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DEVELOPMENTS IN COMMODITIES LAW 2020 – AN UNCOMMON YEAR IN REVIEW

In this article, the authors review 2020 CFTC enforcement activities, including actions regarding spoofing, compliance functions, the Bank Secrecy Act, and insider trading. They then turn to developments in private litigation and trends to follow in 2021.

By Robert G. Houck, David Yeres, Benjamin Peacock, and Brendan Stuart *

2020 was a year marked by unprecedented global change caused by the COVID-19 pandemic and other geo-political events. The field of commodities regulation was no exception, as the ambitious enforcement agenda of the Commodity Futures Trading Commission ("CFTC") pushed the commodities laws into novel areas, while some courts drew tighter jurisdictional boundaries around the application of the Commodity Exchange Act (the "CEA"). In addition to continuing its focus on deceptive order spoofing, the CFTC gave closer scrutiny to corporate compliance functions, brought enforcement actions based on novel anti-money laundering and foreign corrupt practices theories, and increased its enforcement activities in the insider-trading space. As the CFTC opened new enforcement frontiers, courts in the Second Circuit policed the territorial boundaries of the commodities laws, applying a recent appellate decision to dismiss commodities class action claims as impermissibly extraterritorial. This article surveys these noteworthy developments from 2020, and identifies certain trends that may emerge in 2021, including post-pandemic enforcement priorities, potential "turf battles" between the CFTC and the Securities and Exchange Commission, and a potential circuit split regarding the extraterritorial limits of the CEA.

REVIEW OF 2020 CFTC ENFORCEMENT ACTIVITIES

2020 was a busy year for CFTC's Division of Enforcement (the "Division"). In its Fiscal Year 2020 Annual Report, the Division catalogues a record 113 enforcement actions.[1] Just under half of these actions, 56 in total, alleged retail fraud.[2] Of the remaining 57 actions brought in Fiscal Year 2020, 27 involved violations of obligations imposed upon registrants, including supervisory and record-keeping provisions and rules regarding customer funds. The remaining 30 were a mix: 16 alleged spoofing, and three of these spoofing matters also alleged manipulation or attempted manipulation;[3] just one matter alleged manipulation

[1] FY2020: Division of Enforcement Annual Report, COMMODITY FUTURES TRADING COMMISSION, https://www.cftc.gov/media/5321/DOE_FY2020_AnnualReport_120120/download.

[2] *Id*. at 4.

[3] *In re* JPMorgan Chase & Co., CFTC No. 20-69 (Sept. 29, 2020); *In re* Tower Research Capital LLC, CFTC No. 20-06 (Nov. 6,

* *ROBERT HOUCK is a partner, David Yeres is a senior counsel, and Benjamin Peacock and Brendan Stuart are associates in the New York City offices of Clifford Chance US LLP. Their e-mail addresses are robert.houck@cliffordchance.com, david.yeres@cliffordchance.com, benjamin.peacock@cliffordchance.com, and brendan.stuart@cliffordchance.com.*

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outside of the spoofing context;[4] nine involved registration failures or illegal off-exchange contracts;[5] one involved insider trading;[6] one involved wash trading;[7] one involved a violation of speculative position-limits for live cattle futures;[8] one involved provision of false information to CFTC, the National Futures Association, and a futures exchange;[9] and one was a statutory disqualification action.[10] Continuing a recent trend, the U.S. Department of Justice was also very active in policing the commodities and derivatives markets in FY2020, filing 16 actions in parallel with CFTC.[11]

The Division's 2020 activities highlight several important trends. First, the Division continues to focus heavily on spoofing, relative to other forms of market abuse. Second, the Division emphasized the importance of compliance functions in mitigating penalties, through the publication of guidance on civil monetary penalty determinations and on evaluation of corporate compliance programs, and through several enforcement actions in which large penalties were levied as a result of perceived compliance shortcomings. Third, the Division brought its first three actions related to U.S. anti-money laundering laws and the Bank Secrecy Act, and its first action under its foreign corrupt practices program (the creation of which had been announced the prior year). And finally, the Division instituted or settled three insider-trading actions, a larger number than in any previous year, suggesting that this previously sleepy area of CFTC enforcement could become more active going forward.

Continued Focus on Spoofing

The Dodd-Frank Act amended the CEA to prohibit explicitly certain trading practices on regulated exchanges that Congress deemed to be "disruptive," including conduct that "is, or is of the character of," spoofing, which is defined as entering a bid or offer with the contemporaneous "intent to cancel the bid or offer before execution."[12] Critically, the CFTC can punish spoofing without showing that the trader intended to (or did) move the market. Spoofing may therefore be easier for the authorities to prosecute than manipulation, which requires proof of the ability to create an artificial price and the existence of such a price.[13] Indeed, since the Division announced the creation of a spoofing task force in 2018, it has charged spoofing far more than any other manipulation or disruptive-trading offense, perhaps because spoofing may involve more readily identifiable trading patterns than do certain more complex forms of market abuse.

In fiscal year 2020, the CFTC announced "record-breaking" spoofing penalties on three separate occasions, each of which was accompanied by a parallel DOJ criminal resolution. First, in November 2019, the CFTC settled a matter with a proprietary trading firm based in Australia for a total of $67.4 million in disgorgement, restitution, and civil monetary penalties,

footnote continued from previous page…

2019); *In re* The Bank of Nova Scotia, CTFC No. 20-27 (Aug. 19, 2020).

[4] Complaint, *CTFC* v. *Rivoire*, (S.D.N.Y. 2019) (No. 19-cv-11701).

