

THE REVIEW OF
**SECURITIES & COMMODITIES
REGULATION**

AN ANALYSIS OF CURRENT LAWS AND REGULATIONS
AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 54 No. 12 June 16, 2021

INSIDER TRADING IN COMMODITIES MARKETS: AN EVOLVING ENFORCEMENT PRIORITY

The CFTC and the DOJ both now pursue enforcement actions against trading in commodities based on misappropriation of confidential information. The authors discuss the recent cases.

By Douglas K. Yatter, Sohom Datta, and Cameron J. Sinsheimer *

Among the many changes resulting from the Dodd-Frank Act, one that has been slow to develop, but broad in its significance, is the assertion of authority by the Commodity Futures Trading Commission (“CFTC”) to police insider trading and misappropriation of confidential information in commodities markets. As the primary regulator for derivatives across a wide range of markets, spanning agriculture, energy, interest rates, and beyond, the CFTC had limited authority to address insider trading throughout most of its history. Starting in 2015, however, the agency began bringing enforcement actions against individuals and companies for trading based on misappropriation of confidential information. Since then, the CFTC has brought a series of actions that provide insight into the scope of its new authority, and it has devoted substantial resources to pursuing new cases. Recent enforcement actions in 2020 and early 2021 have continued this trend.

This article reviews the evolution of the CFTC’s insider trading enforcement authority, summarizes the agency’s recent cases, and highlights key developments, including the advent of “tipper” liability, the use of data

analytics to identify potential misconduct, and the emergence of parallel criminal enforcement actions. Financial institutions and market participants should be aware that the CFTC — and now also the Department of Justice — will continue to be on the lookout for additional cases to pursue in this emerging area of enforcement.

LIMITED HISTORICAL AUTHORITY

Prior to the Dodd-Frank Act, the CFTC had limited authority to police the use of non-public information in its markets, as the Commodity Exchange Act (“CEA”) included provisions prohibiting insider trading only with respect to misuse of information by the CFTC’s own personnel and those of the exchanges and self-regulatory organizations it oversees.¹ The CFTC had no insider trading tool of general applicability to the markets.

¹ CEA § 9(d), 7 U.S.C. § 13(d) (2008) (regarding “any Commissioner of the Commission or any employee or agent thereof”); CEA § 9(e), 7 U.S.C. § 13(e) (2008) (regarding “an employee . . . of a board of trade, registered entity, or registered futures association”).

* DOUGLAS YATTER is a partner in the New York office of Latham & Watkins and Co-Chair of the firm’s Commodities and Derivatives Regulation and Enforcement Practice. SOHOM DATTA and CAMERON SINSHEIMER are associates in the firm’s New York office. Their e-mail addresses are douglas.yatter@lw.com, sohom.datta@lw.com, and cameron.sinsheimer@lw.com.

In this regard, oversight of commodities markets by the CFTC and oversight of securities markets by the Securities and Exchange Commission differed significantly. As the two agencies noted in a joint report in 2009, the “securities markets are concerned with capital formation,”² and “securities laws are premised on a corporation’s duties to disclose material information to protect shareholders from corporate insiders who have access to non-public information.”³ Securities laws and cases applying them have long prohibited insider trading by corporate insiders and by other individuals who trade on material non-public information in breach of a duty owed to the source of that information.⁴

By contrast, it has been a “primary purpose” of commodity derivatives markets to “facilitate the management and transfer of risk,” including by “permit[ting] hedgers to use their non-public material information to protect themselves against risks to their commodity positions,” which also enhances price discovery for all market participants.⁵ As a result, the CEA did not contain general prohibitions on insider trading, just the more limited provisions noted above.

BROAD NEW POWERS AFTER THE DODD-FRANK ACT

Following the financial crisis of 2008, Congress gave the CFTC broad new authority to regulate the vast swaps

market in addition to futures, as well as new enforcement powers to apply across its markets. This new authority led to two significant developments for insider trading enforcement in commodities.

First, in the more heralded provision at the time, the Dodd-Frank Act expanded the narrow existing prohibition on insider trading to apply not only to misuse of information by personnel of the CFTC, self-regulatory organizations, and exchanges, but also to misuse of information from any federal government source. This new provision targets government personnel who impart confidential government information “in [their] personal capacity and for personal gain with intent to assist another person, directly or indirectly, to use the information to enter into” trades, as well as persons who “knowingly use” such confidential information from a government employee that has been imparted in this manner.⁶ Colloquially known as the “Eddie Murphy Rule,”⁷ this provision expanded the CFTC’s enforcement authority to include a wider range of actors and potential sources of confidential information. In the years since its enactment, the CFTC has yet to base an enforcement action on this provision, but it remains an area of interest for future application and development.

Second, in the change that has had greater impact to date, Section 753 of the Dodd-Frank Act broadly

² *A Joint Report of the SEC and the CFTC on Harmonization of Regulation*, at 1 (Oct. 16, 2009), <https://www.cftc.gov/sites/default/files/stellent/groups/public/@otherif/documents/ifdocs/opaftc-secfinaljointreport101.pdf>.

³ *Id.* at 7.

⁴ *Id.* at 55.

