

# Derivatives Alert

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

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## Mark D. Young

Partner / Washington, D.C.  
202.371.7680  
mark.d.young@skadden.com

## Jonathan Marcus

Of Counsel / Washington, D.C.  
202.371.7596  
jonathan.marcus@skadden.com

## Theodore M. Kneller

Counsel / Washington, D.C.  
202.371.7264  
ted.kneller@skadden.com

## Daniel B. O'Connell

Associate / Washington, D.C.  
202.371.7003  
daniel.oconnell@skadden.com

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Four Times Square  
New York, NY 10036  
212.735.3000

1440 New York Avenue, N.W.  
Washington, D.C. 20005  
202.371.7000

## Ninth Circuit Holds CFTC Dodd-Frank Enforcement Authority Allows Fraud-Only Claims

On July 25, 2019, the Ninth Circuit reinstated the Commodity Futures Trading Commission's (CFTC) lawsuit in *CFTC v. Monex Credit Co.*,<sup>1</sup> interpreting the CFTC's Dodd-Frank enforcement authority under Commodity Exchange Act (CEA) Section 6(c)(1) and CFTC Rule 180.1(a) to extend to cases of fraud. The Ninth Circuit's decision adopts the CFTC's interpretation that fraud violations under CEA Section 6(c)(1) and CFTC Rule 180.1(a) may be brought even in the absence of price manipulation. In doing so, the Ninth Circuit became the first U.S. Court of Appeals to squarely address the issue. The decision is significant because the CFTC in recent years has relied on these Dodd-Frank provisions in cases alleging fraudulent but not manipulative conduct, including cases involving the allegedly fraudulent sale of cryptocurrency<sup>2</sup> and misappropriation of confidential information, often dubbed "insider trading."<sup>3</sup>

The CFTC for decades has had both fraud authority under CEA Section 4b and manipulation authority in connection with futures (currently codified at CEA Sections 6(c)(3) and 9(a)(2) and CFTC Rule 180.2). Yet, prior to the implementation of the Dodd-Frank Act, the CFTC's fraud authority was limited in the related cash or physical markets (e.g., spot and physically delivered forward transactions). Under the Dodd-Frank Act, Congress granted the CFTC new authority prohibiting any manipulative or deceptive device or contrivance in connection with swaps, futures or any contract of sale of any commodity in interstate commerce.<sup>4</sup> The CFTC has subsequently interpreted this new authority and its implementing Rule 180.1(a) (which prohibits any manipulative device, scheme or artifice *to defraud*) to expand its fraud authority to transactions in the cash or physical markets.<sup>5</sup> Federal courts have only recently begun to grapple with the CFTC's expansive interpretation.<sup>6</sup>

<sup>1</sup> No. 18-55815 (9th Cir. July 25, 2019).

<sup>2</sup> See, e.g., *In re Kim*, CFTC No. 19-02 (Oct. 29, 2018); Final Judgment, *CFTC v. Gelfman Blueprint, Inc.*, No. 17-7181 (PKC) (S.D.N.Y. Oct. 18, 2018); *My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492 (D. Mass. 2018); *CFTC v. McDonnell*, 321 F. Supp. 3d 366 (E.D.N.Y. 2018), denying reconsideration in *CFTC v. McDonnell*, 287 F. Supp. 3d 213 (E.D.N.Y. 2018); Complaint, *CFTC v. Blue Bit Banc*, No. 18-cv-2247-SJF-ARL (E.D.N.Y. Apr. 16, 2018).

<sup>3</sup> See, e.g., Complaint, *CFTC v. EOX Holdings LLC*, No. 18-cv-8890 (S.D.N.Y. Sept. 28, 2018); *In re Ruggles*, CFTC No. 16-34 (Sept. 29, 2016); *In re Motazed*, CFTC No. 16-02 (Dec. 2, 2015).

<sup>4</sup> This new authority was modeled on the Securities and Exchange Commission's (SEC) enforcement authority under Securities Exchange Act Section 10(b) and SEC Rule 10b-5.

<sup>5</sup> See, e.g., *supra* note 2 (CFTC cases alleging fraud in connection with cryptocurrencies).

<sup>6</sup> See Skadden's October 1, 2018, [client alert](#).

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In *Monex*, the CFTC alleged that the defendants defrauded retail customers in precious metals sales, charging violations of Sections 4b and 6(c)(1) and Rule 180.1(a).<sup>7</sup> The district court concluded that CEA Section 4b did not reach the defendants. The Dodd-Frank Act extended CEA Section 4b to reach “retail commodity transactions,” which are contracts entered into on a leveraged or margined basis and are not actually delivered within 28 days. The district court determined that the defendants’ practice of delivering precious metals to third-party depositories within 28 days of their purchase by retail customers constituted “actual delivery” and therefore the Section 4b anti-fraud provisions did not apply.<sup>8</sup> The district court also held that CEA Section 6(c)(1) and Rule 180.1(a) only reach manipulation-based fraud, but not fraud in the absence of price manipulation.<sup>9</sup>

The Ninth Circuit disagreed. *Monex*’s practice of delivering precious metals, according to the Ninth Circuit, did not satisfy Section 4b’s actual delivery exception because the “plain language” of the term signifies “at least some meaningful degree of possession or control by the customer.”<sup>10</sup> The court stated that this standard cannot be satisfied “when, as here, metals are in the broker’s chosen depository, never exchange hands, and are subject to the broker’s exclusive control, and customers have no substantial, non-contingent interests.”<sup>11</sup> Therefore the Ninth Circuit found that the CFTC could enforce Section 4b’s anti-fraud provision against the defendants.

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<sup>7</sup> *CFTC v. Monex Credit Co.*, 311 F. Supp. 3d 1173, 1177-78 (C.D. Cal. 2018), reversed, No. 18-55815 (9th Cir. July 25, 2019).

<sup>8</sup> See *id.* at 1183.

<sup>9</sup> See *id.* at 1185-89.

<sup>10</sup> *CFTC v. Monex Credit Co.*, No. 18-55815, slip op. at 12, 14 (9th Cir. July 25, 2019).

<sup>11</sup> *Id.* at 14.

The Ninth Circuit also rejected the district court’s conclusion that Section 6(c)(1)’s prohibition of manipulative “or” deceptive devices requires that both manipulative *and* deceptive devices be present to charge a violation, stating, “When Congress places ‘or’ between two words, we assume that Congress intended the two terms as alternatives.”<sup>12</sup> Finally, the court concluded that — in addition to Section 4b — Section 6(c)(1) and Rule 180.1(a) also prohibit fraud in connection with leveraged or margined retail commodity contracts that are not actually delivered in 28 days. The court was not persuaded that such a reading “would mean that even everyday grocery sales would be subject to the CFTC’s enforcement power. . . . [I]t is not clear that this amounts to an elephant in a mousehole.”<sup>13</sup> The Ninth Circuit limited its holding to transactions involving leveraged retail commodity contracts and declined to address whether the CFTC has fraud authority in connection with any transaction in the cash or physical market.

The CFTC may view the Ninth Circuit’s decision as a “test case” for how courts of appeals will view defendants’ attempts to cabin the scope of its enforcement authority under Section 6(c)(1) and Rule 180.1(a). The agency will surely view the result as a green light to press ahead with the agency’s practice of charging those provisions in fraud-only cases. But it remains to be seen whether other courts of appeals will adopt a different approach, as significant questions remain about the scope of the CFTC’s authority over fraudulent practices in the cash and physical markets.

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<sup>12</sup> *Id.* at 18.

<sup>13</sup> *Id.* at 20-21.