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The CFTC defends its jurisdiction before the Second Circuit

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The U.S. Commodity Futures Trading Commission (CFTC) recently took the relatively unusual step of filing an *amicus* brief in a private litigation to defend its jurisdiction.

The case is *Laydon v. Coöperatieve Rabobank U.A.*, where the U.S. Court of Appeals for the Second Circuit, in affirming the dismissal of a putative class action brought in part under Section 22 of the Commodity Exchange Act (CEA), concluded that the alleged foreign manipulation of London- and Tokyo-based interest-rate benchmarks, with purported price impact on a U.S.-traded futures contract, was outside the reach of the CEA — contrary to the CFTC's established view and enforcement precedent.[1]

In so ruling, the court applied *Prime Int'l Trading, Ltd. v. BP p.l.c.*,[2] a Second Circuit decision concerning a similarly foreign chain of alleged events, where another panel held that neither the CEA's anti-manipulation provisions nor Section 22's private rights of action apply extraterritorially, such that a private CEA claim premised on manipulation requires both violative domestic conduct (the manipulation) and affected domestic transactions (the private injury).

Initially, however, the *Laydon* panel went a step further, finding that the benchmarks at issue were not commodities at all — presenting a latent second threat to the CFTC's jurisdiction.

But when the CFTC filed its *amicus* brief urging *en banc* rehearing and arguing that the court's "mistaken holding" in that respect misread the CEA and created a circuit split,[3] the panel promptly changed course, issuing an amended opinion a week later, in early December, omitting all discussion of whether the relevant benchmarks were commodities.[4]

What remains, then, is the more potent challenge to the CFTC's jurisdiction: the Second Circuit's conclusion in *Prime*, now reaffirmed by *Laydon*, that the CEA's anti-manipulation provisions "apply only to *domestic* conduct, and not to foreign conduct."[5]

The case calls into question the CFTC's authority to police foreign manipulation affecting U.S.-traded derivatives — authority that it exercised, for example, in bringing (and settling) enforcement actions against various of the *Laydon* defendants for the very same underlying conduct, and many times over in other cases.

The plaintiff has now renewed his petition for rehearing *en banc*, and the CFTC is again urging reconsideration of *Prime*, in a second *amicus* brief, as it did in its first.[6] But whatever the ultimate outcome, this case underscores the CFTC's broad view of the scope of its enforcement authority, and the partly untested jurisdictional bounds that it has pressed largely through negotiated resolutions.

The allegations

In 2006, Jeffrey Laydon lost about $2,000 trading three-month Euroyen TIBOR (i.e., Tokyo Interbank Offered Rate) futures contracts on the Chicago Mercantile Exchange (CME). He claimed he was harmed in the United States by manipulation abroad.

The details of the relevant futures contract (now defunct) are important to the court's decision:

> Euroyen are yen-denominated cash deposits held outside Japan. Euroyen TIBOR is an interest-rate benchmark reflecting the cost to borrow such yen, calculated daily by the Japanese Bankers Association based on rate submissions from a panel of mainly Japanese banks.

A person holding a Euroyen TIBOR futures contract to expiration would either make or receive a cash payment reflecting the difference between the price of the futures contract and the value of interest on a three-month ¥100,000,000 deposit, calculated using Euroyen TIBOR at expiry.

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Put simply, Euroyen TIBOR futures prices could be viewed as indications of what market participants expected that the Euroyen TIBOR rate would be in the future. There was no physically deliverable underlying asset.

Mr. Laydon did not hold his futures position to expiration; rather, he closed out his position when the price moved against him. But in bringing suit against a few dozen non-U.S. financial institutions in the U.S. District Court for the Southern District of New York, he alleged that his loss had been caused by a long-running conspiracy to manipulate foreign interest-rate benchmarks through false rate submissions.

The relevant defendants — those that remained after others settled the claims — had no role in the Euroyen TIBOR process, but they served as panel banks for the British Bankers' Association's similar

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benchmark, Yen-LIBOR (the London Interbank Offered Rate for yen).

The mechanism of the purported harm to Mr. Laydon and the putative class was indirect and attenuated:

(1) Defendants made false, manipulative rate submissions for Yen-LIBOR;

(2) Yen-LIBOR was calculated based on those submissions;

(3) The published Yen-LIBOR rate informed and thus impacted Japanese banks' rate submissions for Euroyen TIBOR;

(4) Euroyen TIBOR was calculated based on those impacted submissions; and

(5) The published Euroyen TIBOR rate affected Euroyen TIBOR futures prices on the CME.

In short, the purported harm at the end of the chain was in the United States, but the alleged manipulative conduct happened elsewhere.[7]

Laydon follows *Prime*: domestic conduct required

While *Laydon* was pending in the district court, the Second Circuit decided another CEA Section 22 case involving a similar chain-reaction theory based on foreign conduct.

