



Division
Of
Enforcement

U.S. COMMODITY FUTURES TRADING COMMISSION

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January 19, 2016

VIA ECF

The Honorable Analisa Torres
United States District Judge
Southern District of New York
500 Pearl Street
New York, New York 10007

Re: U.S. Commodity Futures Trading Commission v. Donald R. Wilson & DRW Investments, LLC, No. 13-7884 (AT/KF)

Dear Judge Torres:

Pursuant to Rule III.A(ii) of the Court's Individual Practices in Civil Cases ("Individual Practices"), plaintiff U.S. Commodity Futures Trading Commission ("Commission") respectfully opposes prospective *amici curiae*'s ("amici")¹ request for leave to file a brief in support of defendants Donald R. Wilson and DRW Investments, LLC's (together, "defendants") summary judgment motion and in opposition to the CFTC's motion for summary judgment ("*amici* letter") (ECF No. 125).²

Amici's belated request to file what is, effectively, a sur-reply in opposition to plaintiff's motion for partial summary judgment, and an additional reply brief in support of defendants' summary judgment motion, should not be allowed by the Court. As discussed below, nothing in *amici*'s letter justifies its tardiness or its reiteration of defendants' legal arguments. Therefore, the Commission respectfully requests that the Court deny *amici*'s request for leave.

¹ *Amici* include CME Group, Inc. ("CME"), Commodity Markets Council ("CMC"), Futures Industry Association, Inc. ("FIA"), Intercontinental Exchange, Inc. ("ICE"), and Managed Funds Association ("MFA").

² *Amici* did not follow Rule III.A(ii) of the Court's Individual Practices, mandating a pre-motion conference prior to the filing of a motion. Instead, *amici* went ahead and not only filed the motion for leave, but the *amici* brief itself ("*Amici* Br.") (ECF No. 125-1). In addition, the *Amici* Br. does not identify that it is (1) in support of defendants' summary judgment motion and (2) in opposition to the Commission's summary judgment motion. See Fed. R. App. P. 29(c).

I. AMICI'S PROFFERED BRIEF IS NOT USEFUL.

“An amicus curiae proves true to its name as a ‘friend of the court’ when it offers a fresh perspective on an unsettled question of law *that the actual parties to the litigation have not fully addressed.*” *United States v. Yaroshenko*, 86 F. Supp. 3d 289, 290-91 (S.D.N.Y. 2015) (emphasis added). “There is no governing standard, rule or statute ‘prescrib[ing] the procedure for obtaining leave to file an *amicus* brief in the district court.’” *Lehman XS Trust, Series 2006-GP2 v. Greenpoint Mortg. Funding, Inc.*, Nos. 12 Civ. 7935, 7942, 7943, 2014 WL 2655784, at *1 (S.D.N.Y. Jan. 23, 2014) (alteration in original; citation omitted). “Nevertheless, the Court looks to the Federal Rules of Appellate Procedure, which does provide a rule for the filing of an *amicus* brief, and also considers the instances when an *amicus* brief serves a laudable, rather than distractive, purpose.” *Id.* As *amici* correctly point-out, the decision for leave to file is in the “firm discretion” of the Court. *Id.*

Courts in the Second Circuit often use the Seventh Circuit’s “useful” litmus test for when an *amicus* brief would be beneficial, including (1) when a party is not represented competently or is not represented at all; (2) when the *amicus* has an interest in some other case that may be affected by the decision in the present case; or (3) when the *amicus* has unique information or perspective that can help the court beyond the help that the lawyers for the parties are able to provide. *Id.* at *2. None of these factors are present here. *See also Ryan v. CFTC*, 125 F.2d 1062, 1063 (7th Cir. 1997) (Posner, J.) (noting that “The vast majority of amicus curiae briefs are filed by allies of litigants and duplicate the arguments made in the litigants’ briefs, in effect merely extending the length of the litigant’s brief. Such amicus briefs should not be allowed. They are an abuse. The term ‘amicus curiae’ means friend of the court, not friend of a party.”).

Consistent with the defendants’ position and without adding anything new, *amici* ask the Court to credit their view that a claim for attempted manipulation requires proof of specific intent to create an artificial price and that any other interpretation violates Due Process. *Amici Br.* at 4-10. Defendants have repeatedly touted this argument over the last two years, even after the Court considered the parties’ extensive motion to dismiss briefs, and subsequently rejected this argument in *CFTC v. Wilson*, 27 F. Supp. 3d 517, 530-35 (S.D.N.Y. 2014). *See* Defs.’ Mem. in Support of Mot. to Dismiss or Transfer Venue at 18-19 (ECF No. 33) (raising Due Process argument); Defs.’ Reply in Support of Mot. to Dismiss or Transfer Venue at 8-11 (ECF No. 37) (arguing intent standard, interpreting *In re Indiana Farm Bureau Coop. Ass’n, Inc.* and raising Due Process argument); Defs.’ Mem. in Support of Mot. for Summary Judgment at 23-38, 46-48 (ECF No. 112) (same); Defs.’ Reply in Support of Mot. for Summary Judgment at 4-13, 30-35 (ECF No. 126) (same); Defs.’ Opp. to Pl.’s Mot. for Partial Summary Judgment at 4-11 (ECF No. 120) (arguing intent standard and interpreting *Indiana Farm Bureau*). Therefore, *amici*’s attempt to parrot the defendants’ arguments should not be permitted. *See Ryan*, 125 F.2d at 1063-64 (holding that the Chicago Board of Trade’s attempt as *amicus* falls into “forbidden category” by duplicating litigant’s arguments and “merely extending the length of the litigant’s brief”).

Additionally, “the partiality of an amicus is a factor to consider in deciding whether to allow participation.” *Picard v. Greiff*, 797 F. Supp. 2d 451, 452 (S.D.N.Y. 2001) (citation omitted). The *Amici Br.* fails to disclose that defendant Donald R. Wilson, according to

Bloomberg.com, is in fact a member of CME, an *amicus* here.³ It also fails to disclose Mr. Wilson's various affiliations with FIA.⁴ Additionally, the similarities between *amici*'s and defendants' arguments suggest an inherent partiality in favor of defendants; that is, the *amici* here are "friends of the litigant," not "friends of the court."

