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Court Clarifies Standard For CFTC Price-Based Manipulation Charge

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On September 30, 2016, the United States District Court for the Southern District of New York issued an order in *CFTC vs Wilson, et. al*, 13 Civ. 7884 (NYSD), denying motions for summary judgment in an action by the Commodity Futures Trading Commission ("CFTC") concerning alleged violations of the prohibition on market manipulation contained in Sections 6(c) and 9(a)(2) of the Commodity Exchange Act ("CEA"). In its order, the Court clarified the burden of proof that the CFTC faces when making a price-based manipulation claim under these sections, including that acting with the intent to influence price is not sufficient to sustain a market manipulation claim.

The Court first rejected the CFTC's interpretation that all it must prove to satisfy the intent element of a price-based market manipulation claim is the "intent to affect market price." Relying on its own precedent, the Court held that "[t]he CFTC must prove that Defendants had the specific intent to affect market prices that 'did not reflect the legitimate forces of supply and demand.'" In other words, "there is 'no manipulation without intent to cause artificial prices.'"

Nevertheless, the Court denied the Defendants' (together "DRW") motion for summary judgment on the basis that there was sufficient evidence such that a jury could reasonably conclude that the Defendants had the specific intent to create artificial prices. In particular, the Court cited evidence indicating "DRW developed a long position in the [relevant contract] and then undertook a bidding strategy to create artificial prices" by placing bids it did not believe would be accepted with the intent to affect the relevant market price. At the same time, the Court found that summary judgment in favor of the CFTC was unwarranted because a jury might reasonably conclude that DRW lacked the specific intent required based on evidence that DRW "believed the [relevant contract] had been undervalued and that DRW's bids were a legitimate source of supply and demand."

The Court then elaborated on the meaning of "legitimate source of supply and demand" in its discussion of the artificial-price element of the manipulation claim. The Court explained that a reasonable jury could conclude that the CFTC met its burden with respect to proving an artificial price by finding that "DRW did not intend to transact on its bids—*i.e.*, they were not a legitimate source of supply and demand." The Court's interpretation of this element bears a striking resemblance to the CFTC's prohibition on "spoofing," which prohibits the submission of bids or offers with the intent to cancel the bid or offer before execution. Similar to the reasoning employed in *Wilson*, when construing the scope of the spoofing prohibition, both the

CFTC and the courts have distinguished between legitimate trading strategies—which may result in a good-faith cancellation of orders in some cases—and entering into transactions with the "intent to cancel."

Separately, the Court rejected several other grounds for summary judgment:

- First, the Court rejected DRW's argument that the CFTC had failed to provide evidence to support its allegation that DRW's bidding was the proximate cause of an artificial price because the derivatives clearing organization ("DCO") had discretion as to whether to base the settlement price on DRW's bids. The Court reasoned that a jury might find that the practice was to set prices based on DRW's bids and that this was predictable.

- Second, the Court also rejected DRW's arguments that the CFTC's action was inconsistent with due process because DRW did not have adequate notice that their conduct was unlawful. The Court rejected this argument on the basis that the CFTC's manipulation claim involved the application of well-established legal principles.

- Lastly, the Court rejected DRW's jurisdictional claims on the basis that bids on a registered exchange were subject to CFTC jurisdiction.