[5] Division of Enforcement Annual Report at 4.

[6] *In re* Marcus Schultz, CFTC No. 20-76, (Sept. 30, 2020). In addition to this matter, CFTC settled a longstanding insider-trading case against a futures exchange, and shortly after the end of its Fiscal Year 2020, on December 3, 2020, CFTC entered a settlement order with an energy company involving allegations of insider trading. Each of these matters is discussed in more detail below.

[7] *In re* Mehran Khorrami and Cayley Investment Management, LLC, CTFC No. 20-15, (May 7, 2020).

[8] *In re* Sukarne SA de CV, CTFC No. 20-60, (Sept. 18, 2020).

[9] *In re* The Bank of Nova Scotia, CTFC No. 20-27 (Aug. 19, 2020).

[10] *In re* Matter of Phy Cap. Inv. LLC, CFTC No. SD 20-01 (Aug. 31, 2010).

[11] FY2020: Division of Enforcement Annual Report, COMMODITY FUTURES TRADING COMMISSION, https://www.cftc.gov/media/5321/DOE_FY2020_AnnualReport_120120/download (last visited Mar. 3, 2021).

[12] 7 U.S.C. § 6c(a)(5)(C) (2014).

[13] Indiana Farm Bureau Coop. Ass'n Inc., Comm. Fut. L. Rep. (CCH) P21,796, 1983 WL 30249 (Dec. 17, 1982).

based on "thousands" of instances of spoofing in various stock-index futures between March 2012 and December 2013.[14] At the time, this was the largest monetary relief ever ordered in a spoofing action. The CFTC broke this spoofing penalty record in August 2020, when it settled a matter with a bank headquartered outside the United States for $127.4 million, based on "thousands" of instances of spoofing of precious metals futures contracts between 2008 and 2016.[15] The settlement comprised a $42 million civil monetary penalty for spoofing, a $17 million civil monetary penalty for false statements, a $50 million civil monetary penalty for compliance and supervision failures, and a combined $18.4 million in disgorgement and restitution.[16] Just one month later, the CFTC again broke its own record, announcing a $920 million settlement with a major bank based on allegations of "tens of thousands" of instances of spoofing in the precious metals and treasuries markets from 2008 through 2016.[17]

Among other things, the string of record-breaking penalties assessed in FY2020 underscores the Division's increased ability to review and process large amounts of trading data in connection with its investigations. The CFTC has conceded that the volume of data that it requested from the CME Group in connection with the investigation leading to its $920 million settlement was so massive that the CFTC did not yet even have the ability to store it, let alone to analyze it meaningfully, when it first sought the data in 2017.[18] The ability to collect, host, and analyze massive amounts of trading data marks a significant advancement in the CFTC's enforcement toolkit. Indeed, in 2013, the CFTC publicly announced that it was closing without charges an investigation, which it had begun in 2008, into potential misconduct in the silver futures market.[19] Seven years later, the CFTC would announce back-to-back, record-breaking spoofing penalties, based in part on spoofing of silver futures from 2008 to 2016.

The DOJ has similarly made spoofing an enforcement priority. The Market Integrity and Major Frauds Unit of DOJ's Criminal Division, Fraud Section has obtained multiple convictions of individuals for spoofing conduct, and has also entered into five corporate resolutions of spoofing matters in the prior two years, assessing total criminal fines of more than $1 billion.[20] The SEC has also prosecuted spoofing, though with far less frequency. The Exchange Act does not specifically prohibit spoofing, and the SEC has principally targeted spoofing in the securities markets under its existing anti-fraud and anti-manipulation authority found in Section 10(b) of the Exchange Act, SEC Rule 10b-5, and Section 17(a) of the Securities Act, which requires them to show that the conduct intentionally or recklessly: (1) artificially affected the price of a security, (2) sent a false pricing signal, or (3) deceived market participants about the natural interplay of supply and demand. The SEC also sometimes targets spoofing under Section 9(a)(2) of the Exchange Act, prohibiting transactions that either "creat[e] actual or apparent trading" or raise or lower the price of a security "for the purpose of inducing" others to buy or sell.

Increased Scrutiny of Compliance Functions

A pair of guidance documents propounded by the Division in 2020 suggest that the CFTC will seek to assess the adequacy of compliance functions in making its charging and penalty decisions. It is noteworthy that these documents were issued by the Division rather than another function within CFTC: While CFTC rules do impose some prescriptive compliance requirements, these are applicable only to CFTC registrants (such as futures commission merchants and swap dealers), who are primarily market intermediaries. "End users" of the commodities and derivatives markets are not as a general rule subject to prescriptive compliance requirements imposed by CFTC regulation. However, the Division's guidance makes clear that the presence of an effective compliance function will be a mitigating factor in charging decisions and penalty determinations — and that the absence of effective compliance will be an aggravating factor.

[14] *In re* Tower Research Capital LLC, CFTC No. 20-06 (Nov. 6, 2019).

[15] *In re* The Bank of Nova Scotia, CTFC No. 20-27 (Aug. 19, 2020).

[16] *Id.*

[17] *In re* JPMorgan Chase & Co., CFTC No. 20-69 (Sept. 29, 2020).

[18] Dave Michaels, *JPMorgan Probe Revived by Regulators' Data* Mining, THE WALL STREET JOURNAL (Oct. 5, 2020), https://www.wsj.com/articles/jpmorgan-probe-revived-by-regulators-data-mining-11601892000.

[19] Press Release, CFTC, CFTC Closes Investigation Concerning Silver Markets (Sept. 25, 2013), https://cftc.gov/PressRoom/PressReleases/6709-13.

