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COMMENTARY

DECEMBER 2018

## Trial Loss Unlikely to Significantly Alter CFTC Efforts to Police Market Manipulation

### IN SHORT

**The Situation:** Judge Richard Sullivan of the Southern District of New York ("SDNY") recently issued a post-trial decision in a market manipulation action brought by the Commodity Futures Trading Commission ("CFTC") in 2013.

**The Result:** Judge Sullivan concluded that the CFTC failed to prove its claim that the defendants manipulated the market for certain interest rate swap futures because it failed to prove that the defendants' conduct created an artificial price.

**Looking Ahead:** While this decision was a setback for the CFTC, it is unlikely to affect the CFTC's ongoing efforts to police market manipulation, which may actually increase in the years to come.

### The *Wilson* Decision

In *U.S. CFTC v. Wilson*, No. 13-7884 (SDNY), the CFTC alleged that DRW Investments, LLC and its CEO, Donald R. Wilson (collectively, "Defendants"), manipulated the market for an interest rate swap futures product in 2011 by placing a large number of electronic bids for this product in the last 15 minutes of the trading day (an interval that weighed heavily in the clearinghouse's determination of the settlement price of the product for that day). The CFTC asserted that the Defendants submitted these bids with the specific intent of inflating the settlement price of the product, which would benefit their existing positions.

On November 30, 2018 (after a four-day bench trial in late 2016), Judge Sullivan concluded that while the Defendants had the ability to influence the settlement price of the product, the CFTC had failed to prove that the Defendants' conduct resulted in an "artificial" price. In particular, the court was persuaded by evidence demonstrating that the Defendants stood willing to transact at the prices they bid and vigorously pursued a counterparty that tried to back out of a trade. The court also emphasized that the Defendants' intent to influence the price of the futures at issue did not establish that their bids were inherently manipulative.

### Impact Going Forward

The *Wilson* decision demonstrates that the artificial price element of a market manipulation claim can be difficult to prove, with the court commenting that the CFTC's expert testimony on this issue was "conclusory" and not premised on "settled economic principles." However, the facts of *Wilson* were somewhat unique, in that the Defendants believed (due to their superior knowledge of the product) that they could bid up the price of the product at the end of the day while still entering into profitable trades. As a result, the Defendants' strategy did not constitute "banging the close" (i.e., attempting to inflate the value of large existing positions by entering into numerous small, unprofitable trades shortly before the market close), which the CFTC has successfully challenged in other contexts (and will likely continue to challenge in the future).

In addition, the conduct at issue in *Wilson* occurred in early 2011, and the court, therefore, did not address the Dodd-



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Frank amendments to the Commodity Exchange Act ("CEA"). If the same conduct occurred post-Dodd-Frank, the CFTC likely would have asserted claims under the less stringent requirements of the amended Section 6(c)(1) of the CEA and Rule 180.1(a) promulgated thereunder. Like SEC Rule 10b-5, Rule 180.1(a) only requires the plaintiff to prove recklessness (rather than specific intent to manipulate) to establish scienter. The CFTC has also asserted that Rule 180.1(a) can be applied to manipulative conduct regardless of whether that conduct created an artificial price.

In the wake of the *Wilson* decision, CFTC Chairman J. Christopher Giancarlo reportedly indicated that the CFTC would continue pursuing market manipulation cases. Earlier this year, the CFTC also issued a statement indicating that "manufactured credit events" (i.e., intentionally causing a credit event on a credit default swap) could constitute market manipulation and that it would "carefully consider all available actions to help ensure market integrity and combat manipulation or fraud involving CDS..." In light of these statements, market participants should not expect the *Wilson* decision to result in a decline in the CFTC's efforts to curtail market manipulation. Instead, market participants (including dealers, traders, trading platforms, and clearinghouses) should anticipate that the CFTC will continue to investigate practices that appear to affect the integrity of the markets and should monitor the CFTC's use of market manipulation theories to target new and emerging trading and business strategies.

### THREE KEY TAKEAWAYS

1. The decision in *Wilson* demonstrates that the artificial price element of a traditional market manipulation claim can be difficult to prove in practice.
2. Post-Dodd-Frank, the CFTC has more tools at its disposal to target manipulative conduct, including Rule 180.1(a). The *Wilson* decision is, therefore, unlikely to deter the CFTC from asserting market manipulation claims in the future.
3. The CFTC appears to be willing to use market manipulation as a theory to target new trading and business strategies, including "banging the close" and "manufactured credit events."



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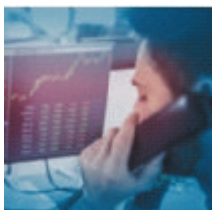
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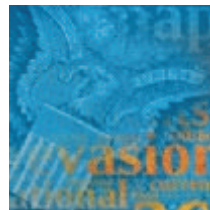
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