In *Prime Int'l Trading*, the defendants — producers, refiners, and distributors of Brent crude oil — were alleged to have manipulated the Platts Dated Brent Assessment, a leading benchmark for the physical Brent crude oil market, by orchestrating artificial transactions in Brent crude and reporting those transactions to Platts, the London-based price-reporting agency.

The purported harm to the putative class stemmed from the impact of the Dated Brent Assessment on another foreign benchmark, the ICE Brent Index, which affected the settlement of Brent futures on a European exchange, which, in turn, affected CME-traded Brent futures in the United States.[8]

The district court in *Prime* dismissed the CEA claims as impermissibly extraterritorial, and the Second Circuit affirmed, holding that CEA Section 22 and anti-manipulation Sections 6(c)(1) and 9(a)(2) alike "contain[] no affirmative, textual indication that [they] appl[y] to conduct abroad," such that "a proper claim under Section 22" would require "not only a domestic transaction, but also domestic — not extraterritorial — *conduct* by Defendants that is violative of the CEA."[9]

The court cited the Supreme Court's holding in *Morrison v. Nat'l Australia Bank Ltd.*,[10] that a claim brought under a statute lacking a '"clear [textual] indication of extraterritoriality"' must be based on a '"domestic application"' of the statute,[11] and found that "[a]ll of the [alleged] conduct relevant to" the anti-manipulation focus of Sections 6(c)(1) and 9(a)(2) "occurred abroad," such that the alleged manipulation was "'so predominantly foreign' as to render the claims impermissibly extraterritorial," even assuming that the purportedly affected transactions were domestic.[12]

"Were we to hold otherwise," the court concluded, "the CEA would indeed 'rule the world.'"[13]

The defendants in *Laydon* soon moved to dismiss the CEA claims on the same basis — and in opposition, the plaintiff sought to distinguish *Prime* by pointing to CFTC enforcement settlements with several of the defendants for the same underlying conduct, contending that those settled enforcement actions "show[ed]" that Yen-LIBOR and Euroyen TIBOR "are domestic commodities," and that manipulation of such commodities "is exactly the type of misconduct that falls squarely within the territorial reach of the CEA" — apparently unconvincingly reframing domestic impact as domestic conduct.[14]

The defendants replied that the settled CFTC enforcement actions were irrelevant to the analysis because the CFTC had brought those actions pursuant to its own broad view that its jurisdiction extends to "overseas conduct." They noted that *Prime* "calls into question whether manipulation of a foreign benchmark through foreign conduct will be within the CFTC's enforcement jurisdiction going forward," but suggested that the court "need not resolve this issue to rule in favor of" dismissal.[15]

"Were we to hold otherwise," the court concluded, "the CEA would indeed 'rule the world.'"

And indeed the district court granted the motion without touching that thorny question, nor the contention that Yen-LIBOR and Euroyen TIBOR were "domestic commodities." Hewing to *Prime*, the court dismissed the CEA claims as impermissibly extraterritorial, finding that the alleged "causal chain" of manipulation, which involved no "relevant conduct by Defendants in the United States," was even "more attenuated" than the "'ripple effects' theory [that] the Circuit in *Prime International Trading* rejected as predominantly foreign."[16]

Laydon in the Second Circuit: The CFTC defends its jurisdiction

On appeal — where the plaintiff again argued that the alleged manipulation was sufficiently domestic because Yen-LIBOR and Euroyen TIBOR were "domestic commodities" — the Second Circuit chose not to dispense with the issue by focusing only on the locus of the conduct, as the district court had.

Instead, although the issue had not been framed for the court, the panel also looked to the CEA's definition of "commodity" and undertook an isolated reading of it to exclude benchmarks and price indexes, apparently on the basis that they are not physically deliverable and have no intrinsic value, unlike traditional commodities.[17]

The panel went on to explain that *Prime* "mandates dismissal" given the foreign conduct alleged, and that the plaintiff's contention that the relevant benchmarks were "domestic commodities" was incompatible with the outcome there: "According to Plaintiff, the crude index in *Prime* would also have been a commodity and,

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because the futures contract traded in the United States, any claims concerning that future would have been domestic. But we rejected this theory and held that the claims in *Prime* were impermissibly extraterritorial."[18]

The court said it was "unpersuaded by Plaintiff's argument that dismissal of his claims will 'fatally undermine the ability of U.S. law and U.S. regulators to protect domestic markets and investors,'" because "[t]he extraterritorial reach of Section 22, which concerns private rights of action, has nothing to do with government enforcement,"[19] — notwithstanding the *Prime* panel's conclusion that the anti-manipulation provisions on which the claims were based, the same provisions that the CFTC enforces, "likewise contain[] no affirmative, textual indication" that they apply to "conduct abroad."[20]

When the plaintiff then petitioned the court for *en banc* rehearing, the CFTC filed an *amicus* brief in which it argued that the panel's ruling did not address another CEA provision clarifying the broad scope of the term "commodity," and that the panel's "mistaken holding splits the circuits," because the U.S. Court of Appeals for the Seventh Circuit has recognized that indexes encompassed by that other provision are "commodities under the [CEA] as a whole."[21]