[20] Fraud Section Year in Review – 2020, UNITED STATES DEPARTMENT OF JUSTICE, CRIMINAL DIVISION, FRAUD SECTION, at 34, https://www.justice.gov/criminal-fraud/file/1370171/download.

In May 2020, the Division for the first time published guidance for the assessment of civil monetary penalties.[21] This guidance instructs Division staff to consider: the gravity of the violation (including the nature and scope of the misconduct, any consequences, and the respondent's state of mind); any mitigating or aggravating circumstances; and "other considerations," including any relief in parallel actions by other authorities and penalties assessed in analogous cases. Notably, the Division's penalty guidance specifically lists the "[e]xistence and effectiveness of the company's pre-existing compliance program" as a mitigating (or aggravating) factor.

In September 2020, the Division elaborated on the compliance element of its penalty guidance, providing its staff with guidelines for evaluating corporate compliance programs in connection with charging decisions and penalty assessments.[22] In particular, this guidance instructs staff to consider whether a company's compliance program "was reasonably designed and implemented to achieve three goals, namely: (1) to prevent the underlying misconduct at issue; (2) to detect the misconduct; and (3) to remediate the misconduct." This includes consideration of what the company did to review and modify its compliance program after discovering any malfeasance, including mitigation where harm occurs and discipline for culpable individuals.

Although styled as principles-based, rather than strictly prescriptive, guidance, the September 2020 guidance nevertheless provides a checklist of items for the staff's consideration in evaluating corporate compliance programs.[23] For example, the guidance suggests that any consideration of a compliance program's effectiveness at prevention should assess policies and procedures, training, remediation of known deficiencies, adequacy of resources, and independence from the organization's business functions. The assessment of a program's ability to detect misconduct should include an analysis of internal surveillance and monitoring systems, internal reporting, and procedures for evaluating unusual or suspicious activity. And finally, the assessment of remediation should consider whether the program mitigates or otherwise addresses harmful impacts, disciplines responsible individuals, and addresses any compliance deficiencies that contributed to the misconduct or failure to detect it.

Two of the spoofing matters discussed above underscore the CFTC's increased focus on compliance programs. In its August 2020 spoofing resolution, the CFTC took the unusual step of issuing three separate orders instituting proceedings against one respondent, rather than folding all three into a single order. One of the orders dealt with spoofing, while the others dealt with compliance failures and false statements.[24] The compliance order faulted the respondent's compliance function for failure to supervise its swap-dealer business, which led to the provision of inadequate, mid-market marks over a long period, and a failure to maintain necessary records.[25] The false statements order similarly faulted the respondent's compliance function for passing along inaccurate information to the NFA, the CME, and the CFTC in connection with the spoofing investigation.[26]

The CFTC's September 2020 spoofing resolution similarly faulted the respondent's compliance function for failures to identify, investigate, and stop the spoofing conduct, specifically criticizing the respondent's surveillance system for lacking "the ability to effectively identify spoofing conduct" prior to 2014. That order also stated that the respondent failed to provide adequate supervision despite the rollout of an improved surveillance system and "numerous red flags," such as internal alerts and trader complaints, as well as CME and CFTC inquiries.[27] However, the CFTC also noted the respondent's significant subsequent cooperation and "extensive remedial measures" to prevent future misconduct.

In settling a parallel criminal investigation, the DOJ required the respondent in the September 2020 matter to

[21] Memorandum from the James M. McDonald, Director, Division of Enforcement, to Division of Enforcement Staff, Civil Monetary Penalty Guidance, (May 20, 2020), https://www.cftc.gov/media/3896/EnfPenaltyGuidance052020/download.

[22] Memorandum from James M. McDonald, Director, Division of Enforcement, to Division of Enforcement Staff (Sept. 10, 2020), https://www.cftc.gov/media/4626/EnfGuidanceEvaluatingComplianceePrograms091020/download.

[23] *Id.*

[24] *In re* The Bank of Nova Scotia, CTFC No. 20-27 (Aug. 19, 2020); *In re* The Bank of Nova Scotia, CTFC No. 20-28 (Aug. 19, 2020); *In re* The Bank of Nova Scotia, CTFC No. 20-26 (Aug. 19, 2020).

[25] *In re* The Bank of Nova Scotia, CTFC No. 20-26 (Aug. 19, 2020).

[26] *In re* The Bank of Nova Scotia, CTFC No. 20-28 (Aug. 19, 2020).

[27] *In re* JPMorgan Chase & Co., *et al*, CFTC No. 20-69 (Sept. 29, 2020).

agree to an exacting set of standards for its corporate compliance program, providing yet another indication of the authorities' increasing interest in this function.[28] Among other things, the respondent agreed to provide Board and senior management support to compliance, to promulgate "policies and procedures designed to reduce the prospect of violations of the Securities and Commodities Laws." The respondent further agreed to review and update its policies at least annually, and to conduct periodic risk assessments of its "compliance code, policies, and procedures regarding the Securities and Commodities Laws designed to evaluate and improve their effectiveness in preventing and detecting violations." Finally, the respondent agreed to ensure that its compliance program had adequate surveillance capabilities to detect any violations, as well as enforcement and disciplinary measures to address any violations.

Taken together, the CFTC's guidance documents and these resolutions suggest that the authorities will seek to exact higher penalties based on any perceived failures in compliance's ability to prevent, detect, and remediate misconduct.

