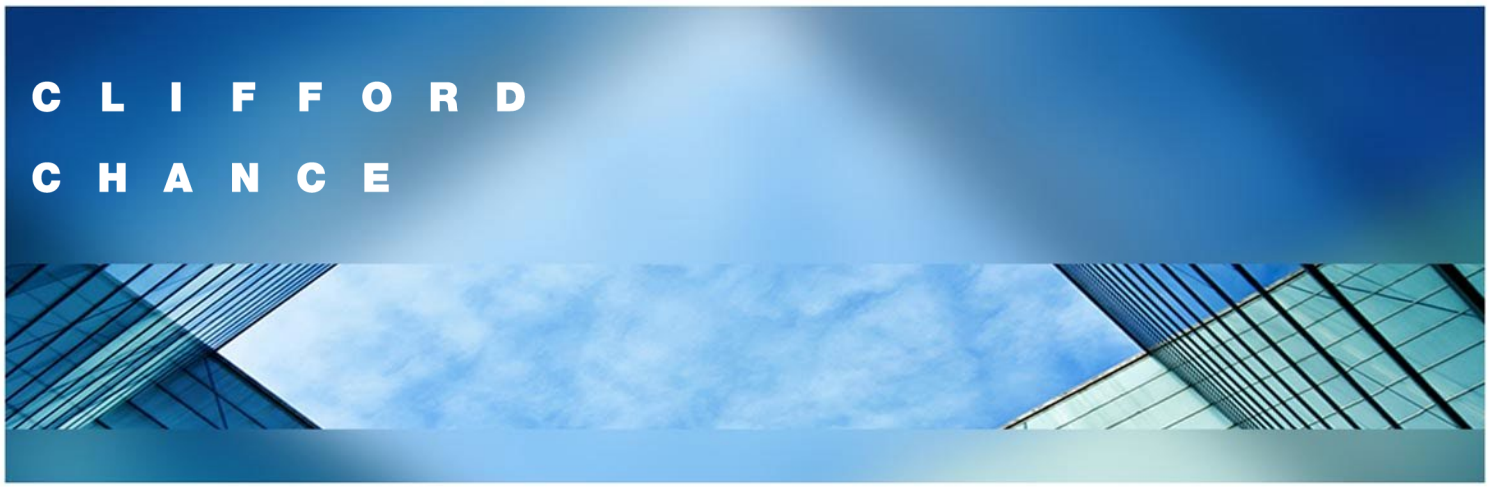

DEFENDING AGAINST U.S. TRADING-RELATED INVESTIGATIONS AND LITIGATIONS: THE SECOND CIRCUIT'S NARROWING VIEW OF THE CEA'S EXTRATERRITORIAL APPLICATION

On June 22, 2021, the Second Circuit Court of Appeals issued its latest ruling recognizing limits on the scope and reach of the Commodity Exchange Act. The Second Circuit had previously applied the Supreme Court's holding in *Morrison v. National Australia Bank* to the Commodity Exchange Act, holding that any application of that statute would be impermissibly extraterritorial unless predicated upon domestic "misconduct." And on June 22, the court clarified that, with respect to futures trading, even domestic misconduct would not suffice unless the futures contracts in question trades on, or subject to the rules of, a futures exchange registered with the U.S. Commodity Futures Trading Commission. The holding provides further suggestion that persons defending futures actions involving non-U.S. exchanges may be able to obtain early and efficient resolutions to their matters.

Choi v. Tower Research Capital LLC (Choi VI)[1] is the latest word from the Second Circuit concerning the application of the Commodity Exchange Act ("CEA") to non-U.S. activities. This ruling follows the Second Circuit's prior decision in *Prime International Trading, Ltd. v. B.P. P.L.C.* Our prior discussions of this case and the topic more broadly can be found here and here. In *Prime International Trading*, the Second Circuit applied a Supreme Court case*, Morrison v. National Australia Bank Ltd*., to conclude that the CEA did not apply "extraterritorially," with the exception of certain provisions regulating swaps.[2] In *Morrison*, the Supreme Court held that

1 2021 WL 2546166 (Jun. 22, 2021).

