

ALERTS

CFTC Insider Trading Enforcement Efforts Increase: Implications for Private Fund Managers

October 3, 2018

On Sept. 28, 2018, the Commodity Futures Trading Commission (“CFTC”) filed a civil enforcement action against EOX Holdings LLC, an introducing broker, and one of its registered associated persons, Andrew Gizienski. The CFTC’s complaint, which charges that EOX Holdings and Gizienski misused material, nonpublic information in connection with block trades of energy contracts on the ICE Futures U.S. exchange, represents the latest assertion of CFTC jurisdiction over the relatively new concept of illegal insider trading in the commodity futures, options and swaps markets.

More importantly, on that same day, the CFTC also announced the formation of a special insider trading task force within the CFTC’s Division of Enforcement. The new Insider Trading and Information Protection Task Force aims to identify incidents of potential insider trading in the commodity derivatives markets and to bring charges for illegal insider trading. It is a national effort that draws on several CFTC offices for personnel and support.

Taken together, these steps make it clear that the CFTC is actively trying to expand the scope of its traditional enforcement role and to nurture the growth of traditional insider trading principles in the commodity derivatives markets. The fact that the CFTC is voluntarily undertaking to grow its capabilities in this area, at a time when its overall budget is seen by many observers as not being sufficient to support its growing scope of overall responsibility, only underscores the agency’s determination.

Managers that actively trade in this space should ensure that they understand the scope of the CFTC's new role and that they address the various risks raised by their trading and investment strategies.

Insider Trading Enforcement Efforts in the Commodity Derivatives Markets

The Dodd-Frank Wall Street Reform and Consumer Protection Act, [1] signed into law in 2010, amended the Commodity Exchange Act and strengthened several aspects of the CFTC's regulatory and enforcement powers. With respect to insider trading, the Dodd-Frank Act (i) granted the CFTC authority to promulgate such "rules and regulations as ... are reasonably necessary to prohibit ... [any] trading practice that is disruptive of fair and equitable trading[.]"[2] and (ii) made it unlawful to violate the CFTC anti-manipulation and antifraud regulations.

The CFTC subsequently promulgated a new Rule 180.1 that significantly expanded the scope of its anti-manipulation regulations. Rule 180.1 is expressly modeled on Rule 10b-5 under the Securities Exchange Act of 1934, which is the foundation of many insider trading actions in the securities markets. The CFTC views Rule 180.1, like Rule 10b-5, as prohibiting "trading on the basis of material nonpublic information in breach of a pre-existing duty (established by another law or rule, agreement, understanding or some other source) and trading on the basis of material nonpublic information that was obtained through fraud or deception."[3]

To date, the CFTC has secured two settlements in insider trading actions brought under Rule 180.1, *In re Motazed*[4] and *In re Ruggles*,[5] both of which involved allegations of employees trading for personal accounts on the basis of their respective employers' proprietary and confidential trading and portfolio information.

Charges Against EOX Holdings and Gizienski

In its Sept. 28, 2018 complaint,[6] the CFTC alleged that EOX Holdings and Gizienski, in 2013 and 2014, violated the CEA and CFTC insider trading regulations by:[7]

- Gizienski sharing with one EOX Holdings customer material, nonpublic information relating to other customers, including those other customers' identities, trading activity and positions;
- Gizienski trading for a customer's account while in possession of and on the basis of material, nonpublic information of other EOX Holdings customers;
- Gizienski quoting bids and offers to EOX Holdings customers for the purpose of negotiating block trades without disclosing that he was doing so for the benefit of his discretionary trading; and
- EOX Holdings failing to effectively supervise Gizienski and to implement policies and procedures sufficient to monitor Gizienski's trading and to minimize the "readily apparent conflicts of interest" created by his access to material, nonpublic information.

In its complaint, the CFTC is seeking monetary, injunctive and equitable relief against and from EOX Holdings and Gizienski. By pursuing this case, the CFTC clearly is seeking to aggressively prosecute insider trading violations and to bolster its recent insider trading victories; it may also be trying to expand the case law by bringing cases under a variety of fact patterns.

New Insider Trading Task Force

In conjunction with the filing of the *EOX Holdings* complaint, CFTC enforcement director James McDonald announced the formation of an Insider Trading and Information Protection Task Force, which will have members in the CFTC's Washington, D.C. headquarters and in the New York, Illinois and Missouri regional offices.[8] According to the CFTC, the task force is "a coordinated effort across the Division [of Enforcement] to identify and charge those who engage in insider trading or otherwise improperly use confidential information in connection with markets regulated by the CFTC." [9] The public announcement of this new effort – in conjunction with the *EOX Holdings* complaint – sends a clear and unambiguous message to the market on the seriousness of the CFTC's focus and attention.

Next Steps for Private Fund Managers

While none of the CFTC's insider trading actions, to date, involve private fund managers, the lessons in these cases are broadly applicable. In the Sept. 28 EOX Holdings press release, the CFTC identified four common ways by which market participants could run afoul of the insider trading rules, including:

- Misappropriating confidential information;
- Improperly disclosing a client's trading information;
- Front-running; or
- Using confidential information to unlawfully prearrange trades.

While the CFTC generally does not examine its registrants, usually deferring to the National Futures Association to do so, any manager that trades in the commodity futures, options or swaps markets and comes under CFTC scrutiny could be asked to substantiate its commitment to the prevention of insider trading and to demonstrate the sufficiency of its corresponding policies and compliance procedures. Managers should specifically consider whether their policies and procedures address the four high-risk areas flagged in the Sept. 28 press release.

In its Sept. 28 press release, the CFTC also made it clear that it:

- Will thoroughly investigate and prosecute instances where individuals have abused their access to confidential information; and
- Will ensure that its registrants develop and enforce policies prohibiting the misuse of confidential information, "as they are required to do under the law."

Managers that engage in commodity interest trading, therefore, should have policies and procedures in place that specifically address the insider trading risks that their investment programs pose. As with the policies and procedures intended to prevent, detect and address insider trading in the securities markets, managers should carefully consider their individual risks and design and administer tailored surveillance, training and other compliance efforts. As with all matters that touch on insider trading, the stakes are high, and it often makes sense to seek outside advice to assess the appropriate level of corresponding compliance efforts.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-2031, § 753, 124 Stat. 1376 (2010).

[2] 7 U.S.C. § 6c(a)(6) (2018).

[3] Commodity Futures Trading Commission, *Q & A – Anti-Manipulation and Anti-Fraud Final Rules* (2011), available here.

[4] *In re Arya Motazed*, Commodity Futures Trading Commission Docket No. 16-02 (Dec. 2, 2015), available here.

[5] *In re John P. Ruggles*, Commodity Futures Trading Commission Docket No. 16-34 (Sept. 29, 2016), available here.

[6] Complaint, *Commodity Futures Trading Commission v. EOX Holdings LLC et al.*, Case No.: 1:18-cv-08890 (S.D.N.Y. filed Sept. 28, 2018).

[7] The Complaint also charges EOX with failing to supervise its personnel and with certain books and records violations.

[8] Jody Godoy, “CFTC Starts Insider Trading Task Force, Sues Energy Broker,” *Law360* (Sept. 28, 2018, 7:57 PM EDT), available here.

[9] Press Release, Commodity Futures Trading Commission, *CFTC Charges Block Trade Broker with Insider Trading* (Sept. 28, 2018), available here.

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