The Division's First Actions Based on the Bank Secrecy Act and Foreign Corrupt Practices

In 2020, the Division brought its first three actions alleging violations of CFTC Regulation 42.2, which requires futures commission merchants and introducing brokers to implement effective policies and procedures to detect potentially criminal activities by customers. Among other things, Regulation 42.2 requires FCMs and IBs to implement "Know Your Customer" and anti-money laundering procedures, and to submit suspicious activity reports regarding any illegal customer activities to the Financial Crimes Enforcement Network in a timely fashion.

In the first such action, on August 10, 2020, the Division alleged that an FCM missed various red flags regarding trading by multiple customers, which should have caused the FCM to file SARs with FinCEN, as required by the Bank Secrecy Act and related regulations.[29] The red flags that the FCM allegedly overlooked included:

- a customer making deposits exceeding her stated net worth into a personal trading account, and repeatedly incurring losses amounting to a substantial percentage of her stated net worth (the customer was ultimately charged by the CFTC with operating an unregistered commodity pool through the account);

- a commodity trading adviser deducting fees equivalent to 25% per year of the value of the customer accounts it maintained at the FCM; and

- a customer incurring very large losses, equivalent to nearly the full amount he had deposited with the FCM, through a repeated practice of entering very large market orders on a futures exchange, which had the effect of eliminating all the liquidity in the order book and potentially causing aberrant prices in the futures contracts he was trading.[30]

The Division further alleged that the FCM failed to file SARs after receiving subpoenas and other requests concerning the above suspicious trading patterns and others from the Manhattan District Attorney, the CFTC, the CME Group, and the NFA.[31] To settle the allegations, the FCM agreed to a penalty of $11.5 million, disgorgement of more than $700,000, and the appointment of an outside consultant to advise on remediation and report progress to CFTC.[32]

On September 30, 2020, the CFTC settled a second matter based on alleged violations of CFTC Regulation 42.2, exacting a civil monetary penalty of $400,000 and disgorgement of $95,329.[33] In that matter, an IB allegedly learned that another broker firm, with whom the IB had an ongoing relationship, was engaged in unauthorized trading of customer accounts. The IB allegedly failed to file SARs after learning this information and continued to trade with the other broker firm. And on October 1, the next day, the CFTC filed a complaint against a digital asset exchange, alleging (among other things) that it had illegally failed to register as an FCM, and had failed to implement KYC

[28] Deferred Prosecution Agreement, *United States* v. *JPMorgan Chase & Co.*, (D. Conn.), https://www.justice.gov/opa/press-release/file/1320576/download.

[29] *In re* Interactive Brokers LLC, CFTC No. 20-25 (Aug. 10, 2020).

[30] *Id.* at 4–9.

[31] *Id.* at 8.

[32] Order, CFTC Docket No. 20-25, at 13.

[33] *In re* Matter of A&A Trading, Inc., CFTC No. 20-77, (Sept. 30, 2020).

and AML programs as required of FCMs by Regulation 42.2.[34]

In another novel exercise of its authority, in December 2020, the CFTC settled its first action arising from foreign corrupt practices, against a target who jointly resolved a parallel investigation by the DOJ.[35] The prior year, in March 2019, the Division issued an advisory on foreign corrupt practices, signaling its intent to bring enforcement actions in matters involving foreign corrupt practices that violate the CEA.[36] The effect of this advisory was not immediately clear, as the Foreign Corrupt Practices Act, which is enforced by the DOJ and the SEC, does not provide the CFTC with authority to pursue foreign bribery cases, nor does the CEA grant such authority. The CFTC's first foreign corrupt practices settlement therefore provides some helpful clarity. In that matter, the CFTC alleged that a multinational energy company committed fraud in connection with bribes that it allegedly paid to state-owned energy companies in Brazil, Ecuador, and Mexico. The order alleged two species of fraud. First, the order alleged insider trading (although without using that term), in particular, that the respondent received non-public information regarding a state-owned energy company's planned trades in exchange for bribes, and that it used this information to obtain better prices, to the detriment of the state-owned entity. And second, the respondent allegedly received preferential treatment and access to trades in exchange for bribe payments, to the detriment of the state-owned entities and other market participants. The respondent entered a deferred prosecution agreement and paid approximately $164 million to settle the DOJ's and CFTC's investigations.

Increasing Activity in Insider Trading

2020 saw the CFTC resolve three insider-trading matters, including the foreign corrupt practices settlement discussed above. In addition to that settlement, the CFTC also resolved a longstanding case against a futures exchange, and charged an energy trader with misappropriating his employer's information for his own benefit. This level of activity — which is modest relative to the SEC's insider-trading enforcement but more active than the CFTC has been in any prior year — may indicate that the CFTC will be more active in prosecuting insider trading going forward.

On August 3, 2020, the CFTC entered into a $4 million joint settlement with a futures exchange and two of its former employees.[37] The Division alleged that over a period of several years from 2008 to 2010, two exchange employees divulged to a commodities broker confidential information regarding the identities of parties and brokers involved in certain trades, the structures of certain transactions, and the trading strategies of certain market participants.[38] The broker was also a defendant in the case, but did not join the exchange and its two employees in settling.

