the level of maintenance margin because of adverse price movement, the broker must issue a margin call to restore the customer's equity to the initial level. Exchanges specify levels of initial margin and maintenance margin for each futures contract, but futures commission merchants may require their customers to post margin at higher levels than those specified by the exchange.

Market Maker: A professional securities dealer or person with trading privileges on an exchange who has an obligation to buy when there is an excess of sell orders and to sell when there is an excess of buy orders. By maintaining an offering price sufficiently higher than their buying price, these firms

are compensated for the risk involved in allowing their inventory of securities to act as a buffer against temporary order imbalances. In the futures industry, this term is sometimes loosely used to refer to a floor trader or local who, in speculating for his own account, provides a market for commercial users of the market. Occasionally a futures exchange will compensate a person with exchange trading privileges to take on the obligations of a market maker to enhance liquidity in a newly-listed or lightly-traded futures contract.

Mark-to-Market: Part of the daily cash flow system used by U.S. futures exchanges to maintain a minimum level of margin equity for a given futures or option contract position by calculating the gain or loss in each contract position resulting from changes in the price of the futures or option contracts at the end of each trading session. These amounts are added or subtracted to each account balance.

Notice of Intent to Deliver: A notice that must be presented by the seller of a futures contract to the clearing organization prior to delivery. The clearing organization then assigns the notice and subsequent delivery instrument to a buyer.

Open Interest: The total number of futures contracts long or short in a delivery month or market that has been entered into and not yet liquidated by an offsetting transaction or fulfilled by delivery. Also called open contracts or open commitments.

Open Outcry: A method of public auction, common to most U.S. commodity exchanges during the 20th century, where trading occurs on a trading floor and traders may bid and offer simultaneously either for their own accounts or for the accounts of customers. Transactions may take place simultaneously at different places in the trading pit or ring. At most exchanges open outcry has been replaced or largely replaced by electronic trading platforms.

Out-Of-The-Money: A term used to describe an option that has no intrinsic value. For example, at expiry, a call with a strike price of $400 on gold trading at $390 is out-of-the-money by $10, and has no value because the option will not be exercised.

Over-the-Counter (OTC): The trading of commodities, contracts, or other instruments not listed on any exchange. OTC transactions can occur electronically or over the telephone.

Pit: A specially-constructed area on the trading floor of some exchanges where trading in a futures contract or option is conducted.

Position: An interest in the market, either long or short, in the form of one or more open contracts

Price Discovery: The process of determining the price level for a commodity through the interaction of buyers and sellers, based on supply and demand conditions.

Sample Grade: Usually the lowest quality of a commodity, too low to be acceptable for delivery in satisfaction of futures contracts.

Security: Generally, a transferable instrument representing an ownership interest in a corporation (equity security or stock) or the debt of a corporation, municipality, or sovereign. Other forms of debt such as mortgages can be converted into securities. Certain derivatives on securities (e.g., options on equity securities) are also considered securities for the purposes of the securities laws.

Self-Regulatory Organization: Exchanges and registered futures associations that enforce financial and sales practice requirements for their members.

Settlement: The act of fulfilling the delivery requirements of a futures contract.

Settlement Price: The daily price at which the clearing organization clears all trades and settles all accounts between clearing members of each contract month. Settlement prices are used to determine both margin calls and invoice prices for deliveries. The term also refers to a price established by the exchange to even up positions which may not be able to be liquidated in regular trading.

Shipping Certificate: A negotiable instrument used by several futures exchanges as the futures delivery instrument for several commodities (e.g., soybean meal, plywood, and white wheat). The shipping certificate is issued by exchange-approved facilities and represents a commitment by the facility to deliver the commodity to the holder of the certificate, under the terms specified therein. Unlike an issuer of a warehouse receipt, who has physical product in store, the issuer of a shipping certificate may honor its obligation from current production or through-put as well as from inventories.

Spot: Market of immediate delivery of and payment for the product.

Spot Commodity: (1) The actual commodity as distinguished from a futures contract; (2) sometimes used to refer to cash commodities available for immediate delivery.

