

## FIFTH CIRCUIT REVERSES CFTC PENALTY JUDGMENT UNDER “FAIR NOTICE” DOCTRINE

*By Alexander C. Drylewski, David Meister, Daniel Michael, Chad E. Silverman, Daniel Merzel and Nia Colon*

*Alexander Drylewski, David Meister, Daniel Michael, and Chad Silverman are partners, Daniel Merzel is a counsel, and Nia Colon is a law clerk in the New York office of Skadden, Arps, Slate, Meagher & Flom LLP. Contact: [alexander.drylewski@skadden.com](mailto:alexander.drylewski@skadden.com) or [david.meister@skadden.com](mailto:david.meister@skadden.com) or [daniel.michael@skadden.com](mailto:daniel.michael@skadden.com) or [chad.silverman@skadden.com](mailto:chad.silverman@skadden.com) or [daniel.merzel@skadden.com](mailto:daniel.merzel@skadden.com) or [nia.colon@skadden.com](mailto:nia.colon@skadden.com).*

On January 8, 2024, in a decision that underscores the potential viability of fair-notice defenses to U.S. regulators’ rule interpretations, the U.S. Court of Appeals for the Fifth Circuit reversed a \$6.5 million penalty judgment that the U.S. Commodity Futures Trading Commission (“CFTC”) had obtained against defendants charged in federal court in Texas with violating a decades-old CFTC rule that prohibited brokers from taking the other side of customer orders.<sup>1</sup> The court in *CFTC v. EOX Holdings LLC* concluded that the CFTC’s interpretation of the rule, which the CFTC had never publicly articulated, was “unprecedented” and left the defendants without “fair notice of the CFTC’s construction.”<sup>2</sup>

### Background

The decision stems from a September 2018 CFTC complaint charging broker EOX Holdings and employee Andrew Gizienski with, among other things, misappropriating material nonpublic information in connection with block trades of energy contracts.<sup>3</sup> Principally, the CFTC alleged that Mr. Gizienski traded in a

discretionary account on behalf of a friend based on confidential information that he derived from the block trades he was broking for other customers.<sup>4</sup> He also allegedly executed block trades with other customers on behalf of his friend without identifying himself to the other customers, which the CFTC charged as a violation of Rule 155.4(b)(2), which prohibits “knowingly tak[ing] . . . the other side of [a customer’s order] . . . except with the [customer’s] prior consent . . . .”<sup>5</sup> This was the first case in which the CFTC charged a violation of Rule 155.4(b)(2), which was promulgated more than 30 years earlier.

In the district court, the defendants moved to dismiss the Rule 155.4 charge on the basis that “taking the other side of an order” means transacting as a principal “with a financial interest and the possibility of profit or loss,” which would exclude Mr. Gizienski’s conduct, given that he was trading for his friend’s account, not

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his own. The CFTC argued that “taking the other side” more broadly encompasses “mak[ing] the decision to trade opposite the order and execut[ing] the trade opposite the order,” irrespective of any financial interest in the trade, as Mr. Gizienski had done.<sup>6</sup> The district court agreed with the CFTC, finding that “[n]othing in the language of [the rule] limits its application to principals with an ownership or financial interest.”<sup>7</sup>

The jury found for the CFTC on the Rule 155.4 claim, among other charges, but found for the defense on the charge for trading based on misappropriated information.

### The Fifth Circuit Decision

On appeal, the defendants argued that they did not have fair notice of the CFTC’s interpretation of the rule at the time of the conduct, while the CFTC contended that it had “consistently interpreted [the rule] according to its plain language,” and that this “controlling plain language” provided “fair notice” to the public.<sup>8</sup> The Fifth Circuit rejected the CFTC’s position. The court concluded that the text of the rule was “at best ambiguous” and “did not give fair notice to the Defendants absent further guidance from the CFTC”—and the panel observed that “for nearly four decades, no such guidance came.”<sup>9</sup> Noting the district court’s view that noth-

ing in the text of Rule 155.4 “limit[ed]” its application to transactions on a principal basis, the panel reasoned that, to the contrary, the ambiguity of the rule did not serve to “*extend*[ ] its application beyond principals either.”<sup>10</sup> Because “the CFTC had *never* publicly stated that to ‘take the other side of trades’ includes the broker’s trading for a discretionary account,” the defendants lacked fair notice of the CFTC’s interpretation of the rule at the time of the conduct, per the principle that “ ‘a regulation cannot be construed to mean what an agency intended but did not adequately express.’ ”<sup>11</sup> Finding “the CFTC’s construction of the Rule to be thoroughly unpersuasive,” the panel remarked: “Maybe, as the CFTC stated at oral argument, the agency has reasons for wishing to regulate such conduct. But if so, ‘it is the regulation as written which must bear the blame.’ ”<sup>12</sup> Accordingly, the court reversed the judgment on the Rule 155.4 charge.<sup>13</sup>

### Takeaway Point

The Fifth Circuit’s ruling in *EOX Holdings* demonstrates the potential viability of fair-notice defenses where regulatory agencies advance novel interpretations or seek to apply their rules in novel contexts—with potential implications for registrants as well as emerging industries such as Web3, digital assets and decentralized finance. Consistent with CFTC Commissioner Summer

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West LegalEdcenter  
610 Opperman Drive  
Eagan, MN 55123

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Mersinger's remarks last year on "engaging with the public" instead of pursuing "enforcement first,"<sup>14</sup> the *EOX* decision also highlights the benefits of clear and more frequent regulatory guidance, both for regulators and for those they regulate.

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## ENDNOTES:

<sup>1</sup>*Commodity Futures Trading Commission v. EOX Holdings, L.L.C.*, 90 F.4th 439 (5th Cir. 2024).

<sup>2</sup>*Id.* at 441, 444, 448.

<sup>3</sup>Complaint, *CFTC v. EOX Holdings LLC et al.*, No. 1:18-cv-08890 (S.D.N.Y. Sept. 28, 2018). (The case was later transferred to the Southern District of Texas.)

<sup>4</sup>The CFTC Division of Enforcement initially announced the complaint as charging "insider trading," and simultaneously announced the creation of an Insider Trading & Information Protection Task Force to investigate and prosecute such conduct. *See* "CFTC Charges Block Trader With Insider Trading," CFTC Rel. No. 7811-18 (Sept. 28, 2018) (<https://www.cftc.gov/PressRoom/PressReleases/7811-18>).

<sup>5</sup>17 C.F.R. § 155.4(b)(2).

<sup>6</sup>*EOX Holdings*, No. 22-20622, Dkt. No. 91-1, at \*7.

<sup>7</sup>*Id.* at \*8.

<sup>8</sup>*Id.* at \*7-8.

<sup>9</sup>*Id.* at \*8.

<sup>10</sup>*Id.*

<sup>11</sup>*Id.* at \*12, 16.

<sup>12</sup>*Id.* at \*16 (citation omitted).

<sup>13</sup>*Id.* at \*18.

<sup>14</sup>Dissenting Statement of Commissioner Summer K. Mersinger Regarding Enforcement Actions Against: 1) Oryn, Inc.; 2) Deridex, Inc.; and 3) ZeroEx, Inc., CFTC Rel. No. 8774-23 (Sept. 7, 2023). (<https://www.cftc.gov/PressRoom/SpeechesTestimony/mersingerstatement090723>.)