This conduct was charged as a violation of Section 9(e)(1) of the CEA, which is a longstanding prohibition against insider trading that applies to certain registrants and their employees, and CFTC Regulation 1.59(d), an insider-trading rule applicable to self-regulatory organizations and their employees. While charged under CEA Section 9(e), which applies only to a relatively narrow swath of market participants, CFTC now has the authority to pursue insider-trading violations against anyone based on trading in U.S. commodities markets. This broadened authority was granted by the Dodd-Frank Act, which created a new anti-fraud provision, CEA Section 6(c), similar in language to the statute giving rise to securities insider trading, Section 10(b) of the Exchange Act. Following the DFA Amendments, CFTC finalized its new Rule 180.1, which is modeled after the language of SEC Rule 10b-5 and broadly prohibits "intentionally or recklessly" using or attempting to use any manipulative device, scheme, or artifice to defraud. Together, Section 6(c) and Rule 180.1 give the CFTC jurisdiction to pursue insider trading in the commodities markets analogous to the SEC's jurisdiction over securities insider trading. In other words, the CFTC can bring an insider-trading action against anyone who trades while in possession of material, non-public information that was obtained in

[34] Complaint, *CFTC* v. *HDR Global Trading Ltd.*, (S.D.N.Y. 2020) (No. 20 Civ. 08132), https://www.cftc.gov/media/4886/enfhdrglobaltradingcomplaint100120/download.

[35] *In re* Vitol Inc., CFTC No. 21-01 (Dec. 3, 2020); Deferred Prosecution Agreement, *United States* v. *Vitol Inc.*, (E.D.N.Y.), https://www.justice.gov/opa/press-release/file/1342896/download.

[36] CFTC, Enforcement Advisory: Advisory on Self Reporting and Cooperation for CEA Violations Involving Foreign Corrupt Practices (Mar. 6, 2019), https://www.cftc.gov/sites/default/files/2019-03/enfadvisoryselfreporting030619.pdf.

[37] *CFTC* v. *William Byrnes*, 13 Civ. 1174 (S.D.N.Y. Aug. 4, 2020).

[38] Amended Complaint for Injunctive and Other Equitable Relief and Civil Monetary Penalties under the Commodity Exchange Act at ¶ 1-9, *United States CFTC* v. *Byrnes*, 13 Civ. 1174 (S.D.N.Y.).

breach of a duty or through fraud or deception, as well as against anyone who knowingly provides such information to someone else with the expectation that that person will trade.

CFTC demonstrated this expanded authority (albeit not for the first time) in September 2020, when it settled an insider-trading case against a Houston-based natural gas trader.[39] In that matter, the trader, who also pleaded guilty to a criminal charge of conspiracy to commit wire fraud and violate the CEA, allegedly passed information about his employer's positions, including information about the price, volume, thresholds, and limits of pending trades, to a voice broker with whom the trader had a relationship. The trader also allegedly provided the voice broker with non-public information regarding his employer's proprietary views of the market. The trader allegedly provided this information with the expectation that he would receive a kickback of any profits generated by his sharing of this information. In settling with the CFTC, the trader paid over $1 million in penalties and disgorgement to CFTC and agreed to a six-year trading ban. He also pleaded guilty to conspiracy to commit wire fraud in a parallel criminal investigation.[40]

DEVELOPMENTS IN PRIVATE LITIGATION

In contrast to the busy year in enforcement, there were fewer developments in private litigation. Most importantly, 2020 saw the U.S. Court of Appeals for the Second Circuit's 2019 decision in *Prime International Trading* applied to dismiss CEA claims in two longstanding class actions, which allege manipulation of platinum and palladium prices in one case,[41] and of Japanese Yen LIBOR and Euroyen TIBOR in the other.[42] In August 2019, the Second Circuit, in *Prime International Trading* v. *BP p.l.c. et al*, applied the Supreme Court's reasoning in *Morrison* v. *National Australia Bank* to the anti-fraud and anti-manipulation provisions of the CEA. The *Morrison* court held that the securities laws do not apply extraterritorially, and thus, that any securities fraud action must be predicated on a domestic violation of the statute.[43] Applying this logic to the CEA, the Second Circuit in *Prime International* upheld a district court's dismissal as improperly extraterritorial of a class action alleging violations of the anti-fraud and anti-manipulation provisions of the CEA.[44] In doing so, the appellate court concluded, for the first time, that claims under the CEA must be premised on domestic misconduct.

The class action had been brought by individuals and entities who traded crude oil futures and derivatives contracts, including in the United States on NYMEX, against several entities involved in the production of Brent crude oil in Europe's North Sea.[45] Plaintiffs alleged that defendants had traded physical Brent crude in Europe in order to manipulate an important Brent crude benchmark, the Dated Brent Assessment, with the goal of benefitting their own physical Brent positions and related futures positions, including their futures positions on NYMEX.[46] The Dated Brent Assessment is factored into the price of futures contracts traded on ICE Europe, an exchange located outside the United States that lists the most actively traded Brent futures contract (where plaintiffs also claimed to have transacted).[47] The price of the futures contract on ICE Europe, in turn, is factored into the price of the Brent futures contract traded on NYMEX.[48] Plaintiffs alleged that defendants' manipulative trading of physical Brent crude in Europe harmed them by impacting the price of their NYMEX Brent futures.[49]

The court, following the Supreme Court's reasoning in *Morrison* v. *National Australia Bank*, as well as other appellate precedent, concluded, for the first time, that the anti-fraud and the anti-manipulation provisions of the CEA cited in plaintiffs' complaint (namely, CEA Sections 6(c)(1) and 9(a)(2)) do not apply extraterritorially.[50] On that basis, the court next considered whether the plaintiffs had alleged a domestic violation of the CEA. The court assumed for purposes of its analysis that plaintiffs' alleged trades on NYMEX and ICE Futures Europe constituted "domestic transactions." But the court nevertheless dismissed the

[39] *In re* Schultz, CFTC No. 20-76 (Sep. 30, 2020).

[40] *United States* v. *Schultz*, 20-CR-270 (S.D. Tex. July 20, 2020).