II. AMICI'S PROFFERED BRIEF IS UNTIMELY.

Rule 29 of the Federal Rules of Appellate Procedure provides that any *amicus* brief must be filed "no later than 7 days after the principal brief of the party being supported." Fed. R. App. P. 29(e). Here, *amici* did not seek leave to file during the briefing on defendants' motion to dismiss, but instead waited nearly eighteen months—*after Wilson's* holding regarding the applicable intent standard, and after the parties completed briefing their summary judgment motions.⁵ *Amici* provide no justification or excuse for their delay. *See Yaroshenko*, 86 F. Supp. 3d at 290 (finding application filed by *amicus* to be untimely as "[o]nly now, ten months after defendant filed his motion and well after defendant's much-delayed final briefing is complete, has [*amicus*] seen fit to approach the Court to request to file its brief and thereby further extend these already protracted proceedings").

III. AMICI'S PROFFERED BRIEF IS WITHOUT MERIT.

Amici's proposed brief offers this Court nothing new. It ignores the Court's considered decision on the motion to dismiss, the Law of the Case Doctrine and Second Circuit case law. *See Wilson*, 27 F. Supp. 3d at 531; *see also DiPlacido v. CFTC*, 364 F. App'x 657, 661 (2d Cir. 2009); Pl.'s Opp. to Defs.' Mot. for Summary Judgment at 26-42 (ECF No. 119); Pl.'s Reply in Support of Mot. for Partial Summary Judgment at 4-14 (ECF No. 123). The Court already has had the benefit of 80 pages of briefing by the parties on the intent and Due Process issues, and has already considered and ruled on the issues, thus setting the law of the case. *See Wilson*, 27 F. Supp. 3d at 530-533; Pl.'s Resp. in Opp. to Defs.' Mot. to Dismiss or Transfer Venue at 48-50, 60-63 (ECF No. 35); Pl.'s Resp. in Opp. to Defs.' Mot. for Summary Judgment at 26-42, 62-65

³ *See* Bloomberg Business Overview of DRW Holdings, LLC, <http://www.bloomberg.com/research/stocks/private/person.asp?personId=33499153&privcapId=33430748> (last visited Jan. 14, 2016) (attached hereto as Exhibit A) ("Mr. Wilson is a Member of the CME, the Chicago Board of Trade, the Chicago Board Options Exchange, and the LIFFE. Over the course of his Membership at the CME, Mr. Wilson has been an active participant in exchange matters. He has been actively involved in GLOBEX, the electronic trading platform at the CME.").

⁴ In March 2013, Mr. Wilson was a member of the board of directors of FIA. *See* <https://fia.org/articles/fia-elects-directors-and-officers-0>. In 2012, Mr. Wilson was chairman of the FIA Principal Traders Association. *See* <https://ptg.fia.org/articles/case-you-missed-it-qa-don-wilson-founder-drw-trading-group>. (Both attached hereto as Exhibit B.)

⁵ Additionally, even if one ignores the parties' 12(b)(6) briefing in 2014, *Amici's* Br. was still due on November 30, 2015, seven days after the parties' summary judgment motions were filed, and in time for the Commission to respond to it in due course.

(ECF No. 119); Pl.’s Mem. in Support of Mot. for Partial Summary Judgment at 19-21 (ECF No. 109); Defs.’ Mem. in Support of Mot. to Dismiss or Transfer Venue at 18-19 (ECF No. 33); Defs.’ Reply in Support of Mot. to Dismiss or Transfer Venue at 8-11 (ECF No. 37); Defs.’ Mem. in Support of Mot. for Summary Judgment at 23-38, 46-48 (ECF No. 112); Defs.’ Reply in Support of Mot. for Summary Judgment at 4-13, 30-35 (ECF No. 126); Defs.’ Opp. to Pl.’s Motion for Partial Summary Judgment at 4-11 (ECF No. 120). To put it mildly, this issue has been thoroughly litigated.

Additionally, while *amici* (inaccurately) attack the CFTC for purportedly ignoring older Commission cases, they do not reveal that at least three of the *amici* themselves previously (and publicly) endorsed the very legal standard for intent that they now attack, intent to “affect” or “influence” the pre-existing price. In addition, while in their current brief *amici* (inaccurately) characterize this standard as an abrupt departure from precedent, the three previous endorsements accurately noted that this standard was the “traditional” and “long standing” intent standard for attempted manipulation:

- MFA previously explained: “MFA respectfully urges the Commission to adopt a specific intent standard as it is also consistent with the traditional elements required to prove attempted manipulation. Courts have held that to satisfy a claim for attempted manipulation, the Commission must show: (1) an intent to affect market prices and (2) an overt act in furtherance thereof.” Letter from MFA to CFTC, dated Dec. 28, 2010, at 6-7 (citing with approval attempted manipulation standard in *McGraw-Hill*) (attached hereto as Exhibit C).
- FIA previously explained: “The Associations support the Commission’s statement reaffirming that the traditional four-part test, developed from manipulation cases involving ‘corners’ and ‘squeezes,’ needed to impose liability under its proposed rule, which requires the Commission to establish that: (1) *the alleged manipulator had the ability to influence market prices*; (2) *the alleged manipulator specifically intended to do so*; (3) artificial prices existed; and (4) the alleged manipulator caused the artificial prices. *This is a long-standing test that market participants are familiar with and provides some guidance for their trading activities.*” Letter from FIA to CFTC, dated Dec. 28, 2010, at 11 (attached hereto as Exhibit D) (emphasis supplied). *See also id.* at 8 n.21 (citing with approval attempted manipulation standard in *CFTC v. McGraw-Hill Cos.*, 507 F. Supp. 2d 45, 51 (D.D.C. 2007)).
- CME previously explained: “CME Group recommends that the Commission adopt the approach to determining price artificiality outlined in *Cox . . .*” Letter from CME to CFTC, dated Jan. 3, 2011, at 14 (attached hereto as Exhibit E).