⁵ *Id.* at 7. As former CFTC Chair Heath Tarbert recently observed, “[w]hile insider stock trades harm market integrity and can produce conflicts of interest for corporate officers, derivatives regulations permit — and actually encourage — what is commonly viewed as insider trading.” Heath Tarbert, *What Is Insider Trading In the Derivatives Markets?*, Law360 (Jan. 12, 2021), <https://www.law360.com/banking/articles/1343854>.

⁶ CEA § 4c(a)(4)(A), 7 U.S.C. § 6c(a)(4)(A).

⁷ When describing this prospective amendment to the CEA, then-CFTC Chair Gary Gensler told Congress, “[t]o protect our markets, we have recommended what we call the ‘Eddie Murphy’ rule to ban insider trading using non-public information misappropriated from a government source.” *Hearing to Review Implementation of Changes to the CEA Contained in the 2008 Farm Bill Before the Subcomm. on Gen. Farm Commodities & Farm Mgmt. of the H. Comm. on Agric.*, 111th Cong. 4 (2010) (statement of Hon. Gary Gensler, CFTC Chairman), <https://www.govinfo.gov/content/pkg/CHRG-111hhrg55459/html/CHRG-111hhrg55459.htm>. This provision filled a legal gap highlighted by the 1983 film *Trading Places*, which involved a scheme to misappropriate information from a governmental source that arguably would not have been covered by the CEA at the time.

prohibited fraud and manipulation “in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery.”⁸ On July 14, 2011, pursuant to this provision, the CFTC promulgated Rule 180.1, a “broad, catch-all provision, reaching any manipulative or deceptive device or contrivance” modeled after the SEC’s Rule 10b-5.⁹ In the years since adopting Rule 180.1, the CFTC has indeed used it as a broad tool in a variety of manipulation and fraud cases.

Of particular note for today’s era of insider trading enforcement, the CFTC regards Rule 180.1 to prohibit “trading on the basis of material non-public information in breach of a pre-existing duty (established by another law or rule, or agreement, understanding, or some other source), or by trading on the basis of material non-public information that was obtained through fraud or deception.”¹⁰ When the CFTC announced in 2011 that it would pursue enforcement against misappropriation of confidential information, the agency stated that it would be guided (though not bound) by the large body of case law on insider trading in securities under SEC Rule 10b-5.

The CFTC’s interpretation and use of Rule 180.1 focuses on the misappropriation theory of insider trading. Under this theory, which has long been applied in the securities markets, fraud occurs when “a person misappropriates confidential information for . . . trading purposes, in breach of a duty owed to the source of the information.”¹¹ Some commenters have criticized the CFTC for referring to such conduct in the commodities markets as “insider trading,” since these markets lack the traditional notion of “insiders” associated with securities. Like misappropriation cases under SEC Rule 10b-5, however, Rule 180.1’s applicability to so-called insider trading turns on the use of confidential information in breach of a pre-existing duty owed to the source of the information. Recent enforcement actions, as discussed below, cast light on the broad range of duties the CFTC considers when determining whether to pursue a charge based on misappropriation of confidential information.

EXPANSION OF CFTC RESOURCES TO DETECT AND DETER INSIDER TRADING

In 2018, to enhance its efforts to identify and take action against insider trading, the CFTC announced the formation of an Insider Trading and Information Protection Task Force. The CFTC described the Task Force as “a coordinated effort across the Division to identify and charge those who engage in insider trading or otherwise improperly use confidential information in connection with markets regulated by the CFTC.”¹² The Task Force has endeavored to “thoroughly investigate and, where appropriate, prosecute instances in which individuals have abused access to confidential information — for example, by misappropriating confidential information, improperly disclosing a client’s trading information, front-running, or using confidential information to unlawfully pre-arrange trades.”¹³ The Division of Enforcement has noted the ongoing importance of this effort, including in its FY2019 Annual Report, which emphasized that “[i]llegal use of confidential information can significantly undermine market integrity and harm customers in our markets.”¹⁴

As in other types of market misconduct, such as manipulative and disruptive trading, the CFTC has emphasized data analytics as an important tool to detect and investigate potential insider trading. With vast markets to oversee and a comparatively small staff, the CFTC has invested significant resources in market surveillance and data analysis tools. The agency has described this investment as “a multi-year project to enhance our ability to detect misconduct through the use of data analytics. As part of this effort, we have developed an ability to identify, in the trading data, forms of misconduct that we might otherwise have been unable to detect.”¹⁵ For insider trading enforcement, this effort may include processing large amounts of trading data to identify trades that appear to benefit from market-moving news or events, among other forms of quantitative analysis.

⁸ Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub. L. No. 111-203, § 753, 124 Stat. 1376, 1750 (2010).

⁹ Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,403 (July 14, 2011).

¹⁰ *Id.*

¹¹ *United States v. O’Hagan*, 521 U.S. 642, 652 (1997).

¹² CFTC Press Release, *CFTC Charges Block Trade Broker with Insider Trading* (Sept. 28, 2018), <https://cftc.gov/PressRoom/PressReleases/7811-18>.