Spot Month: The futures contract that matures and becomes deliverable during the present month.

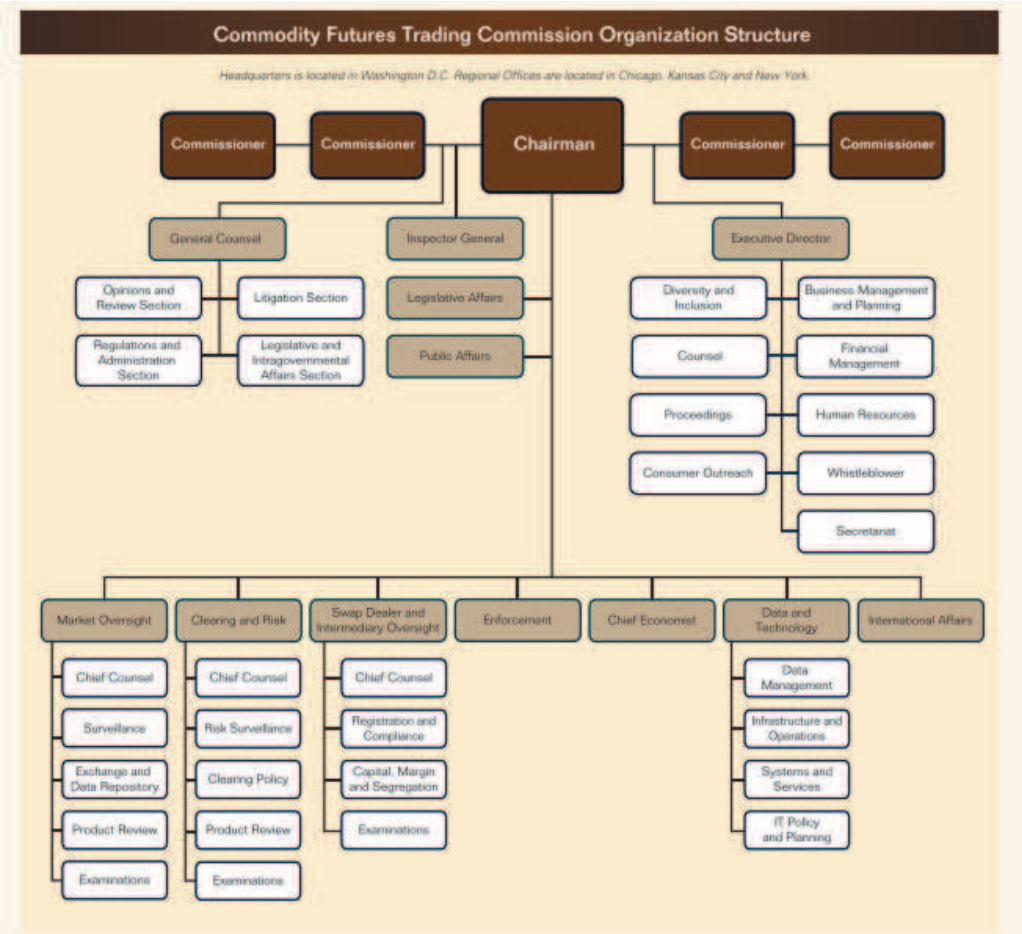
Spot Price: The price at which a physical commodity for immediate delivery is selling at a given time and place.

Strike Price (Exercise Price): The price, specified in the option contract, at which the underlying futures contract, security, or commodity will move from seller to buyer.

Warehouse Receipt: A document certifying possession of a commodity in a licensed warehouse that is recognized for delivery purposes by an exchange.

CFTC Organization Structure

Reproduced below is a chart of the organizational structure of the Commodity Futures Trading Commission (CFTC), excerpted from CFTC, ANNUAL PERFORMANCE REPORT: FISCAL YEAR 2012, at 5 (2013).