[41] *In re Platinum and Palladium Antitrust Litigation*, (S.D.N.Y. 2020) (No. 14 Civ. 939).

[42] *Laydon* v. *Mizuho*, (S.D.N.Y. 2020) (No. 12 Civ. 3419).

[43] 561 U.S. 247 (2010).

[44] *Prime Int'l Trading, Ltd.* v. *BP p.l.c.*, 937 F.3d 94 (2d Cir. 2019).

[45] *Id*. at 98–100.

[46] *Id*. at 100.

[47] *Id*. at 99.

[48] *Id*. at 100.

[49] *Id*.

[50] *Id.* (*citing Morrison*, 561 U.S. 247 (2010) *and Parkcentral*, 763 F.3d 198 (2d Cir. 2014)).

claims, because it concluded that a properly domestic application of the CEA requires plaintiffs to plead not only domestic transactions but also domestic misconduct, "*conduct* by defendants that is violative of a substantive provision of the CEA."[51] Although plaintiffs had alleged that their domestic purchases were harmed by defendants' allegedly manipulative trading in Europe, the court concluded that such "ripple effects" were insufficient to render the alleged violations domestic. Because defendants had allegedly acted outside the United States to manipulate the price of Brent crude cargoes that were also located outside the United States, plaintiffs' claims were "so predominantly foreign as to [be] impermissibly extraterritorial."[52]

Applying the *Prime International* court's reasoning, two district courts within the Second Circuit dismissed similarly extraterritorial claims in longstanding CEA class actions. First, in March 2020, a court in the Southern District of New York dismissed CEA claims based on alleged manipulation of platinum and palladium prices. As that court explained: "[T]he alleged unlawful conduct in this case is the manipulation of [fixing prices] that took place during [fixing calls] in London, not manipulation of particular transactions [in a U.S. domestic market.]"[53] And second, in August 2020, a court in the Eastern District of New York dismissed CEA claims based on alleged manipulation of Japanese Yen LIBOR and Euroyen TIBOR, explaining:

> [I]nstead of alleging any relevant conduct by Defendants in the United States, Plaintiff merely relies on the attenuated "ripple effects" theory the Circuit in *Prime International Trading* rejected as predominantly foreign. More specifically, Plaintiff claims that (1) the alleged manipulative Yen LIBOR submissions occurred abroad, which (2) affected the setting of Yen LIBOR determined abroad, which (3) was then disseminated by the BBA in London, which (4) essentially affected Euroyen TIBOR, which, in turn (5) impacted the trading prices of Euroyen TIBOR futures contracts traded on the CME.[54]

[51] *Id.* 105 (emphasis in original).

[52] *Id.* at 107 (internal quotations omitted).

[53] *In* re Platinum and Palladium Antitrust Litigation, (S.D.N.Y. 2020) (No. 14 Civ 939).

[54] *Laydon* v. *Mizuho*, (S.D.N.Y. 2020) (No. 12 Civ. 3419).

TRENDS TO FOLLOW IN 2021

2020 saw unprecedent changes in working conditions caused by the COVID-19 pandemic, with accompanying market disruptions, and a new presidential administration was inaugurated at the beginning of 2021. It is virtually assured that CFTC will continue to work closely with DOJ in 2021 and will continue to vigorously prosecute spoofing investigations. However, the uncertainty generated by the pandemic and by the new administration in tandem raise interesting questions about the direction of CFTC enforcement going forward, including how CFTC will respond to fallout from the pandemic and how it will resolve potential jurisdictional battles with the SEC. In addition, the Second Circuit's *Prime International* decision and subsequent decisions by district courts may come into conflict with other circuits, which may yet be further litigated in other circuits where the CFTC or private plaintiffs may advocate for a broader understanding of "domestic transactions" under the CEA.

Will Commodities Insider-Trading Actions Increase Due to the Pandemic?

CFTC moved quickly in early 2020 to adopt its regulatory scheme to changing market conditions, issuing 11 no-action letters intended to ease certain recording and recordkeeping obligations of registrants, which had been rendered impracticable by widespread work-from-home requirements.[55] However, these same work-from-home arrangements also made the job of compliance much harder. SEC Enforcement foresaw the potential for increased insider trading of securities and issued a statement highlighting that risk: "Given these unique circumstances, a greater number of people may have access to material nonpublic information than in less challenging times. . . . Trading in a company's

[55] Joshua B. Sterling, CTF No-Action Letter, CFTCLTR No. 20-02 (Mar. 17, 2020); Joshua B. Sterling, CTF No-Action Letter, CFTCLTR No. 20-03 (Mar. 17, 2020); Joshua B. Sterling, CTF No-Action Letter, CFTCLTR No. 20-024 (Mar. 17, 2020); Joshua B. Sterling, CTF No-Action Letter, CFTCLTR No. 20-05 (Mar. 17, 2020); Joshua B. Sterling, CTF No-Action Letter, CFTCLTR No. 20-06 (Mar. 17, 2020); Dorothy DeWitt, CTF No-Action Letter, CFTCLTR No. 20-07 (Mar. 17, 2020); Dorothy DeWitt, CTF No-Action Letter, CFTCLTR No. 20-08 (Mar. 17, 2020); Dorothy DeWitt, CTF No-Action Letter, CFTCLTR No. 20-09 (Mar. 17, 2020); Joshua B. Sterling, CTF No-Action Letter, CFTCLTR No. 20-11 (Mar. 20, 2020); Joshua B. Sterling, CTF No-Action Letter, CFTCLTR No. 20-12 (Mar. 31, 2020); M. Clark Hutchinson III, CTF No-Action Letter, CFTCLTR No. 20-13 (Apr. 14, 2020).

securities on the basis of inside information may violate the anti-fraud provisions of the federal securities laws."[56] Very little attention, however, has been paid to the increased risk of insider trading in the commodities markets. This disparity is understandable, given the relative paucity in commodities insider-trading actions.