See also Wilson, 27 F. Supp. 3d at 531-32 (relying, in part, on *In re Cox* and *McGraw-Hill* in articulating standards for manipulation and attempted manipulation).

These statements of *amici* were in response to a notice of proposed rulemaking pursuant to the Dodd-Frank Act’s market manipulation provisions. Yet *amici* now reverse course to support the application of a different wording for the standard, hoping to open the door for an

argument that as long as the defendants, themselves, purportedly believe that the pre-existing price was incorrect, then efforts to move that price to one more to the defendants' liking, in order to profit, is lawful. Of course, none of the decisions *amici* cite apply the "intent to create an artificial price" standard in the rule-swallowing manner *amici* propose. *See generally* Pl.'s Reply in Support of Mot. for Partial Summary Judgment at 9-10 (ECF No. 123); Pl.'s Resp. in Opp. to Defs.' Mot. for Summary Judgment at 39-41 (ECF No. 119). That is, these cases do not stand for the proposition that the intent requirement is unsatisfied where (1) the undisputed evidence (2) demonstrates that a defendant intentionally acted (3) with the purpose of setting its own settlement price, like the immediate case. *See id.* Finally, in their hypotheticals, *amici* conflate intent to affect price with the knowledge that an overt act will likely cause a price movement.⁶

IV. CONCLUSION.

For the reasons stated above, plaintiff respectfully requests that this Court deny *amici*'s request for leave to file a brief in support of defendants, or in the alternative, and should the Court desire additional briefing on the matter, allow plaintiff to file a responsive pleading.

Respectfully submitted,

/s/ David Kent

A. Daniel Ullman II (*pro hac vice*)

Jason Mahoney (*pro hac vice*)

Sophia Siddiqui (*pro hac vice*)

Jonah McCarthy

David Kent (*pro hac vice*)

**ATTORNEYS FOR PLAINTIFF
U.S. COMMODITY FUTURES
TRADING COMMISSION**

cc: Counsel of Record
Counsel for *Amici*

⁶ Should the Court accept *amici*'s brief, and desire additional briefing, plaintiff will respond to *amici*'s hypotheticals. Plaintiff notes, however, that issues of law should not rest on hypotheticals, especially those that appear to be arguing the evidence of this case.

Exhibit A

Capital Markets
Company Overview of DRW Holdings, LLC

January 14, 2016 9:58 AM ET

Snapshot

People

Overview **Board Members** **Committees**

Executive Profile

Donald R. Wilson Jr.

Founder and Chief Executive Officer, DRW Holdings, LLC

Age Total Calculated Compensation This person is connected to **2** Board Members in **2** different organizations across **4** different industries.

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See Board Relationships

Background

Mr. Donald R. Wilson Jr., also known as Don, is a Co-Founder of Digital Asset Holdings, LLC. Mr. Wilson is the Founder and Chief Executive Officer at DRW Trading Group. Mr. Wilson is the founder at DRW Investments, LLC. He serves as Head Financial Advisor at L3 Development LLC. Mr. Wilson began his career in the trading industry in 1989 and started trading in the Eurodollar option pit at the Chicago Mercantile Exchange ("CME"). Mr. Wilson has traded in several different markets over the years and focuses his trading on fixed income derivatives. He started his career at LETCO, where he participated in a special training program, was involved in a number of research projects and traded interest rate and currency options from off the trading floor. After his time off the trading floor, he began to trade Eurodollar options, and interest rate products tied to three month LIBOR, on the floor of the CME. He has been instrumental in development of Eurodollar option pit into one of the largest and most successful option pits at any exchange. Mr. Wilson has also traded in the Bund option pit at the London International Financial Futures and Options Exchange ("LIFFE") and has traded a variety of other financial products. He is a Strategic and Financial Advisor and Member of the Operating and Financial Advisory Board of VO2 Partners. He serves as a Director of Digital Asset Holdings, LLC. Mr. Wilson is a Member of the CME, the Chicago Board of Trade, the Chicago Board Options Exchange, and the LIFFE. Over the course of his Membership at the CME, Mr. Wilson has been an active participant in exchange matters. He has been actively involved in GLOBEX, the electronic trading platform at the CME. He graduated with honors from the University of Chicago with a B. A. degree in Economics in 1988.

Collapse Detail

Corporate Headquarters

540 West Madison Street
Chicago, Illinois 60661

United States

Phone: 312-542-1000
Fax: 312-526-5619

Annual Compensation

There is no Annual Compensation data available.

Stocks Options

There is no Stock Options data available.

Total Compensation

There is no Total Compensation data available.

Board Members Memberships

Co-Founder and Director
Digital Asset Holdings, LLC

Education

BA 1988
The University of Chicago

Other Affiliations

The University of Chicago
DRW Investments, LLC
L3 Development LLC
VO2 Partners
Digital Asset Holdings, LLC

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The Huffington Post | Tasting Room

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Exhibit B

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FIA Elects Directors and Officers

13 March 2013 2:45pm EDT // [FIA \(https://fia.org/\)](https://fia.org/)



The Futures Industry Association today announced the election of board directors at its annual meeting in Boca Raton, Fla. Fourteen directors were elected in total at the meeting, including eight regular member directors for two-year terms; one regular member director for a one-year term; and five associate member directors for a two-year terms. Following the election, the new board elected the association's officers and public directors.

* Directors new to the board since the 2012 annual meeting are marked with an asterisk.