¹³ *Id.*

¹⁴ CFTC, *FY2019 Division of Enforcement Annual Report*, at 11 (Nov. 25, 2019), <https://www.cftc.gov/PressRoom/PressReleases/8085-19> (follow “FY2019 Division of Enforcement Annual Report” hyperlink).

¹⁵ *Id.* at 13.

In December 2019, the Director of the Division of Enforcement at the time, Jamie McDonald, noted the significant role data analytics could play in insider trading enforcement: “[E]arly returns on our investments in data analytics have been positive,” and “[w]e expect the longer-term impact of our efforts to be even more substantial, as we continue to prioritize detecting and prosecuting misconduct that can undermine the integrity of our markets, like the various forms of insider trading prohibited in the derivatives and commodities markets.”¹⁶

In its own oversight function, the CME Group has also brought disciplinary actions involving trading in its markets based on misappropriation of confidential information, basing its actions on CME Rule 432, which generally prohibits fraud, bad faith, and conduct inconsistent with just and equitable principles of trade.¹⁷ Surveillance by the exchange is thus an important part of the evolving enforcement landscape for insider trading as well.

ENFORCEMENT ACTIONS SINCE THE DODD-FRANK ACT

Since 2011, the CFTC has taken a deliberative approach to identifying and pursuing cases involving misappropriation of confidential information, with just a handful of actions since its first such case in 2015. Slowly but surely, these cases have entrenched Rule 180.1’s application to insider trading in the commodities markets. This section provides an overview of the CFTC’s first few actions and the most recent developments, all of which show how the agency’s use of this authority may continue to evolve.

FOUNDATIONAL CASES

In the Matter of Motazedi

On December 2, 2015, the CFTC announced its first insider trading enforcement action based on misappropriation of confidential information under Rule 180.1.¹⁸ *In the Matter of Arya Motazedi* involved a

gasoline trader who, on 12 occasions, placed oil and gas futures trades for his personal account ahead of trades for his employer’s account. The CFTC found that Motazedi misappropriated the company’s confidential information regarding “times, amounts, and prices at which the company intended to trade energy commodity futures.”¹⁹ It further found that “Motazedi misappropriated and used his employer’s non-public, material trading information to orchestrate trades between his employer’s proprietary trading account and personal trading accounts, and to front-run his employer’s orders to benefit the personal trading accounts to the detriment of his employer.”²⁰ Without admitting or denying the charges, Motazedi settled with the CFTC and agreed to pay restitution of \$216,955 and a civil monetary penalty of \$100,000.²¹ He also received permanent trading and registration bans.²²

In the Matter of Ruggles

On September 29, 2016, the CFTC brought another insider trading enforcement action involving an employee trading oil and gas futures, *In the Matter of Jon P. Ruggles*.²³ Like Motazedi, the CFTC found that Ruggles used his knowledge of his employer’s trading strategies, which he was responsible for implementing, to enter trades in personal accounts that would be executed against his employer’s trades or the trades of other market participants, at prices beneficial to himself. The CFTC concluded that this conduct breached the individual’s duty to his employer not to misappropriate material non-public information. Ruggles settled with

footnote continued from previous column...

In re Motazedi, CFTC Dkt. No. 16-02 (Dec. 2, 2015) (“*Motazedi* CFTC Order”).

¹⁹ *Id.* at 3.

²⁰ *Id.* at 5.

²¹ All values are in US\$.

²² *Id.* at 10. In a parallel disciplinary action, the CME found Motazedi to have used personal accounts to round-turn or front-run the account he traded on behalf of his employer. The CME fined Motazedi \$100,000, required him to pay his employer \$216,955.80 in restitution, and suspended him from CME Group trading floors and electronic trading for five years. Notice of Disciplinary Action, NYMEX 14-9723-BC (Dec. 2, 2015).

²³ Order Instituting Proceedings Pursuant to Secs. 6(c) and 6(d) of the CEA, Making Findings and Imposing Remedial Sanctions, *In re Ruggles*, CFTC Dkt. No. 16-34 (Sept. 29, 2016) (“*Ruggles* CFTC Order”).

¹⁶ Matt Robinson & Benjamin Bain, *Wall Street Is Being Hunted by Futures Cops for Government Leaks*, Bloomberg, Dec. 12, 2019, <https://www.bloomberg.com/news/articles/2019-12-12/wall-street-is-being-hunted-by-futures-cops-for-government-leaks>.

¹⁷ CME Rulebook, *Chapter 4 Enforcement of Rules*, at 18, <https://www.cmegroup.com/content/dam/cmegroup/rulebook/CE/1/4/4.pdf>.

¹⁸ Order Instituting Proceedings Pursuant to Secs. 6(c) and 6(d) of the CEA, Making Findings and Imposing Remedial Sanctions,

the CFTC without admitting or denying the charges, agreeing to disgorge more than \$3.5 million in profits and pay \$1.75 million in penalties. He also received permanent trading and registration bans.²⁴

CFTC v. EOX Holdings LLC and Gizienski

On September 28, 2018, the CFTC filed its first federal court action involving allegations of insider trading under Rule 180.1, against an introducing broker and one of its employees.²⁵ The complaint in *CFTC v. EOX Holdings LLC et al.* alleged that the individual misused confidential trading information of certain customers to benefit a favored customer with whom he wanted to pursue business opportunities. In particular, the CFTC alleged that the individual (1) disclosed other customers' identities, trading activities, and positions to the favored customer to benefit the favored customer in his own trading and (2) breached a duty of confidentiality to the firm's customers that arose from various sources, including its written customer agreements, CFTC Regulation 155.4 (trading standards for introducing brokers), and futures exchange rules.

