Tracking The Expansion Of CFTC's Manipulation Rule

By **Daniel Waldman** (March 24, 2022)

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Rule 180.1 of the Commodity Futures Trading Commission, touted as an effort to address fraud-based manipulation, has transformed itself in recent years into a catch-all fraud provision, albeit with the higher sanctions attributable to manipulation claims.

Recently, the CFTC has used its authority under Rule 180.1 to go after trading on material nonpublic information;[1] misstatements to exchanges and futures commission merchants;[2] misappropriation of customer funds;[3] spoofing;[4] wash trading;[5] and even foreign corrupt practices.[6]

Perhaps most importantly, in a series of cases involving digital assets, the commission has used its new authority under Section 6(c)(1) of the Commodity Exchange Act and Rule 180.1 to extend the commission's traditional jurisdiction beyond futures, options and swaps to pursue acts of fraud in connection with the purchase or sale of any commodity in interstate commerce, including digital assets.[7]

These cases have prompted CFTC Commissioner Dawn Stump, in a series of concurring opinions,[8] to warn the public that notwithstanding the CFTC's new authority to pursue fraud, the commission does not regulate commodity trading more generally, only derivatives — i.e., futures, options and swaps — and that in many instances these markets, including the those for trading digital assets, remain unregulated.

The CFTC's use of Rule 180.1 to pursue commodities fraud beyond the futures or swaps markets has not been limited to cryptocurrencies. In December 2021, the commission brought charges related to futures trading in CFTC v. Easterday Ranches Inc.,[9] and also sued Easterday Ranches in the U.S. District Court for the Eastern District of Washington under Rule 180.1 for defrauding its counterparty in connection with cash cattle transactions.

In approving the settlement order with Easterday, Stump dissented in part. She wrote:

> The Commission has neither the capacity nor the expertise to become an "uber cop on the beat" to police all fraud in all cash transactions involving all commodities. It is essential, therefore, that the Commission exercise caution in applying the new anti-fraud authority over cash commodity transactions provided in the Dodd-Frank Act.[10]

As Stump has recognized, how the CFTC exercises its new fraud authority under Rule 180.1 beyond derivatives is an important policy question for the commission. This is all the more significant because Congress has defined the term "commodity" extremely broadly to cover virtually all goods, rights and services. The commission has clearly decided that it will pursue fraud aggressively in the cryptocurrency space.

This decision is driven, no doubt, by a perception of rampant fraud, lack of customer protection, significant involvement of retail investors and the reality that there are significant gaps in federal jurisdiction over this fast growing financial marketplace.

In addition to cryptocurrencies, we can also expect that the commission will pursue fraud claims involving other commodities when the fraud is inextricably linked to derivatives trading. But how far beyond cryptocurrencies and derivatives-related fraud will the CFTC take this new authority? Stump's concern about severely stretching the commission's limited resources is surely a reasonable one.

Despite these concerns, it is clear that Rule 180.1 has quickly become the most powerful weapon in the CFTC's arsenal. It is a multipurpose tool, like a Swiss Army knife, available to address a wide variety of intentional and reckless misconduct in the commodities and derivatives fields.

While legitimate questions can be raised as to the commission's bandwidth to handle the breadth of its new jurisdiction, the Division of Enforcement's recent emphasis on the use of Rule 180.1 to combat hardcore fraudulent activity, as opposed to more problematic theories of manipulation, is laudable.

It is hard to argue with the theory of liability advanced by the commission in virtually any of its recent Rule 180.1 cases. By contrast, as a rule designed to address manipulation, Rule 180.1 introduces unnecessary uncertainly and confusion.

The commission, in a transparent effort to make it easier to prove manipulation cases, used Rule 180.1 to eliminate the previous twin pillars of a manipulation claim: specific intent and artificial price.[11] The result was a manipulation rule that does violence to both a common sense and an economic understanding of what market manipulation is. But, even in the area of manipulation, it is important to ask: Notwithstanding the confusion that the new manipulation standard creates, is Rule 180.1 bad policy?

Let's start with the absence of the element of proof of an artificial price. The commission assumes that any injection of false information into the market alters the fundamentals of legitimate supply and demand, and is therefore manipulative.

While one could quibble with the assumption that every false statement creates an artificial price resulting in a successful market manipulation, the idea of injecting false information into the marketplace is surely behavior that should be discouraged and would almost certainly qualify as fraud, assuming that the statement was made with the requisite intent and was material.