The following directors were re-elected as officers by the new board:

- **Michael C. Dawley**, Managing Director, Co-Head of Futures and Derivatives Clearing Services, Goldman, Sachs & Co., was re-elected as chairman
- **Gerald Corcoran**, Chairman and Chief Executive Officer, R.J. O'Brien & Associates LLC, was elected as vice chairman
- **Emily Portney**, Global Head of Agency Clearing, Collateral Management and Execution, J.P. Morgan Securities LLC, was elected as secretary
- **Michael Yarian**, Managing director, head of agency derivatives services, Barclays

The following individuals were elected as public directors by the new board:

- **Michael R. Schaefer**
- **Alice P. White**

Eight directors were elected for two-year terms in the regular member category:

- * **Maureen Downs**, President, Rosenthal Collins Group LLC
- **Malcolm Clark Hutchison, III**, Global Head of Listed Derivatives, Morgan Stanley
- **Jeffrey Jennings**, Managing Director, Global Head of Prime Services Listed Derivatives, OTC Derivatives Clearing and FX Prime Brokerage, Credit Suisse Securities (USA) LLC
- **Peter G. Johnson**, Managing Director, Global Head of Futures, OTC Clearing and FX Prime Brokerage, Bank of America Merrill Lynch
- **Jerome Kemp**, Global Head of Exchange-Traded Derivatives Sales and Clearing, Citigroup Global Markets Limited
- **Emily Portney**, Global Head of Agency Clearing, Collateral Management and Execution, J.P. Morgan Securities LLC
- **Ajay Singh**, Global Head of Listed Derivatives, Deutsche Bank AG
- **Jeremy Wright**, Global Head of Futures and Options Markets, The Royal Bank of Scotland plc

One director was elected to fill the remainder of a two-year term expiring in 2014 in the regular member category:

- **Antoine Babule**, Chief Executive Officer, Newedge USA, LLC, and Head of Newedge Americas

Five directors were elected for two-year terms in the associate member category:

- **George E. Crapple**, Co-Chairman & Co-Chief Executive Officer, Millburn Ridgefield Corporation
- * **Thomas J. Erickson**, Vice President, Government & Industry Affairs, Bunge North America
- **Christopher Hehmeyer**, Managing Member, HTG Capital Partners LLC
- **Andy Milnes**, Head of Supply and Trading, Global Oil Americas, BP Corporation North America, Inc.
- **Edward J. Rosen**, Partner, Cleary Gottlieb Steen & Hamilton LLP

The new board re-appointed the following individuals as special advisers to the board:

Richard Berliand and **Gary DeWaal**. In addition, the board re-appointed **John Damgard** as senior adviser to the board.

The FIA's board of directors holds elections each year at the annual meeting in March, with terms staggered so that approximately half of the directors are elected each year. In addition to **Walt Lukken**, president and chief executive officer of the Futures Industry Association, who serves on the board *ex officio*, the continuing board directors are:

- **Patrice Blanc**, President, Futures Brokerage Division, Jefferies & Company, Inc., and Chief Executive Officer, Jefferies Bache LLC
- **Gerald Corcoran**, Chairman and Chief Executive Officer, R.J. O'Brien & Associates LLC
- **Michael C. Dawley**, Managing Director, Co-Head of Futures and Derivatives Clearing Services, Goldman, Sachs & Co.
- **Richard B. Gorelick**, Chief Executive Officer, RGM Advisors LLC
- **Arthur W. Hahn**, Partner, Katten Muchin Rosenman LLP
- **Sanjay Kannambadi**, Chief Executive Officer and Global Head, BNY Mellon Clearing LLC
- **Najib Lamhaouar**, Global Head of Exchange-Traded Derivatives and OTC Clearing, Global Markets, HSBC Securities (USA) Inc.
- **David S. Mitchell**, Partner, Fried, Frank, Harris, Shriver & Jacobson LLP
- **Reinhardt Olsen**, Managing Director, Global Head of Execution and Derivatives Clearing, UBS Securities LLC
- **Kenneth M. Raisler**, Partner, Sullivan & Cromwell LLP
- **Edward J. Rosen**, Partner, Cleary Gottlieb Steen & Hamilton LLP
- **Donald R. Wilson, Jr.**, Chief Executive Officer, DRW Trading Group
- **Michael Yarian**, Managing Director, Head of Futures and OTC Derivative Clearing, Barclays

[Press Releases \(/categories/press-releases/\)](/categories/press-releases/)

EVENTS

FIA Division Planning Session (/events/fia-division-planning-session-0)

20 January 2016 3:00pm EST to 22 January 2016 9:00pm EST // Innisbrook // Palm Harbor, FL

FIA/SIFMA Asset Management Derivatives Forum 2016 (<https://fia-sifmaforum2016.fia.org/>)

3 February 2016 8:00am PST to 5 February 2016 4:00pm PST // Montage Laguna Beach // Laguna Beach, CA

Boca 2016 (<https://boca2016.fia.org/>)

41st Annual International Futures Industry Conference

15 March 2016 8:00am EDT to 18 March 2016 10:30pm EDT // Boca Raton Resort & Club // Boca Raton, FL

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In Case You Missed It: Q&A with Don Wilson, Founder of DRW Trading Group

6 April 2012 1:00am EDT // [FIA Principal Traders Group \(https://ptg.fia.org/\)](https://ptg.fia.org/)



In [this interview with Open Markets \(http://openmarkets.cmegroup.com/2156/qa-with-don-wilson-founder-of-drw-trading-group\)](http://openmarkets.cmegroup.com/2156/qa-with-don-wilson-founder-of-drw-trading-group), Don Wilson talks about his experience trading Eurodollar options on the floor of the CME and observes that high-frequency trading is a natural evolution of the trading process. He also describes the opportunities created by the Dodd-Frank Act for firms like DRW to access the interest rate swaps market and provide liquidity to customers in that market. Don Wilson is the founder and chief executive of DRW Trading Group. He is also chairman of the FIA Principal Traders Association.