In the pending federal court action, the defendants initially filed a motion to dismiss, arguing among other points that the misappropriation theory of insider trading "applied only when an individual owes a *fiduciary* duty to the principal whose information was allegedly misappropriated."²⁶ On September 26, 2019, the district court rejected the defendants' position, ruling that misappropriation theory is not limited to fiduciary relationships, and that the CFTC's allegations of breach of a legal duty of trust and confidentiality were sufficient to satisfy the pleading standard.²⁷ The case has

proceeded into discovery and there are indications that settlement may be under discussion.²⁸

In addition to providing a court's view of the scope of the duties on which the CFTC may rely in pursuing misappropriation charges, *EOX* has demonstrated an important evolution in the types of situations that may lead to enforcement. In *Motazed* and *Ruggles*, the individual in possession of the confidential information was also the person alleged to have traded on the information. In contrast, *EOX* presents aspects of a "tipping" case, in which the individual who shared confidential information did so to benefit another person rather than simply trade for himself. In securities cases, insider trading often involves situations in which a person with inside information (the tipper) tips off another person who then trades on that information (the tippee).²⁹ With CFTC Rule 180.1 modeled on SEC Rule 10b-5, practitioners anticipated that the CFTC would pursue tipper-tippee cases in its markets, and *EOX* provided the first example.³⁰ Perhaps not coincidentally, it was in the press release announcing the *EOX* case that

footnote continued from previous column...

Mem. Op.") (declining to dismiss charge based on defendants' argument that "the duties of trust and confidentiality that plaintiff alleges the defendants owed to EOX customers 'by rule, by agreement, and by understanding,' are not fiduciary or fiduciary-type relationships") (citation omitted).

²⁸ See, e.g., Defs.' Mot. to Compel Disc., *CFTC v. EOX Holdings LLC*, No. 19-cv-02901 (S.D. Tex. June 30, 2020), ECF No. 103; Minute Entry, *CFTC v. EOX Holdings LLC*, No. 19-cv-02901 (S.D. Tex. Dec. 15, 2020) (noting settlement conference and ongoing negotiations).

²⁹ In securities cases, tipper liability generally requires that the tipper disclosed material non-public information in breach of a duty of trust and confidence owed to the source of the information for a personal benefit. *SEC v. Obus*, 693 F.3d 276, 288 (2d Cir. 2011); see also *Salman v. United States*, 137 S. Ct. 420, 428 (2016). Tippee liability requires that "(1) the tipper breached a duty by tipping confidential information; (2) the tippee knew or had reason to know that the tipper improperly obtained the information; and (3) the tippee, while in knowing possession of the material non-public information, used the information by trading or tipping for his own benefit." *Obus*, 693 F.3d at 289.

³⁰ As the court noted, the CFTC asserted claims against EOX and Gizienski for alleged violations of Regulation 180.1(a) "arising from multiple instances in which Gizienski allegedly traded on the basis of material, non-public information or tipped material." *EOX* Mem. Op. at 7.

²⁴ *Id.* at 10. In a parallel disciplinary action, the CME found Ruggles to have used his wife's accounts to trade opposite his employer, offset positions opposite his employer, or front-run his employer's orders. The CME fined Ruggles \$300,000, required him to disgorge profits of \$2,812,126.20 (with offsets for any amount paid in connection with his CFTC settlement), and banned him permanently from CME's trading floors and platforms. See Notice of Disciplinary Action, NYMEX 12-9153-BC-1 (June 13 2016).

²⁵ Complaint for Injunctive Relief, Civil Monetary Penalties, and Other Equitable Relief, *CFTC v. EOX Holdings LLC*, No. 18-cv-8890 (S.D.N.Y. Sept. 28, 2018), ECF No. 1.

²⁶ Defs.' Joint Mem. in Support of Mot. to Dismiss, at 12, *CFTC v. EOX Holdings LLC*, No. 18-cv-8890 (S.D.N.Y. Dec. 3, 2018), ECF No. 24.

²⁷ Mem. Op. & Order, at 28, *CFTC v. EOX Holdings LLC*, No. 19-cv-02901 (S.D. Tex. Sept. 26, 2019), ECF No. 74 ("*EOX*

the Division of Enforcement publicized the formation of its Task Force.

In the Matter of Classic Energy LLC and Webb

On September 30, 2019, the CFTC brought an enforcement action against a Houston-based brokerage firm and its president.³¹ The firm facilitated block trades between customers in natural gas futures. In its order, the CFTC stated that the individual defrauded customers by executing block trades between customers' accounts and a personal trading account, without disclosing to his customers that he was acting as counterparty. The CFTC stated that this activity knowingly or recklessly defrauded the customers by using material non-public information about their orders to trade against them, contrary to duties owed to the customers and in violation of Regulation 155.4.³² Without admitting or denying the charges, the respondents agreed to settle with the CFTC by disgorging \$413,065 in profits and paying \$1.5 million in penalties. The individual also received a two-year trading and registration ban. Like the few cases before it, *In the Matter of Classic Energy LLC and Mathew D. Webb* shows the CFTC will cast a wide net in identifying contractual, statutory, or regulatory duties as bases for misappropriation claims.