The CFTC also emphasized in its brief that "the relevant discussion was not necessary to the Panel's decision." It acknowledged that the panel was bound by *Prime* and urged *en banc* reconsideration of that holding, on the basis that *Prime* and *Laydon* represent "an overbroad application of the presumption against extraterritoriality," and because "continued application of *Prime* ... threatens to subject U.S. derivatives market participants to intentional manipulation merely because the perpetrators and the means of such manipulation are offshore."[22]

Under the CEA's anti-manipulation provisions, "[i]t makes no difference if [the conduct] occurred overseas," argued the CFTC, as "Congress deliberately included overseas commodities within the scope of the CEA" — so "if the elements [of manipulation] are met, neither the means of manipulation nor the location of the wrongdoer is relevant."[23]

As to the definition of "commodity," the panel was quick to respond: The following week, it issued an amended opinion omitting the entirety of its discussion of whether the relevant benchmarks were commodities under the CEA. The portion of the opinion addressing the domestic-conduct requirement — the more potent challenge for the CFTC — remained unchanged.[24]

* * *

The plaintiff is now again seeking rehearing *en banc*, and the CFTC has renewed its call for reconsideration of *Prime*, in a second *amicus* brief. The derivatives world will be closely watching how the Second Circuit handles the CFTC's concerns.

In any event, while the question of the CFTC's reach remains unsettled, we can well expect that the CFTC will continue to aggressively police conduct affecting U.S.-traded derivatives, foreign and domestic alike, perhaps with a wary eye on the challenges presented by *Laydon* and *Prime*.

Notes

[1] No. 20-3626, ECF No. 362 (2d Cir. Oct. 18, 2022), 51 F.4th 476 (withdrawn), *amended and superseded*, 55 F.4th 86 (2d Cir. Dec. 8, 2022). The plaintiff also brought antitrust claims under the Sherman Act (dismissed) and sought leave to add RICO claims (denied).

[2] 937 F.3d 94 (2d Cir. 2019).

[3] Br. for *Amicus Curiae* CFTC, *Laydon v. Coöperatieve Rabobank, U.A.*, No. 20-3626, ECF No. 383 (2d Cir. Nov. 29, 2022) ("1st CFTC *Amicus* Br., *Laydon*").

[4] 55 F.4th 86 (2d Cir. 2022).

[5] 937 F.3d at 105.

[6] Br. for *Amicus Curiae* CFTC, *Laydon*, No. 20-3626, ECF No. 403 (2d Cir. Jan. 19, 2023).

[7] *See Laydon v. Mizuho Bank, Ltd.*, No. 12 Civ. 3419 (GBD), 2020 WL 5077186, at *2 (S.D.N.Y. Aug. 27, 2020). The plaintiff did identify "a handful of communications sent from Defendants' foreign-based employees through or to servers located in the United States," and "an email in furtherance of the conspiracy [that one foreign employee sent] while on a brief, two-day trip in Las Vegas," but there was no allegation that any false Yen-LIBOR rate submissions were sent from the United States. *Laydon*, 55 F.4th at 95, 98.

[8] *See* 937 F.3d at 98–100.

[9] *Id.* at 103, 105.

[10] 561 U.S. 247, 265–66 (2010).

[11] 937 F.3d at 102.

[12] *Id.* at 106–08 (quoting *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE*, 763 F.3d 198, 216 (2d Cir. 2014)).

[13] *Id.* at 108 (quoting *Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437, 454 (2007)).

[14] Pl's Mem. in Opp. to Defs' Mot. for Judg. on Pleadings, *Laydon*, No. 12 Civ. 3419 (GBD), ECF No. 987, at *13–14 (S.D.N.Y. Nov. 1, 2019).

[15] Defs' Reply Mem. in Supp. of Mot. for Judg. on Pleadings, *Laydon*, No. 12 Civ. 3419 (GBD), ECF No. 1005, at *4 n.5, 6 (S.D.N.Y. Nov. 15, 2019).

[16] *Laydon*, 2020 WL 5077186 at *2.

[17] *Laydon*, No. 20-3626, ECF No. 362, at *15–17.

[18] *Id.* at *17–18.

[19] *Id.* at *18 n.14.

[20] 937 F.3d at 103.

[21] 1st CFTC *Amicus* Br., *Laydon*, at *2, 8–10 (citing *United States v. Wilkinson*, 986 F.3d 740, 745 (7th Cir. 2021)).

[22] *Id.* at *2–3; *see also id.*, Ex. A, at *26 (Br. for *Amicus Curiae* CFTC, *Prime Int'l Trading v. BP p.l.c.*, No. 17-2233, ECF No. 148 (2d. Cir. Nov. 22, 2017) (incorporated by reference)).

[23] *Id.*, Ex. A, at *22–23.

[24] *See* 55 F.4th 86 (2d Cir. 2022).

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