However, the market disruption unleashed by the pandemic may have created a particularly acute risk of commodities insider trading, given that the potential for insider trading increases in troubled economic conditions. A recent study examining insider trading around the government's Troubled Asset Relief Program ("TARP"), enacted in the wake of the 2008 financial crisis, found "strong evidence of a relation between political connections and informed trading during the period in which TARP funds were disbursed."[57] As in the last financial crisis, the government's and Federal Reserve's COVID-19 stimulus efforts present greater opportunities for insider trading. Information about COVID-19 vaccines and treatments likewise present greater insider-trading opportunities.

Because the commodities insider-trading prohibition is relatively new and relatively unexamined, some businesses may have been caught flat-footed and failed to take effective steps to prevent it. For example, some businesses may not have adequate information barriers in place to prevent non-securities traders from accessing confidential government or scientific information, and may not adequately surveil the communications of non-securities traders for signs of improper information sharing. Will 2021 witness an increase of commodities insider-trading actions as a result?

How Will the CFTC and the SEC Resolve Potential "Turf Battles"?

With new leadership at both the CFTC and the SEC, there is an increased potential for "turf battles" as each regulator defines its new enforcement priorities. There are several areas in which the regulators may now find themselves overlapping, including in ongoing investigations into manipulation involving exchange-traded funds ("ETFs") and potential enforcement actions against digital-assets businesses.

Recent reports indicate that the CFTC is investigating potential manipulation of silver prices, including potential manipulation that may have occurred through the purchase of ETF shares.[58] Similarly, the CFTC is likely investigating potential manipulation in connection with the negative oil futures prices that were observed on April 20, 2020, and any such investigation may analyze potentially manipulative trading of crude oil ETFs.[59] The CFTC and SEC have separate — but potentially overlapping — jurisdiction in this area. Any trading of futures or swaps, as well as wholesale interstate trading of physical commodities, are subject to the anti-manipulation provisions of the CEA and would be subject to the CFTC's civil enforcement jurisdiction.[60] On the other hand, ETF share offerings which are registered under the U.S. securities laws are subject to the SEC's direct regulatory oversight and civil enforcement authority.[61] The CFTC's enforcement jurisdiction over trading of ETF shares would be less direct.[62] Although not without litigation risk, the CFTC could seek to exercise enforcement jurisdiction over potentially manipulative trading of ETFs based on the price impact that such trading would be expected to have on the prices of underlying commodities. Because shares of commodities ETFs effectively represent an interest in a physical commodity or commodity future that is held by the ETF sponsor, the sponsor must buy and sell physical commodities or futures as ETF shares are issued and redeemed, respectively, and this buying and selling would affect the price of physical commodities, as well as the price of futures and swaps.

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[56] Statement from Stephanie Avakian and Steven Peikin, Co-Directors, Division of Enforcement, U.S. Securities and Exchange Commission (Mar. 23, 2020).

[57] Alan D. Jagolinzer, *Political Connections and the Informativeness of Insider Trades*, 75 J Finance 1833, (2020).

[58] Dave Michaels, *GameStop Mania Is Focus of Federal Probes Into Possible Manipulation*, The WALL STREET JOURNAL (Feb. 11, 2021), https://www.wsj.com/articles/gamestop-mania-is-focus-of-federal-probes-into-possible-manipulation-11613066950.

[59] Ryan Dezember, *U.S. Oil Costs Less Than Zero After a Sharp Monday Selloff*, THE WALL STREET JOURNAL (Apr. 21, 2020), https://www.wsj.com/articles/why-oil-is-11-a-barrel-now-but-three-times-that-in-autumn-11587392745.

[60] The Commodity Exchange Act gives CFTC jurisdiction over the trading of "commodities," which is very broadly defined and includes any products (other than securities) for which futures contracts are currently traded — such as silver. 7 U.S.C. 1a (9).

[61] *See, e.g.*, 15 U.S.C. 78i, 78j, 78l.

[62] Silver ETFs are generally not structured as commodity pools for Commodity Exchange Act purposes, and the sponsors are generally not commodity pool operators or commodity trading advisors. As a result, silver ETFs are typically not subject to regulatory oversight by CFTC.

It remains to be seen whether the CFTC would aggressively seek to assert jurisdiction over potentially manipulative trading in commodities ETFs, and if so, how the SEC would react.

The CFTC and the SEC may similarly find themselves in conflict regarding actions against digital-assets businesses. In FY2020, CFTC brought a record seven actions against such businesses.[63] To date, the CFTC's actions in this space have largely focused on retail fraudsters, but they have brought a handful of actions against more established digital-assets businesses. And with the new presidential administration reportedly considering Professor Chris Brummer, an expert in digital-assets regulation, as the new Chairman of the CFTC, there is reason to suspect that CFTC's digital-assets enforcement will increase. The SEC has also been active in this area, but crucially, neither CFTC nor DOJ has provided concrete guidance on which digital assets constitute commodities and which constitute securities.