LATEST DEVELOPMENTS

Three additional settlements recently announced by the CFTC further reinforce the agency's interest in identifying and deterring misappropriation of confidential information. The latest matters also herald the arrival of criminal enforcement by the DOJ in this area.

Resolving Old Business

On August 4, 2020, the CFTC announced a consent order (the "Byrnes Consent Order") settling its long-running case against the New York Mercantile Exchange and two of the exchange's former employees, Byrnes and Curtin.³³ *CFTC v. Byrnes, et al.*, filed in

February 2013 based on conduct from 2008 to 2010,³⁴ involved charges under the CFTC's pre-Dodd-Frank authority for misuse of confidential information by exchange personnel.³⁵ On February 19, 2021, the CFTC announced a consent order (the "Eibschutz Consent Order") resolving its action against the last of the defendants in this case, a broker of energy futures and options.³⁶

As set forth in the consent orders (the facts of which the defendants neither admitted nor denied), Byrnes and Curtin on multiple occasions disclosed to Eibschutz certain "confidential information about derivatives trading activity that [they] obtained during the course of their employment" with the exchange.³⁷ These disclosures "pertained to trading activity in options on commodity futures, principally in the crude oil and natural gas markets," and included, "among other things, the identities of counterparties to specific options trades, whether a particular counterparty purchased or sold the option, whether it was a call or a put, the volume of contracts traded, the expiry, the strike price, and the trade price."³⁸ The consent orders stated that Byrnes and Curtin "knew or recklessly disregarded that they should not disclose the trade information" to Eibschutz and that "the information was both non-public and material."³⁹ The Eibschutz Consent Order stated that he "solicited and received from Byrnes and Curtin confidential information" and thereby "willfully aided and abetted Byrnes and Curtin's wrongful conduct."⁴⁰

³¹ Order Instituting Proceedings Pursuant to Secs. 6(c) and 6(d) of the CEA, Making Findings and Imposing Remedial Sanctions, *In re Classic Energy LLC*, CFTC Dkt. No. 19-50 (Sept. 30, 2019) ("Classic Energy CFTC Order").

³² *Id.* at 2.

³³ CFTC Press Release, *NYMEX and Two Former Employees to Pay \$4 Million for Disclosing Material Non-Public Information* (Aug. 4, 2020), <https://www.cftc.gov/PressRoom/PressReleases/8216-20>.

³⁴ Compl. for Inj. and Other Equitable Relief and Civil Monetary Penalties Under the CEA, *CFTC v. Byrnes*, No. 13-cv-1174 (S.D.N.Y. Feb. 21, 2013), ECF No. 1 ("Byrnes Compl."). On May 8, 2013, the CFTC amended this Complaint to add Eibschutz as a defendant, charging him with aiding and abetting the other defendants' conduct. Amended Compl. for Inj. and Other Equitable Relief and Civil Monetary Penalties Under the CEA, *CFTC v. Byrnes*, No. 13-cv-1174 (S.D.N.Y. May 8, 2013), ECF No. 19.

³⁵ *Byrnes* Compl. at 15; Amended *Byrnes* Compl. at 18-21 (setting forth allegations under CEA Section 9(e)(1) and Rule 1.59(d)).

³⁶ Eibschutz Consent Order, *CFTC v. Byrnes*, No. 13-cv-1174 (S.D.N.Y. Aug. 3, 2020), ECF No. 241.

³⁷ Eibschutz Consent Order at 6; Byrnes Consent Order, at 5, *CFTC v. Byrnes*, No. 13-cv-1174 (S.D.N.Y. Aug. 3, 2020), ECF No. 227.

³⁸ Byrnes Consent Order at 6; Eibschutz Consent Order at 6.

³⁹ *Id.*

⁴⁰ Eibschutz Consent Order at 6-7.

In *Byrnes*, the CFTC took a broad view of confidentiality duties underlying the alleged violation, relying on CFTC Rule 1.59(d) and also citing the exchange's Code of Conduct and Employee Handbook.⁴¹ *Byrnes* is also an example of the CFTC's efforts to hold an employer liable for the conduct of its employees, as it charged the exchange itself for *Byrnes* and Curtin's violations even though their actions violated the exchange's policies.⁴² The Eibschutz Consent Order also demonstrates that the CFTC will utilize other forms of liability, such as aiding and abetting, to hold others accountable too.

