

CFTC Presses Its Case to Expand Conduct Punishable as Manipulation.¹

In a brief filed in New York federal court on July 13,² in support of an enforcement action, the U.S. Commodity Futures Trading Commission (“CFTC”) pressed again its controversial view that a trader can be guilty of attempted price manipulation without the specific intent to create an “artificial price.” Rather, the CFTC, contesting an industry *amicus curiae* brief that cited more than 30 years of contrary CFTC and judicial precedent, insists that proof of attempted price manipulation can be based upon a trader’s acts intended to simply *influence* price, regardless of the trader’s belief, or the reality, that his or her act was in furtherance of achieving a true value of the traded instrument.

Distinguishing unlawful price manipulation from legitimate market activity by the specific intent to create an artificial price represents a critical protection to traders whose bids, offers, and trades may be expected to move markets. This safeguard was clearly articulated by the CFTC in its early years when it dismissed charges of alleged price manipulation in its oft-cited 1982 *Indiana Farm Bureau* decision, in which the CFTC clearly stated that “it is not enough to prove simply that the accused intended to influence price.”³ The CFTC’s present arguments indicate that they are now backing away from that more measured view.

*CFTC v. Wilson and DRW Investments, LLC*⁴

The history of this case is helpful in understanding its significance. In November 2013, the CFTC brought a civil enforcement action in the Southern District of New York, charging that Donald R. Wilson Jr. and his proprietary trading firm, DRW Investments, LLC (collectively, “DRW”), attempted to and did manipulate an exchange-traded interest rate swap futures contract by placing bids to influence its settlement price. In seeking to dismiss the claims against it at the pleadings stage, DRW did not deny that its trading conduct was intended to influence price. Instead, they argued that they lacked the requisite intent because their bids were not intended to create *artificial* prices; rather, the bids were based on their “own calculations and beliefs about value,” and thus reflected a legitimate source of demand instead of an intent to manipulate. The court rejected DRW’s dismissal motions, holding that it was inappropriate at that early stage to rule on DRW’s factually-disputable argument that bids based on its

¹ For further information on this topic, please review *Freedom to Trade in the Age of Heightened Market Protection* (April 3, 2016), available at <https://corpgov.law.harvard.edu/2016/04/03/freedom-to-trade-in-the-age-of-heightened-market-protection/>.

² CFTC’s Response in Opposition to Brief of Amici, *U.S. Commodity Futures Trading Comm’n v. Donald R. Wilson, Jr. and DRW Invs., LLC*, No. 13-7884 (S.D.N.Y. June 13, 2016), ECF No. 137.

³ *In re Ind. Farm Bureau Coop. Ass’n, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) P 21, 796, 1982 WL 30249 (CFTC Dec. 17, 1982).

⁴ *U.S. Commodity Futures Trading Comm’n v. Donald R. Wilson, Jr. and DRW Invs., LLC*, No. 13-7884 (S.D.N.Y. filed Nov. 5, 2013).

subjective belief regarding the "true economic value" of the contract were not intended to manipulate price. In so doing, the court cited a short-hand version of the CFTC's traditional four-part manipulation test characterizing the requisite intent as the intent to "influence market prices."

In November 2015, after the conclusion of discovery, DRW sought summary judgment, including on the fact-specific argument that had been deemed premature at the pleadings stage: that no evidence in the record supported a reasonable inference that DRW "specifically intended to cause an artificial price." The CFTC not only opposed DRW's summary judgment motion, but also filed its own motion for partial summary judgment with respect to the attempted price manipulation. In so doing, the CFTC asserted that, under the law of the case, it need only prove that defendants: (i) intended to affect the price of the relevant contracts and (ii) took an overt act in furtherance of that intent. The CFTC maintained that both elements of this test were satisfied because DRW did not dispute that it "intentionally placed bids with the intent to affect price." In response, DRW argued that the CFTC's position on the requisite intent standard runs counter to decades of precedent requiring a specific intent to create artificial prices.

In June 2016, the district court accepted an amicus curiae brief filed by five key participants in the futures market, including futures exchanges, clearinghouses, and trade associations, expressing concern that under the CFTC's looser interpretation of the requisite intent, there may be no way "to ensure that innocent trading activity not be regarded with the advantage of hindsight as unlawful manipulation."⁵ That is precisely the concern that led the CFTC in *Indiana Farm Bureau* to require a showing of specific intent to create artificial prices. There, the CFTC recognized that a lesser standard could "wreak havoc with the market place" by blurring the line between lawful and unlawful activity, leaving traders without adequate guidance on what constitutes manipulation. The amici share those concerns. Because the CFTC now seeks to punish all attempted price influences, even ones that would result in more accurate prices, the amici fear that traders may "abstain from legitimate trading to avoid the risk of being branded an attempted manipulator."

In its July 13, 2016 response to the amici, the CFTC reiterated its interpretation of attempted price manipulation that does not require proof of an intent to create artificial prices. The CFTC argues that the amici conflated (1) "trading with the expectation that new prices could occur" (not manipulation); and (2) "trading with the specific intent to define new prices" (manipulation, according to the CFTC). However, the meaningfulness of this distinction appears questionable, since the concepts of expectation and intent are so closely linked that the law has historically permitted a jury to assume every person intends the expected consequences of his or her acts.

Unless and until the courts were to reject the CFTC's new stance on intent, market participants can reasonably expect CFTC to aggressively pursue a similar approach to completed manipulation as well, likely by relying on Commission and judicial precedent stating that the intent requirement is the same for both actual and attempted manipulation. Further, the risks voiced by the DRW amici may be substantially greater if the CFTC determines to bring price manipulation charges under its Rule 180.1, which prohibits manipulative and deceptive devices and schemes. The CFTC asserts that mere recklessness is adequate to establish the requisite scienter under that provision, which raises the possibility of CFTC bringing price manipulation charges against a trader for merely recklessly influencing prices or perhaps attempted manipulation based simply upon a reckless act which could have, but did not, actually influence price.

While it is by no means certain that the CFTC will ultimately prevail in its new view of what is required to establish manipulative intent, traders would be well advised to carefully consider it in connection with their policies, strategies, and controls.

⁵ Brief of The CME Group, Inc. et al. as Amici Curiae at 5-6, *U.S. Commodity Futures Trading Comm'n v. Donald R. Wilson, Jr. and DRW Invs., LLC*, No. 13-7884 (S.D.N.Y. June 16, 2016), ECF No. 133 (quoting *Indiana Farm*, 1928 WL 30249 at *6).

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