In 2018, the Director of the SEC's Corporate Finance Division gave a speech in which he suggested that many digital assets start out as securities, but may ultimately achieve a sufficient level of decentralizations that they no longer qualify as such.[64] The scope of CFTC jurisdiction over digital assets also remains unsettled, but in October 2019, the then-Chairman suggested that both Bitcoin and Ether would qualify as commodities subject to the CEA.[65] And in 2020, CFTC settled an enforcement action in which it asserted that Ether and Litecoin are both commodities subject to the CEA.[66] Both the Chairman's claim and the 2020 enforcement action seem to take overly expansive views of the CEA. Section 1a(9) of the CEA defines "commodity," in relevant part, to include "all services, rights, and interests [other than securities]. . . in which contracts for future delivery are presently or in the future dealt in."[67] Under a narrow reading of this definition, then, a digital asset would only become a commodity at such time as a futures contract for that asset began to trade on a U.S. futures exchange.[68] However, there are no Litecoin futures contracts traded on U.S. exchanges, and while there is an Ether futures contract traded on CME, it only began trading in February 2021. With the CFTC seemingly taking a broad view of its digital-assets jurisdiction, and the SEC having failed thus far to define its own jurisdiction with precision, it remains to be seen whether the regulators' jurisdictional assertions will conflict, and how any such conflict might be resolved.

Will Other Circuits Follow Prime International?

To date, no court outside the Second Circuit has applied *Prime International*'s reasoning to CEA claims. And the Supreme Court recently declined to consider *Prime International*, leaving the issue with the lower courts — for now.[69] However, the reasoning in *Prime International* follows the Second Circuit's reasoning in

[63] *CFTC* v. *Alan Friedland, et al.*, No. 6:20-cv-00652 (M.D. Fla. filed Apr. 16, 2020), https://www.cftc.gov/PressRoom/PressReleases/8148-20; *CFTC* v. *Dennis Jali, et al.*, No. 8:20-cv-02492-GJH (D. Md. Aug. 28, 2020), https://www.cftc.gov/PressRoom/PressReleases/8226-20; *CFTC* v. *Breonna Clark, et al.*, No. 1:20-cv-00382 (D. Colo. filed Feb. 14, 2020), https://www.cftc.gov/PressRoom/PressReleases/8118-20; *CFTC* v. *Daniel Fingerhut, et al.*, (S.D. Fla. filed May 5, 2020), https://www.cftc.gov/PressRoom/PressReleases/8162-20; *CFTC* v. *Q3 Holdings, LLC*, et al., 1:20-CV-01183 (S.D.N.Y. filed Feb. 11, 2020), https://www.cftc.gov/PressRoom/PressReleases/8115-20; *CFTC* v. *Global Trading Club*, No. 4:20-cv-03185 (S.D. Tex. filed Sept. 11, 2020), https://www.cftc.gov/PressRoom/PressReleases/8241-20; *CFTC* v. *PaxForex*, No. 4:20-cv03317 (S.D. Tex. filed Sept. 24, 2020), https://www.cftc.gov/PressRoom/PressReleases/8256-20.

[64] William Hinman, Dir., Division of Corporate Finance, Remarks at the Yahoo Finance All Markets Summit: Crypto. (June 14, 2018).

[65] Press Release, CFTC, Chairman Tarbert Comments on Cryptocurrency Regulation at Yahoo! Finance All Markets Summit (Oct. 10, 2019) https://www.cftc.gov/PressRoom/PressReleases/8051-19.

footnote continued from previous column…

[66] Complaint, *CFTC* v. *PaxForex*, No. 4:20-cv03317 (S.D. Tex. filed Sept. 24, 2020).

[67] 7 U.S.C. Section 1a (9) (2020).

[68] Alternatively, one might read the definition of "commodity" to capture anything for which a futures contract could, at some point, trade on a U.S. exchange, or to capture anything for which a futures contract trades anywhere in the world. Both of these definitions seem untenably broad, however. In theory, one could design a futures contract for just about anything, including the outcome of U.S. elections, but a court would be highly unlikely to agree on that basis that election speech is subject to the fraud and manipulation provisions of the CEA. And futures contracts on U.S. elections already trade on non-U.S. exchanges, suggesting that a definition capturing all products for which a futures contract currently trades globally would also cut too broadly.

[69] *Atlantic Trading USA, LLC,* v. *BP P.L.C.*, Dkt. No. 19-1141, Supreme Court (June 15, 2020).

Parkcentral Global Hub v. *Porsche Automobil Holdings*, a case applying the presumption against extraterritoriality to the securities laws. And the Ninth Circuit has expressly declined to follow *Parkcentral*'s reasoning in the securities context.[70] While the Second Circuit's reasoning in *Prime International* was thorough and persuasive, it remains to be seen whether that reasoning will be adopted by other circuits. And while the Supreme Court has declined to resolve the circuit split between the Second and Ninth Circuits regarding the securities laws, they may ultimately be persuaded to hear a case should that split extend to the securities and commodities laws.[71]

CONCLUSION

2020 was a year of unprecedented global conditions, and a year in which the CFTC opened new frontiers of enforcement even as certain courts in private cases seemingly contracted the reach of the CEA. 2021 will likely see the CFTC seeking to address fallout from the COVID-19 pandemic, and could also see potentially expansive views of CFTC jurisdiction bringing the CFTC into conflict with the SEC. 2021 will likely also see further litigation outside the Second Circuit concerning the application of the presumption against extraterritoriality to the CEA, which could result in a possible split among two or more circuits. ■

[70] *Stoyas* v. *Toshiba Corp.*, 896 F.3d 933 (9th Cir. 2018).

[71] *Toshiba Corp.* v. *Automotive Indus. Pension Trust Fund*, Dkt. No. 18-486, Supreme Court (June 24, 2019).