In the consent orders, the defendants agreed to pay a total of more than \$4 million in civil monetary penalties, and the three individuals were permanently barred from trading commodity interests or registering with the CFTC.⁴³

In announcing the *Byrnes* Consent Order, the CFTC's Director of Enforcement at the time, Mr. McDonald, noted that it "sends a strong message that the CFTC will work tirelessly to protect our market participants against unlawful disclosures of their confidential information to ensure that the fairness and reliability of our markets are not compromised," and that employers may be held "responsible for violations of the CEA or CFTC regulations by their officials, employees, and agents within the scope of their employment or office."⁴⁴ Thus, while the underlying conduct predated the expansion of the CFTC's authority to police its markets more broadly for insider trading, this case stands as a marker of the agency's ongoing commitment to use its authority aggressively to address this type of conduct.

Mapping a New Frontier

On September 30, 2020, the CFTC issued an order against Marcus Schultz, an energy trader, for misappropriating his employer's confidential trading information, among other charges.⁴⁵ Schultz gave his employer's block trade information to a broker, with whom he orchestrated a series of trades in which the broker, Schultz, and others traded with Schultz's employer at non-bona fide prices. According to the CFTC, the broker and other traders shared their trading profits with Schultz,⁴⁶ who defrauded his employer by "creating the false impression that he was executing trades at bona fide prices that were in [the company's] best interest, when in fact he was executing trades at pre-arranged bids and offers that were designed instead to enable [the scheme participants] to make a profit on offsetting trades with other market participants."⁴⁷

As in prior cases, the duty allegedly violated by Schultz's conduct flowed from his employment. The CFTC stated in the order that, as an employee of his company and under the employment agreements, policies, and procedures that governed his employment, Schultz owed his employer a duty to keep inside information confidential.⁴⁸ According to the order, Schultz's misappropriation of confidential information extended beyond the company's trading information to include information related to his employer's analysis of a United States Energy Information Administration Natural Gas Storage Report, a weekly report that measured natural gas held in underground storage.⁴⁹ The CFTC found that Schultz shared information about the report with another person, anticipating that the person would trade on the basis of the information, and that Schultz would receive a share of profits from this trading.⁵⁰

⁴¹ *Byrnes* Consent Order at 7; Eibschutz Consent Order at 7; see also *Byrnes* Compl. at 8, 17-18 Amended *Byrnes* Compl. at 8, 19. Regulation 1.59(d)(1)(ii) provides that "[n]o employee, governing board member, committee member, or consultant shall . . . [d]isclose for any purpose inconsistent with the performance of such person's official duties as an employee . . . any material, non-public information obtained through special access related to the performance of such duties." 17 C.F.R. § 1.59(d)(1)(ii).

⁴² *Byrnes* Consent Order at 7 (finding that *Byrnes* and Curtin "were acting as agents and employees" of the exchange and the exchange was liable as principal under CEA Section 2(a)(1)(B), 7 U.S.C. § 2(a)(1)(B), for acts of its agents).

⁴³ *Id.* at 8-9; Eibschutz Consent Order at 9.

⁴⁴ CFTC Press Release, *NYMEX and Two Former Employees to Pay \$4 Million*, *supra* note 34.

⁴⁵ Order Instituting Proceedings Pursuant to Secs. 6(c) and 6(d) of the CEA, Making Findings and Imposing Remedial Sanctions, *In re Schultz*, CFTC Dkt. No. 20-76 (Sept. 30, 2020) ("*Schultz* CFTC Order").

⁴⁶ CFTC Press Release, *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>.

⁴⁷ *Schultz* CFTC Order at 2.

⁴⁸ *Id.* at 7.

⁴⁹ *Id.* at 4.

⁵⁰ *Id.*

Although Schultz sometimes acted on the confidential information by trading personally, this case is also an example of the CFTC using Rule 180.1 against a tipper who shared information with others so they could trade on that information, with tipper and tippee sharing the benefits. Notably, the recipient of the misappropriated information in this case was a broker who facilitated trades and might otherwise have been regarded as an appropriate recipient of order information. But the CFTC found that Schultz disclosed the information to the broker “under the guise of seeking [the broker’s] assistance in locating a counterparty” for his employer’s order, when instead he was doing so to enable the broker and others to trade at non-bona fide prices against the company rather than to maximize the company’s profit.⁵¹ The CFTC found that Schultz concealed the true nature of these trades from his employer by documenting them as ordinary trades, continuing to incur brokerage commissions, and concealing the source of payments he received from the group’s profits. The CFTC also found that Schultz made false statements to regulators “concerning his knowledge of and authorization for brokers to take the other side of his orders through an account they owned or controlled,” falsely denying that he had “given permission to [the broker] to take the other side of his orders as part of their fraudulent scheme.”⁵²

In the CFTC settlement, Schultz agreed to disgorge \$427,067.45 and pay a civil monetary penalty of \$669,750.⁵³ The order also barred Schultz from trading or seeking registration for a period of six years.