<http://openmarkets.cmegroup.com/2156/qa-with-don-wilson-founder-of-drw-trading-group>

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EVENTS

FIA/SIFMA Asset Management Derivatives Forum 2016 (<https://fia-sifmaforum2016.fia.org/>)

3 February 2016 8:00am PST to 5 February 2016 4:00pm PST // Montage Laguna Beach // Laguna Beach, CA

FIA PTG Members Meeting (</events/fia-ptg-members-meeting-0>)

10 February 2016 4:00pm CST

Boca 2016 (<https://boca2016.fia.org/>)

41st Annual International Futures Industry Conference

15 March 2016 8:00am EDT to 18 March 2016 10:30pm EDT // Boca Raton Resort & Club // Boca Raton, FL

[Past \(/events/past\)](/events/past)

[Upcoming \(/events\)](/events)

Exhibit C

MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK



December 28, 2010

Via Electronic Submission: <http://comments.cftc.gov>

Commodity Futures Trading Commission
c/o David A. Stawick, Secretary
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Notice of Proposed Rulemaking on the Prohibition of Market Manipulation. RIN No. 3038-AD27.

Dear Mr. Stawick:

Managed Funds Association (“MFA”)¹ submits these comments in response to the Commodity Futures Trading Commission’s Notice of Proposed Rulemaking on the Prohibition of Market Manipulation (the “Notice”). We appreciate the opportunity to provide comments to the Commodity Futures Trading Commission (the “Commission”) on its proposed rules to implement new anti-manipulation authority in Section 753 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). We respectfully submit comments on the Commission’s proposed two rules:

- (i) Proposed Section 180.1, implementing Section 6(c)(1) of the Commodity Exchange Act, as amended (the “CEA”), and promulgated pursuant to Section 753 of the Dodd-Frank Act (“Section 180.1”);² and
- (ii) Proposed Section 180.2, implementing Section 6(c)(3) of the CEA, as promulgated pursuant to the Commission’s general rulemaking authority under Section 8(a)(5) of the CEA (“Section 180.2”).³

MFA and its members support the Commission’s mission of deterring and preventing price manipulation and other disruptions to market integrity. We depend on honest markets with prices that accurately reflect supply and demand. We look forward to working closely with the Commission to

¹ MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately \$1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

² Prohibition of Market Manipulation, 75 Fed. Reg. 67,657 (Nov. 3, 2010) (to be codified at 17 C.F.R. pt. 180).

³ *Id.*

Mr. Stawick
December 28, 2010
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promulgate rules that serve the public interest by preserving the liquidity of the futures and derivatives markets. Thus, these markets can continue to provide a means of managing price risks, discovering prices and disseminating price information through liquid, fair and financially secure trading practices.⁴

I. Summary

MFA urges the Commission to adopt rules and guidance that effectively clarify the rights and obligations of market participants. We believe that greater guidance in this area will clarify the lines between permissible and impermissible conduct and allow market participants to develop proper internal controls. To that end, we recommend that:

- 1) The Commission should not import SEC Rule 10b-5 precedent to trading in the futures and derivatives markets;
- 2) No new duties should be implied from the Commission's proposed rule beyond those to which participants in the futures and derivatives markets would otherwise be subject to by agreement or by operation of common law;
- 3) In the alternative, the Commission should adopt a specific intent level of scienter necessary to violate its proposed Section 180.1, or the Commission should at a minimum impose an "extreme recklessness" level of scienter; and
- 4) The Commission should clarify that Section 6(c)(3) of the CEA, as well as proposed Section 180.2, do not provide the Commission with any new enforcement authority beyond extending the Commission's anti-manipulation authority to swap transactions.

II. The Commission's Proposed Section 180.1

A. The Commission Should Not Employ Rule 10b-5 Precedent to Trading in the Futures and Derivatives Markets

We believe that the Commission should not employ the judicial precedent and legal standards under Rule 10b-5 to trading in the futures and derivatives markets. The Commission itself recognized that there are critical differences between the securities markets and the futures and derivatives markets when it stated in its proposing release that the securities laws and its precedents would "guide, but not control" the Commission and that the Commission will take into account the "purposes of the CEA and the functioning of the markets regulated by the Commission."⁵ MFA believes that Rule 10b-5 case law is tailored to the structure of the securities markets, which is significantly different from the futures and derivatives markets. We are concerned that ignoring these differences would hinder market participants' ability to manage and assume price risks, discover prices and disseminate pricing information.

The futures markets have primarily served the public interest by providing a means for managing and assuming price risks, discovering prices and disseminating pricing information through the

⁴ See 7 U.S.C. § 5(a).

⁵ Prohibition of Market Manipulation, 75 Fed. Reg. 67,657, 67,659 (Nov. 3, 2010).

Mr. Stawick
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trading in liquid, fair and financially secure trading facilities.⁶ Securities markets, however, serve an entirely different purpose in that they promote the raising of capital. As such, the underlying policy on antifraud protection in each market has developed for different reasons. Rule 10b-5 standards and case law are based on disclosure duties associated with the purchase and sale of securities. Consistent with the SEC's policy of protecting investors, the disclosure of issuer-specific information generally is aimed at preventing issuers from taking advantage of investors by attempting to give all market participants equal access to material information about their investments. Hence, those who come into possession of material, nonpublic information subject to a duty may not then trade on that information without running afoul of the securities laws.⁷

The duties that exist as a result of the traditional relationships between securities market participants, however, are not applicable to the relationships between the sophisticated commercial and institutional entities in the futures and derivatives space. These entities have the resources, sophistication, experience and bargaining power to negotiate terms and conditions with their counterparties at arm's length. Additionally, market participants do not evaluate a position in a futures or derivatives contract on the basis of an "issuer's" disclosure, a concept that has no relevance in the futures and derivatives markets. Market pricing, too, is conceptually different in that price movements of futures contracts traditionally reflect the supply of and demand for the commodity itself, rather than the financial condition of the issuer and its growth prospects.