2 That provision, Section 2(i), explicitly provides for extraterritorial application where the conduct "(1) ha[s] a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the Commission may prescribe . . . to prevent the evasion of any provision of [the] Act." *Prime Int'l Trading Ltd. v. BP P.L.C.*, 937 F. 3d 94, 103 (2d Cir. 2019) (quoting 7 U.S.C.A. § 2(i)). The Second Circuit concluded that because Section 2(i) explicitly provided for extraterritorial application, Congress would have also explicitly

the Securities Exchange Act applied only domestically, because for a statute to apply extraterritorial it must contain an "affirmative intention of the Congress clearly expressed." The Supreme Court found no such "clear indication of extraterritoriality"[3] in the Securities Exchange Act. Likewise, the Second Circuit concluded in *Prime International* that the CEA did not reflect an affirmative intention of Congress to apply extraterritorially. The Court therefore concluded that neither the antifraud nor the antimanipulation provision of the CEA (specifically Sections 6(c)(1) and 9(a)(2)) applies extraterritorially.[4] Turning next to whether there was a domestic application pleaded in the complaint, the Court held that plaintiffs must allege "domestic—not extraterritorial—*conduct* by defendants that is violative of a substantive provision of the CEA" in order to successfully bring suit under the CEA.[5] Finding that the plaintiffs in *Prime International* had not alleged a domestic application of the CEA, the Second Circuit affirmed the district court's dismissal of those claims. In *Choi VI*, the Second Circuit recognized a further limitation to the reach of the CEA, holding that the CEA's antimanipulation provisions do not reach futures contracts traded on a non-U.S. exchange—even if traded through and matched by the Globex electronic-trading platform overseen by the U.S. based CME Group.

Interestingly, the *Choi VI* opinion suggests that even where the plaintiffs, the defendants, and the conduct occurs in the United States, there *still* may not be recourse under the CEA if the trades occurred on a foreign exchange.

Background

The Plaintiffs, all citizens of South Korea, traded the KOSPI 200 futures contract, which trades on the South Korea¬based Korea Exchange ("KRX") on an overnight market. Plaintiffs placed their orders via the Globex electronic trading platform, which is a platform created and serviced by the U.S.-based CME Group. While daytime orders for KOSPI 200 futures are matched to a counterparty by KRX in South Korea, overnight orders are matched to a counterparty by Globex's trade-matching engine in Aurora, Illinois.[6] After matching, the trades, regardless of whether they are placed during the daytime or overnight, are settled on the KRX.[7]

In 2012, Tower, a high frequency trading firm in New York, executed nearly 4,000,000 trades for KOSPI 200 futures during overnight hours.[8] Plaintiffs, who also traded KOSPI 200 futures, allege that the trades were manipulative "spoof" trades because Tower placed large buy or sell orders and then used its algorithmic and high-speed trading technology to cancel their orders or fill their own orders before other traders could match the orders.[9] Plaintiffs allege that Tower placed these orders in order to artificially increase or decrease prices, earning more than $14,000,000 in illicit profits.[10] After South Korean regulators referred Tower to South Korean prosecutors for potentially unlawful trading in the

provided for extraterritorial application elsewhere in the statute, such as in Sections 6(c)(1) and 9(a)(2), if it had so intended, but did not. Thus, the Second Circuit concluded that those sections of the CEA did not apply extraterritorially. *Id*.

3 Id. at 102. (quoting *Morrison v. Nat'l Australia Bank Ltd*., 561 U.S. 247, 255 (2010)).

4 *Id*.

5 *Id*. at 105 (emphasis in original).

6 *Choi v. Tower Research Capital LLC (Choi V)*, 2021 WL 2546166 at *1.

7 *Id*.

8 *Id*. at 2.

9 *Id*.

10 *Id*.

overnight market for KOSPI 200 futures, plaintiffs instigated a class-action complaint on behalf of themselves and others who were allegedly harmed by Tower's manipulative scheme.

The district court initially dismissed the complaint on the basis that Tower's conduct was not within the territorial reach of the CEA and instead occurred in South Korea under *Morrison v. National Australia Bank Ltd*.[11] After allowing the plaintiffs to amend the complaint, the district court held that the amended complaint still did not allege that CME Globex was a domestic exchange or that Tower's trades were domestic transactions, as required by *Morrison*.[12] The Second Circuit, applying *Morrison*, vacated that dismissal and remanded for further proceedings. The Court of Appeals held that is was plausibly alleged that parties who traded KOSPI 200 futures on the KRX overnight market could be liable under the CEA where their orders were matched through CME Globex as they were plausibly "domestic transactions" under *Morrison*.[13]

On remand, the defendants moved for summary judgment on the theory that their trading of KOSPI 200 futures was not "subject to the rules of any registered entity." The district court agreed and entered final judgment on plaintiffs' CEA claims.[14] Plaintiffs then appealed to the Second Circuit.