Sample Inquiry Letter from Chicago Mercantile Exchange (CME) to Large Financial Institution

RE: [redacted] xx-xxxx-xx FCM: xxx

On xx/xx, 2013, [redacted] sold the following [redacted] futures spread block:

Date	Sell Order #	Buy Firm	Sell Account	Product	QTY	Price	Reported Execution Time	Time Reported to GCC
xx/xx/13	[redacted]	[redacted]	[redacted]	[redacted]	January 1,788 February: 1,795	January: 0.6023 February: 0.6039	11:23 AM	11:32 AM

Please provide the following in electronic format:

- Any documents and/or correspondence (including but not limited to: back office tickets, phone tapes, email, and Bloomberg correspondence) having to do with the discussion, placement, and execution of the above block trade. For any phone tapes supplied, please identify all speakers by name, job title, and location. Please include timing information with any phone tapes, and what this timing is synched to (World Clock, Globex market, etc.).

- Who executed/negotiated the trade, from whom s/he received the orders, how s/he received the orders, and who was responsible for reporting the trade to the Exchange.

- Confirm the accuracy of the execution time (11:23 AM Central Time) of the block provided to the Exchange and indicate what information this confirmation is based on.

- Why the block trade listed above was not reported to the exchange within the requisite time frame.

The requested documents should be provided no later than xx/xx, 2013. They may be sent via email to the [redacted]@cmegroup.com.

For your information, Rule 432.L.3. provides that it is a general offense "to fail to produce any books or records requested by Exchange staff in connection with an investigation within 10 days after such request is made..." In addition, please be advised that a request for an extension of time will be considered only if it is in writing and received by the Department at least two business days before the due date and includes both an explanation of the basis for the extension and a proposed new due date.

If you have any questions concerning the contents of this letter, please do not hesitate to contact me at (xxx) xxx-xxxx.

Sincerely,

Senior Investigator

Sample Inquiry Letter from National Futures Association (NFA) Exchange to Member Firm

Subject: CBOE Futures (CFE) Compliance: EFP (Random Review)

Respondent,

On behalf of CBOE Futures Exchange ("CFE"), NFA conducts periodic random reviews of off-exchange activity. NFA has selected the following Exchange of Contract for Related Position ("EFP") transaction in the [redacted] contract executed on xx/xx, 2013 for further review. The EFP was executed by [redacted] and the buy side was given up to [redacted]. See the below details.

Trade Date	Type	Order ID	Commodity Code	Verb	Quantity	Price	Clearing Member Id	Firm ID	Account Id
xx/xx/13	EFP	[redacted]	[redacted]	B	10	16.01	[redacted]	[redacted]	[redacted]
xx/xx/13	EFP	[redacted]	[redacted]	S	10	16.01	[redacted]	[redacted]	[redacted]

Please submit the following requested information for the EFP transaction by **xx/xx/2013**:

1. The futures account statement(s) showing the confirmation of the CFE futures trade(s) for the ultimate holder(s) of the positions; also include the open position and/or purchase and sale sections of the account statements showing the trade positions. If the account numbers listed on the account statements do not *exactly* match the account numbers listed above please explain why.
2. Documentation supporting the correlating physical component or related contract of this EFP trade.
3. Identification of the ultimate owner(s) and controller(s) of the positions.
4. Documentation (Bloomberg chats, IM, e-mails) supporting when the transaction was agreed upon, when it was reported to the Exchange, as well as documentation supporting the agreed upon price, quantities, account(s) involved, contract(s).
5. Support demonstrating how the physical component (the Related Position) correlates with the futures position. The buy side appears to be related to a larger transaction, if the 10 lot buy is part of a larger transaction, please describe the transaction and detail the total quantity.
6. Any other related documentation that pertains to this trade or any records pertaining to back office transactional activity related to this trade. (e-mails, Bloomberg chats etc.)

Please note: If you cannot identify the end customer with the above positions, as the trade was in an omnibus account, please forward this request *immediately* to the contact person for the account and have the contact person for the account send the requested information to NFA. If you would like us to request documentation directly from them – then please send the contact information to me *immediately* so I may pursue this in a timely manner.

Thank you for your time and attention to this matter.
Kind Regards,

Senior Analyst, Market Regulation
National Futures Association