Antifraud rules in the futures markets are largely meant to protect price discovery and market integrity by prohibiting market manipulation. The Commission has long recognized that information asymmetries inherently exist in futures transactions. However, the Commission considers such asymmetries legitimate, since futures market participants voluntarily accept these terms if they choose to trade.⁸ Even beyond this, information asymmetries are legitimate, because effective market hedging, the basic purpose of the futures market, inherently requires the use of proprietary information which is typically not known to all market participants.⁹ Accordingly, the Commission has not applied a separate trading standard to retail market participants. We respectfully urge the Commission to craft a rule that takes into account the more limited duties that market participants owe one another in light of the markets' non-reliance on disclosure and the absence of concerns about the misuse of insider information.

Market participants in the futures and derivatives markets need clarity on what legal standards will apply given the significant differences between the securities and futures and derivatives markets. We are concerned that ambiguity with respect to legal standards would increase transaction costs and chill legitimate trading practices. The market as a whole would also suffer from decreased

⁶ 7 U.S.C. § 5(a).

⁷ See *Basic v. Levinson*, 485 U.S. 224, 108 S. Ct. 978 (1988); see also *U.S. v. O'Hagan*, 521 U.S. 642 (1997) (sustaining Exchange Act Section 10(b) liability where a person breached a fiduciary duty to the source of the information); *Carpenter v. U.S.*, 484 U.S. 19, 108 S. Ct. 316 (1987) (sustaining liability where a newspaper employee traded on information received for his column prior to publication in violation of his employer's policy that pre-publication content was the property of the newspaper); cf. *Dirks v. SEC*, 463 U.S. 646 (1983). See also Regulation FD, 17 CFR §243.100 *et seq.*

⁸ CFTC, *A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information*, Submitted to H.R. Comm. on Agriculture and S. Comm. on Agriculture, Nutrition and Forestry, at 54 (1984).

⁹ *Id.* at 8.

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depth and liquidity, especially in the thinly traded markets, since market participants could change their trading behavior to mitigate potential regulatory risk.

B. The Commission Should Make It Clear that the Proposed Rule Does Not Impose New Duties

We respectfully ask the Commission explicitly to clarify and confirm that Section 6(c)(1) and Section 4c(a)(7) of the CEA do not impose any new duties of disclosure, inquiry or diligence, other than those that exist or are created under contract, under other laws or by operation of common law. Under CEA Section 4c(a)(7), it is:

unlawful for any person to enter into a swap knowing, or acting in reckless disregard of the fact, that its counterparty will use the swap as part of a device, scheme, or artifice to defraud any third party.

MFA is concerned that without the Commission's clarification, the mere "recklessness" standard in both Section 4c(a)(7) and proposed Section 180.1 could impose new duties of inquiry or diligence.

This clarification is appropriate in the context of different relationships between market participants. The Commission recognized this distinction in its landmark 1984 study entitled "A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information":

In futures trading, as in the trading of securities, fiduciary relationships are established along the trading chain from the public customer to the executing broker. However, unlike the purchase or sale of securities, where the subject of the transaction—the corporate security itself—carries with it a fiduciary relationship between the shareholder and the corporate insider, the futures transaction does not create such a fiduciary relationship between an insider and the person on the opposite side of the trade.¹⁰

We believe the Commission's observations from the 1984 study remain relevant today and that 26 years of reliance on the Commission's findings should not be overturned without careful consideration of the ramifications. In securities laws, duties flow from the structure of the parties' relationships, such as relationships between a broker-dealer and customer, insiders and the public. The corporate insider may not misappropriate information he or she has received to benefit himself to the disadvantage of the outside investor. However, parties in the futures and derivatives markets are in a different position and thus do not have similar duties. The typical party engages in arm's-length transactions standing in equal positions to one another as counterparties. Because of these fundamental distinctions, we believe the Commission should explicitly clarify that no new duties flow from any of the proposed rules beyond those traditionally understood.

MFA supports the Commission's clarification that nothing in proposed Section 180.1 "shall be construed to require any person to disclose . . . nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made

¹⁰

Id. at 55-56.

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to the other person . . . not misleading in any material respect.”¹¹ However, MFA believes the Commission should additionally clarify that Section 180.1 will not prohibit market participants from taking positions and trading on material, nonpublic information obtained lawfully within the purview of the common law, the CEA and regulations promulgated pursuant to it. Market participants routinely use futures and derivatives for hedging purposes, and necessarily enter into transactions with proprietary information regarding their assets and liabilities. It would completely undermine their ability to effectively hedge price risks if they could not trade on the basis of this proprietary information legitimately obtained in the course of their regular business. MFA’s request for clarification is consistent with the Commission’s position stated in its 1984 study:

The ability of any person to capture the value of his or her proprietary information is a traditional prerogative of commercial enterprise. Because the futures markets are derivative, risk-shifting markets, it would defeat the market’s basic economic function—the hedging of risk—to question whether trading on knowledge of one’s own position were permissible.¹²

Without this clarification, the Commission puts into question a practice that has long been one of the futures and derivatives markets’ most important roles in commerce.

C. The Commission Should Clarify the Scope of the Proposed Rule Under Section 6(c)(1) and the Commission’s Already Existing Anti-Manipulation Authority Under CEA Section 9(a)(2) and Broad Antifraud Authority Under CEA Section 4b

MFA seeks clarity and additional guidance from the Commission regarding the scope of the proposed rule under Section 6(c)(1) and how it relates to the Commission’s anti-manipulation authority under Section 9(a)(2) and broad antifraud authority under Section 4b.