The Decision

The Second Circuit, looking at the text of the CEA, which provides,

> It shall be unlawful for any person . . . to use or employ, or attempt to use or employ, in connection with . . . a contract of sale for any commodity . . . for future delivery on or subject to the rules of any registered entity, a manipulative or deceptive device or contrivance. . . . [or] to manipulate or attempt to manipulate . . . any commodity . . . for future delivery on or subject to the rules of any registered entity.[15]

held that the CEA applies only to manipulation claims with respect to futures contracts traded "on or subject to the rules of any registered entity."[16] As a non-U.S. futures exchange, KRX is not a registered entity. Thus, as the plaintiff conceded, KOSPI 200 futures are not traded "on" a registered entity, and the sole issue before the court was whether overnight trading of KOSPI 200 futures is nonetheless "subject to" a registered entity's rules.[17] The Court looked first to the Chicago Mercantile Exchange ("CME") Rulebook, which provides that it applies only to futures that are created by and listed on the CME itself.[18] Finding that the KOSPI 200 futures were not created by or listed on the CME, the Court found this evidence "virtually conclusive."[19] Moreover, CME confirmed itself that it does not regulate the trading of KOSPI 200 futures, even where trades are matched by

---

11 *See Myun-Uk Choi v. Tower Rsch. Cap. LLC (Choi I)*, 165 F. Supp. 3d 42, 48-50 (S.D.N.Y. 2016) (citing *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247, 269-70 (2010)).
12 *Id*.
13 *Myun-Uk Choi v. Tower Rsch. Cap. LLC (Choi III)*, 890 F.3d 60, 63 (2d Cir. 2018).
14 *Myun-Uk Choi v. Tower Rsch. Cap. LLC (Choi VI)*, No. 14 Civ. 9912, 2020 WL 2317363, at *1-2 (S.D.N.Y. May 11, 2020).
15 7 U.S.C. § 9(1), (3).
16 *Choi VI*, at *4.
17 *Id*.
18 *Id*.
19 *Id*.

CME Globex.[20] Indeed, CME included with its Rulebook a list of all futures it regulates, and KOSPI 200 futures were not included on that list.[21]

Finally, the Court rejected the Plaintiffs' public policy arguments. Plaintiffs' argued that the district court's decision would create a "gigantic loophole" in which domestic transactions could evade enforcement under the CEA because they were not traded on a registered entity.[22] The Court was unpersuaded because it found that any other decision would contravene the narrow balance struck by Congress in the statute.[23] Finally, the Court noted that the trades were still subject to Korean jurisdiction, and that the Plaintiffs were not without protection from manipulative trades.[24]

In light of these holdings, the Court affirmed the district court's judgment. Prior cases have made clear that because the CEA covers a broader ambit of conduct than the securities laws, to prove a domestic violation, one must prove domestic misconduct. *Choi VI* represents an incremental further requirement imposed by the CEA – that it only applies to those futures sold on a registered entity. While it may have seemed from *Prime International* that the existence of domestic conduct was sufficient to allege a violation of the CEA, *Choi VI* makes clear that a plaintiff bringing a case under the CEA for misconduct related to futures must also have traded a futures product subject to a registered entity's rules.

20 *Id*.
21 *Id*. at 5.
22 *Id*. at 8.
23 *Id*.
24 *Id*.

CLIFFORD CHANCE

CONTACTS

David Yeres
Senior Counsel

T +1 212 878 8075
E david.yeres
@cliffordchance.com

Robert Houck
Partner

T +1 212 878 3224
E robert.houck
@cliffordchance.com

John Friel
Partner

T +1 212 878 3386
E john.friel
@cliffordchance.com

Benjamin Peacock
Associate

T +1 212 878 8051
E benjamin.peacock
@cliffordchance.com

E. Carlisle Overbey
Associate

T +1 212 878 8504
E carlisle.overbey
@cliffordchance.com

www.cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

Clifford Chance US LLP