More interesting is when the false information injected into the market is not a statement but a market order entered with the purpose and intent to manipulate. Is it fraudulent? Perhaps not in the traditional sense. Does it really matter? It is an attempted manipulation. In essence, by eliminating the requirement that the commission prove an artificial price, the commission in Rule 180.1 has simply converted attempted manipulation claims into manipulation claims. But, again, does it matter?

Attempted manipulation has always been a serious violation of the Commodity Exchange Act. And, if the truth be known, the CFTC's sanctions for manipulation have rarely sought to track or quantify the actual harm to the marketplace caused by the alleged manipulation. Moreover, in the private litigation context, the plaintiff should have to prove an artificial price in order to show actual damages to recover, even if the rule does not require it as an element of the claim.

But what about the specific intent requirement when there is no false statement, but only market orders and actual trades? In other words, what if the market participant enters

orders without a specific intent to manipulate? How can that be false information injected into the marketplace? Can that ever be manipulation? And if the commission is relying on the impact of large orders on the marketplace, shouldn't it have to prove that manipulative impact by showing artificiality?

To be fair, I think the commission recognizes that this is a problem. Indeed, in most, if not all the cases where the commission has brought enforcement actions against traders for reckless manipulation relying on market trading, there is strong evidence from its allegations that the commission believed that there was an actual intent to manipulate,[12] it just didn't want to have to prove it.

Of course there is another possibility. Rule 180.1, to the extent it covers reckless trading that moves market price, is not a manipulation provision at all. It is just another disruptive trading provision.

Section 4c(a) of the Commodity Exchange Act makes it unlawful for any person to engage in trading that demonstrates an intentional or reckless disregard for the orderly execution of transactions during the closing period of a market. It is one of several disruptive trading practices that Congress outlawed in the Dodd-Frank Act. Rule 180.1 would simply extend this provision to prohibit disruptive trading beyond the closing period.

It is well recognized that large trades, as well as certain messaging behavior, can disrupt market pricing under various circumstances. While one could quibble with whether this constitutes reckless manipulation, and also perhaps argue that additional standards need to be established around these concepts, it is certainly reasonable for the CFTC to have the authority to address disruptive trading in the marketplace.

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[1] See e.g CFTC v. Clark, Case No. 4: cv-00365 (S.D. Tex. 2022); In the Matter of Mathew Webb, CFTC Docket No. 21-09 (2021);and In the Matter of Marcus Schultz, CFTC Docket No. 20-76 (2020).

[2] See e.g CFTC v. Easterday, Case No 4:21-cv-5050 (E.D. Wash. 2021); and In the Matter of Aron Seidenfeld, CFTC Docket 19-51 (2019).

[3] See CFTC v. Uduakobong, (D. Mass. 9/30/2021) and CFTC v. Charles McAllister, Civ. Act. No. 1:18-cv-0346 (W. Tex 2018).

[4] See In the Matter of JPMorgan Chase, (CFTC Docket 20-69 2020).

[5] See In the Matter of Coinbase, (CFTC Docket No. 21-03 2021).

[6] In the Matter of Vitol, (CFTC Docket No. 21-01 2020).

[7] See e.g. In the Matter of J Squared Invest LLC, CFTC Docket 21-06 (2021); CFTC v. Saffron, Case No 2:19-cv-01697 (D. Nev. 2021); CFTC v. McAfee, Case No. 21-cv-1919 (S.D.N.Y 2021); CFTC v. Easterday Ranches, Inc., Case No 4:21-cv-5050 (E.D. Wash. 2021) (phantom cattle sales).

[8] CFTC v. Dwayne Golden, (E.D. N.Y. filed March 8,2022) (Concurring Statement of Commissioner Dawn D. Stump); In the Matter of Coinbase, (CFTC Docket No. 21-03 2021)(Concurring Statement of Commissioner Dawn D. Stump).

[9] CFTC v. Easterday Ranches, Inc., Case No 4:21-cv-5050 (E.D. Wash. 2021).

[10] Dissenting Statement of Commissioner Dawn D. Stump Regarding Settlement with Easterday Ranches, Inc. (December 17, 2021).

[11] As I have written before, see Daniel Waldman, Has the Law of Manipulation Lost Its Moorings, Law 360 (April 7, 2017).

[12] See e.g CFTC v. Kraft Foods Group , 153 F. Supp 3d 996 (N.D. Ill. 2015) or CFTC v. JPMorgan Chase Bank, CFTC Docket 14-01 Oct. 16, 2013).