The Commission has historically relied on other provisions of the CEA, including Section 9(a)(2) and the prior Section 6(c), in its administrative and civil enforcement actions against fraud-based manipulation and attempted manipulation, requiring some form of deception, such as reporting of false prices or the making of false statements. Additionally, subsection 6(c)(1)(B) of the Dodd-Frank Act states that nothing in the new law shall affect, or be construed to affect, the applicability of CEA Section 9(a)(2). The Commission has also expressly stated in its proposing release that its authority under Section 9(a)(2) remains unaffected by the proposed rule and thus will remain available as an enforcement mechanism which may be used in concert with the proposed rule.¹³

It is unclear to market participants whether or to what extent the proposed rule under Section 6(c)(1) of the CEA, other than to extend its antifraud authority to swap transactions, will grant to the Commission any new antifraud authority that it did not already have either under Section 9(a)(2) of the CEA or under the broader antifraud provision, Section 4b of the CEA. This ambiguity causes confusion and uncertainty to market participants who require straightforward guidance about the types of behavior that are prohibited. Market participants faced with overlapping and potentially inconsistent rules

¹¹ Prohibition of Market Manipulation, 75 Fed. Reg. 67,657, 67,662 (to be codified at 17 C.F.R. pt. 180).

¹² CFTC, *A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information*, Submitted to H.R. Comm. on Agriculture and S. Comm. on Agriculture, Nutrition and Forestry, at 8 (1984).

¹³ Prohibition of Market Manipulation, 75 Fed. Reg. 67,657, 67,658 (Aug. 12, 2009).

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relating to the same activities are likely to reduce their participation because of the risk that activity permitted by one provision may be penalized under another.

From our review and analysis, we believe that the Commission should interpret Section 6(c)(1) merely to clarify and refine the Commission's authority over swaps but should not grant the Commission any new antifraud authority or create any new duties or obligations, and we respectfully urge the Commission to provide such clarification.

D. The Commission Should Propose a Rule that Requires Specific Intent

Alternatively, if the Commission determines to apply some portions of Rule 10b-5 analysis in this context, MFA urges the Commission to establish a standard of specific intent as the scienter requirement under the Commission's proposed rule, rather than recklessness. We believe a higher scienter standard is appropriate for many reasons.

First, we note that the Commission's proposed rule is essentially an antifraud rule. By its own terms, Section 180.1 prohibits the "[u]se or employ[ment], or attempt[ed] . . . use or employ[ment], [of] any *manipulative* device, *scheme*, or *artifice to defraud*."¹⁴ The Supreme Court held that "to use or employ" and "fraudulent or deceptive," as used in Section 10(b) of the Exchange Act, indicates that Congress intended to prohibit only "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting [price]" in *Ernst & Ernst v. Hochfelder*.¹⁵

Second, we believe the nature and structure of the parties' relationships in the futures and derivatives markets should require a specific intent standard. Parties to futures transactions are generally sophisticated and have the resources and bargaining power to protect themselves. Similarly, parties to swap transactions, "Eligible Contract Participants," as the term is defined in the CEA ("ECPs"), have the same ability to access and evaluate relevant information and to negotiate their own terms. There is no fiduciary relationship between two sophisticated commercial or institutional parties that would warrant heightened duties or increased regulatory protection. While retail participants do have access to the futures markets, unlike the securities markets, no single "issuer" controls access to information in the futures and derivatives markets, and the pricing of futures is reflective of supply and demand, rather than valuation based on such financial disclosure.

Third, we believe a scienter standard that is lower than specific intent could chill legitimate trading activity. A specific intent requirement would appropriately target situations in which parties actively seek to manipulate market prices. Transactions in the futures and derivatives markets have the inherent ability to affect market prices. To impose a lesser standard than specific intent will inhibit market participants from engaging in lawful competitive behavior that ultimately will affect market prices. Rather than chilling legitimate trading that adds value to the markets by lowering spreads and adding liquidity and depth, we believe the Commission should craft an enforcement rule that describes the behavior deserving punishment.

MFA respectfully urges the Commission to adopt a specific intent standard as it is also consistent with the traditional elements required to prove attempted manipulation. Courts have held that to satisfy a claim for attempted manipulation, the Commission must show: (1) an intent to affect market

¹⁴ Prohibition of Market Manipulation, 75 Fed. Reg. 67,657, 67,662 (to be codified at 17 C.F.R. pt. 180) (emphasis added).

¹⁵ *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197-99 (1976).

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prices and (2) an overt act in furtherance thereof.¹⁶ We urge the Commission to adopt the specific intent standard and confirm that the traditionally required elements to prove attempted manipulation, stated above, remain unchanged. This ensures that the prohibitions under the Commission's antifraud rule do not sweep more broadly than do other comparable antifraud rules.

However, if the Commission declines to impose a specific intent requirement, we believe it should be guided by the Federal Trade Commission's ("FTC") anti-manipulation rules and impose, at a minimum, an "extreme recklessness" standard.¹⁷ The "extreme recklessness" standard carries with it the notion that a person is acting willfully to carry out his or her ultimate objective. MFA notes that almost all the circuits that have considered the level of scienter required for a violation of Rule 10b-5 have adopted the extreme recklessness standard.¹⁸ If the Commission declines to adopt a specific intent requirement, we believe the proposed rule should at least require an "*extreme* departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or so obvious that the actor must have been aware of it."¹⁹

III. The Commission Should Clarify that Its Proposed Section 180.2 Does Not Articulate Any New Standards or Obligations

The Commission's Proposed Section 180.2 is consistent with the recent judicial precedent established in the Second Circuit that conduct giving rise to a manipulation charge need not be intrinsically fraudulent or otherwise illegal in order for liability to attach.²⁰ Other than extending its anti-manipulation authority to swap transactions, the Commission should clarify that it is not articulating any new standards or obligations under Section 6(c)(3) of the CEA and proposed Section 180.2 with regard to trading practices that attempt to exploit the illiquidity of markets and are intended to move prices.

MFA supports the Commission's statement that it is reaffirming the traditional four-part test needed to sustain a manipulation charge.²¹ However, MFA strongly believes the Commission should not create a "conclusive presumption" that a price is artificial without proof of *specific intent* to move

¹⁶ *U.S. Commodity Futures Trading Comm'n v. McGraw-Hill Cos.*, 507 F. Supp. 2d 45, 51 (D.D.C. 2007) (stating "Attempted manipulation is demonstrated by the intent to affect market prices and some 'overt act' in furtherance thereof.") (internal citations omitted).