Importantly, Schultz’s conduct was also the subject of a criminal case brought by the DOJ, marking the first instance of parallel criminal enforcement in a matter involving the misappropriation theory of insider trading in the commodities markets.⁵⁴ In the criminal case, filed in federal court in Houston, the government alleged that Schultz engaged with others in a conspiracy to violate the CEA and Rule 180.1 to “enrich themselves from the profits derived from fraudulent and unlawful trading practices, and misappropriation of material, non-public information.”⁵⁵ Schultz pleaded guilty to conspiracy

pursuant to a sealed plea agreement, with sentencing currently scheduled for June 2021.⁵⁶

On February 1, 2021, the DOJ announced that a second energy trader, John Ed James, one of the recipients of the information divulged by Schultz, also pleaded guilty to conspiracy to commit commodities fraud and wire fraud pursuant to a plea agreement. Largely tracking the charges against Schultz, the DOJ accused James of misappropriating confidential information and entering into non-competitive trades to fill Schultz’s orders and offsetting transactions in the market at a profit for personal gain.⁵⁷ His sentencing is currently scheduled for April 2021.⁵⁸

As the DOJ has noted, this pair of actions marks its “first effort to prosecute insider trading in the commodity markets under Section 180.1.”⁵⁹ This matter is also the latest example of the close collaboration between the CFTC’s Division of Enforcement and the Fraud Section of the DOJ’s Criminal Division. The agencies’ cooperative enforcement efforts now extend beyond matters involving disruptive trading and market manipulation to include trading based on misappropriation of confidential information, among other areas. As the DOJ noted in its recent report on the Fraud Section’s activities in 2020, its prosecutors now “focus on identifying and prosecuting complex fraud, price manipulation, and insider trading cases involving core U.S. commodities markets and closely related

⁵¹ *Id.* at 3-4.

⁵² *Id.* at 5.

⁵³ *Id.* at 10-11.

⁵⁴ Compl., *United States v. Schultz*, No. 20-cr-270 (S.D. Tex. June 29, 2020), ECF No. 1.

⁵⁵ *Id.* at 7.

⁵⁶ *United States v. Schultz*, No. 20-cr-270 (S.D. Tex. July 20, 2020), ECF Nos. 19, 27.

⁵⁷ Compl. at 7, *United States v. James*, No. 20-cr-695 (S.D. Tex. Dec. 28, 2020), EFC No. 1 (charging James with conspiracy to commit commodities fraud in violation of 18 U.S.C. § 1348 and wire fraud in violation of 18 U.S.C. § 1343); Plea Agreement at 8, *United States v. James*, No. 20-cr-695 (S.D. Tex. Feb. 1, 2021), ECF No. 20. James also admitted that he and others agreed to falsely document certain proceeds as income on IRS forms in part to conceal the true nature of the funds and to make the illicit profits appear to be legitimate income. *James* Compl. at 7.

⁵⁸ Order, *United States v. James*, No. 20-cr-695 (S.D. Tex. Feb. 1, 2021), ECF No. 21.

⁵⁹ U.S. Dep’t of Justice Press Release, *Former natural gas trader pleads guilty for role in commodities insider trading scheme* (Feb. 1, 2021), <https://www.justice.gov/usao-sdtx/pr/former-natural-gas-trader-pleads-guilty-role-commodities-insider-trading-scheme>.

securities instruments.”⁶⁰ In announcing the CFTC’s order against Schultz and acknowledging the DOJ’s assistance in the case, the CFTC’s Director of Enforcement at the time stated that “[m]isappropriating material, confidential information in order to engage in fictitious trading undermines the integrity of the futures markets and will not be tolerated.”⁶¹ These statements indicate that the agencies will continue to collaborate closely in this new area of enforcement.

Taking a Global View

In another new area of collaboration between the agencies, the CFTC’s Division of Enforcement announced in March 2019 that it would work alongside the DOJ to investigate foreign bribery and corruption relating to commodities markets, issuing an enforcement advisory on self-reporting, and cooperation for violations of the CEA involving foreign bribery.⁶² The agency’s first enforcement action in this area arrived in late 2020, with an order that included a focus on misappropriation of confidential information.

On December 3, 2020, the CFTC announced a settlement with Vitol Inc., a global commodities trading firm with offices in Houston, for alleged violations of the CEA based on bribes to foreign government officials. According to the order, the company violated Section 6(c)(1) of the CEA⁶³ and Regulation 180.1⁶⁴ by making improper payments to employees and agents of certain state-owned enterprises (“SOEs”) in Brazil, Ecuador, and Mexico in connection with trading in oil markets, among other acts.⁶⁵ Some of the payments were

to secure “preferential treatment and access to trades.”⁶⁶ But the CFTC’s order specified that other payments enabled the company to obtain “confidential information,” including “specific price information” and information concerning an SOE’s “projected supply, demand, and strategic planning.”⁶⁷ The order noted that the agents of the SOE who provided the information “owed a duty to the SOE under law and applicable employment policies to keep the information confidential.”⁶⁸ According to the findings in the order (which the company neither admitted nor denied, except to the extent admitted elsewhere), traders at the company, “while in possession of this improperly obtained information, traded and secured physical oil products and related derivative contracts in a broad range of oil markets in the United States and globally,” including exchange for physical (“EFP”) transactions.⁶⁹ As in *Byrnes*, the CFTC found the company liable for the acts of its employees and agents.⁷⁰

The language used by the CFTC in this order suggests that the Division of Enforcement is mindful of aligning the scope of its authority under Rule 180.1 with SEC Rule 10b-5. In adopting Rule 180.1, the CFTC stated that a violation would entail “trading *on the basis of* material non-public information in breach of a pre-existing duty” or “*on the basis of* material non-public information that was obtained through fraud or deception.”⁷¹ Every CFTC order on this topic since then has used the “on the basis of” language to frame the violation, including *Motazed*,⁷² *Ruggles*,⁷³ *Classic Energy*,⁷⁴ and *Schultz*.⁷⁵ Yet here, the CFTC described the offense as trading “while in possession of” the

⁶⁰ U.S. Dep’t of Justice, *Fraud Section Year In Review 2020* (Feb. 2021), <https://www.justice.gov/criminal-fraud/file/1370171/download>.

⁶¹ CFTC Press Release, *CFTC Orders Texas Man to Pay Over \$1 Million*, *supra* note 47.

⁶² CFTC Press Release, *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/7884-9>; *see also* *CFTC Enters the Market for Anti-Corruption Enforcement*, N.Y.U. Compliance & Enforcement Blog (Mar. 20, 2019), https://wp.nyu.edu/compliance_enforcement/2019/03/21/cftc-enters-the-market-for-anti-corruption-enforcement.

⁶³ 7 U.S.C. § 9(1).

⁶⁴ 17 C.F.R. § 180.1.

⁶⁵ Order Instituting Proceedings Pursuant to Sections 6(c) and (d) of the CEA, Making Findings, and Imposing Remedial

footnote continued from previous column...

Sanctions, at 2, *In re Vitol, Inc.*, CFTC Dkt. No. 21-01 (Dec. 3, 2020).

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.* at 4.

⁶⁹ *Id.* at 2, 6.

⁷⁰ *Id.* at 10 (citing CEA § 2(a)(1)(B), 7 U.S.C. § 2(a)(1)(B)).

⁷¹ Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,403 (emphasis added).

⁷² *Motazed* CFTC Order at 6.

⁷³ *Ruggles* CFTC Order at 6.

⁷⁴ *Classic Energy* CFTC Order at 6.

⁷⁵ *Schultz* CFTC Order at 6.

improperly obtained confidential information, not trading “on the basis of” the information.⁷⁶ This subtle but potentially significant shift brings the CFTC into closer alignment with the SEC’s approach under Rule 10b-5, which has a provision defining trading “on the basis of” material non-public information to include trading where “the person making the purchase or sale was *aware* of the material non-public information when the person made the purchase or sale.”⁷⁷

More broadly, as discussed above, the CFTC’s first insider trading cases involved trading by the person who possessed the confidential information, while more recent cases have targeted tippers who disclosed confidential information for others to trade. This latest action demonstrates a further evolution to focus on the recipients of confidential information.⁷⁸ While it remains to be seen how the CFTC will interpret and apply tippee liability beyond the bribery context at issue here, the range of fact patterns of interest continues to grow.

In a parallel criminal case, the same company entered into a deferred prosecution agreement with the DOJ based on two counts of conspiracy to violate the Foreign Corrupt Practices Act, a resolution based largely on the same improper payments at issue in the CFTC case.⁷⁹ The DOJ has also prosecuted individuals involved in the matter.⁸⁰ Although the DOJ did not pursue a charge here under the CEA as it did in *Schultz*, this case stands as a further example of the increasingly close coordination

between the agencies on a growing range of matters involving commodities markets.

CONCLUSION

The recent cases discussed above have each advanced the CFTC’s enforcement program on insider trading and misappropriation of confidential information. Taken together, these cases send a clear signal that the agency is committed to identifying and deterring such conduct in commodity derivatives markets. Like the SEC, on whose rule the CFTC modeled its own, the CFTC may now pursue not only those who trade on misappropriated information for their own benefit, but also those who provide tips for others to do so and the recipients who use such information. The agency takes a broad view of the types of duties that may give rise to liability for misappropriation, including employment agreements and other forms of confidentiality obligations, and it increasingly seeks to use data analytics to identify and investigate trades that may relate to confidential information. In some cases, the CFTC may also collaborate with the DOJ on parallel criminal enforcement.

In this evolving landscape, firms that participate in the commodities markets may wish to review their policies, procedures, and training programs to ensure that their personnel understand how liability can arise from misappropriation of confidential information, and take appropriate steps to prevent and address such conduct. ■

⁷⁶ *Vitol* CFTC Order at 2.

⁷⁷ 17 C.F.R. § 240.10b5-1 (2020) (emphasis added); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716,51,727 (Aug. 24, 2000) (“[T]he goals of insider trading prohibitions . . . are best accomplished by a standard closer to the ‘knowing possession’ standard than to the ‘use’ standard.”).

⁷⁸ *Vitol* CFTC Order at 9 & n.7.

⁷⁹ Deferred Prosecution Agreement, *United States v. Vitol Inc.*, No. 20-cr-539 (E.D.N.Y. Dec. 3, 2020).

⁸⁰ Dep’t of Just. Press Release, *Vitol Inc. Agrees to Pay over \$135 Million to Resolve Foreign Bribery Case*, <https://www.justice.gov/opa/pr/vitol-inc-agrees-pay-over-135-million-resolve-foreign-bribery-case> (noting related charges against an individual who received bribes, an individual who acted as an intermediary, and a trader).