¹⁷ Prohibitions on Market Manipulation, 74 Fed. Reg. 40,686, 40,691-92 (Aug. 12, 2009).

¹⁸ *See Phillips v. LCI Int'l, Inc.*, 190 F.3d 609, 621 (4th Cir. 1999); *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990) (en banc); *Ross v. Bank South, N.A.*, 885 F.2d 723, 730 n.10 (11th Cir. 1989); *Hackbert v. Holmes*, 675 F.2d 1114, 1118 (10th Cir. 1982); *Broad v. Rockwell*, 642 F.2d 929, 961 (5th Cir. 1981) (en banc); *McLean v. Alexander*, 599 F.2d 1190, 1197 (3d Cir. 1979); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1025 (6th Cir. 1979); *see also Greebel v. FTP Software*, 194 F.3d 185, 198 (1st Cir. 1999); *Camp v. Dema*, 948 F.2d 455, 461 (8th Cir. 1991).

¹⁹ *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977) (emphasis added).

²⁰ *In re DiPlacido*, 2008 WL 4831204, Comm. Fut. L. Rep. ¶ 30970 (CFTC 2008), *aff'd in pertinent part*, *DiPlacido v. Commodity Futures Trading Comm'n*, 2009 WL 3326624, Comm. Fut. L. Rep. ¶ 31,434 (2d Cir. 2009), Comm. Fut. L. Rep. (CCH) ¶ 20,271 at 21,477.

²¹ Manipulation cases involving "corners" and "squeezes" produced a framework requiring the Commission establish: "1) That the accused had the ability to influence market prices; 2) that they specifically intended to do so; 3) that artificial prices existed; and 4) that the accused caused the artificial prices." *Prohibition of Market Manipulation*, 75 Fed. Reg. 67,657, 67,660 (2010).

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prices.²² This would constitute an overly aggressive interpretation of judicial precedent like *DiPlacido* and cast too wide a net over legitimate trading activities that are not similarly intended to create artificial prices. There are a variety of *bona fide* commercial reasons for conducting trades that may appear on their face to lack economic rationale but which are not specifically intended to move prices (*e.g.*, hedging activities during the closing period). Indeed, the Second Circuit did not believe the four-part test “collapsed,” as *DiPlacido* argued, because the “Commission stated that ‘violating bids and offers—in order to influence prices,’ was ‘sufficient to show manipulative intent,’” adding:

[The Commission’s] finding of intent thus depended not merely on *DiPlacido*’s having violated bids and offers, but also on taped conversations signaling *manipulative intent* and the ALJ’s finding that *DiPlacido*’s denial of intent lacked credibility. Further, the Commission cited evidence (including expert testimony) that artificial prices were a “reasonably probable consequence” of *DiPlacido*’s large trades made during the Close in an illiquid market. Thus, the Commission carefully applied *all four elements of the traditional test*. . . .²³

The Commission should thus read *DiPlacido* as cautioning against collapsing any of the four elements of the traditional four-part test.

In a market that at times has been called “volatile and esoteric,” we believe that market participants should not be subject to regulations reflecting those same qualities.²⁴ MFA believes that the Commission is uniquely positioned to provide much needed clarity on an uncertain and confused body of the law surrounding manipulation.

* * * * *

²² *Id.* at 67,661.

²³ *DiPlacido v. Commodity Futures Trading Comm’n*, 2009 WL 3326624 at *3, Comm. Fut. L. Rep. ¶ 31,434 (2d Cir. 2009) (emphasis added).

²⁴ *Merrill Lynch v. Curran*, 456 U.S. 353, 355-56 (1982).

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MFA thanks the Commission for the opportunity to provide comments regarding the proposed rules on its new anti-manipulation authority.

We would be pleased to discuss any questions or comments the Commission or its staff might have regarding this letter. Any questions about this letter may be directed to Jennifer Han or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

cc: The Hon. Gary Gensler, CFTC Chairman
The Hon. Michael Dunn, CFTC Commissioner
The Hon. Bart Chilton, CFTC Commissioner
The Hon. Jill E. Sommers, CFTC Commissioner
The Hon. Scott D. O'Malia, CFTC Commissioner

Exhibit D



December 28, 2010

Commodity Futures Trading Commission
c/o David A. Stawick, Secretary
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Notice of Proposed Rulemaking on the Prohibition of Market Manipulation
RIN No. 3038-AD27

Dear Mr. Stawick:

The Futures Industry Association (̈FIÄ),¹ the Securities Industry and Financial Markets Association (̈SIFMÄ)² and the International Swaps and Derivatives Association (̈ISDÄ)³ (together with FIA and SIFMA, the ̈Associations̈) submit these comments in response to the Notice of Proposed Rulemaking on the Prohibition of Market Manipulation in which the Commodity Futures Trading Commission (the ̈Commission̈) solicited comments on its proposed rules to implement new anti-manipulation authority in Section 753 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (̈Dodd-Frank̈). Specifically, the Associations submit their comments in response to:

¹ FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants (̈FCMs̈) in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States designated contract markets. For more information, visit www.futuresindustry.org.

² SIFMA brings together the shared interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

³ The International Swaps and Derivatives Association, or ISDA, was chartered in 1985 and has over 830 member institutions from 57 countries on six continents. Our members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the risks inherent in their core economic activities. For more information, visit www.isda.org.

- (i) the Commission's notice of proposed rulemaking to implement a new anti-manipulation rule prohibiting fraud-based manipulative schemes under the new Section 6(c)(1) of the Commodity Exchange Act ("CEA") pursuant to Section 753 of Dodd-Frank; and
- (ii) the Commission's notice of proposed rulemaking to implement a new anti-manipulation rule under the new Section 6(c)(3) of the CEA pursuant to the Commission's general rulemaking authority.

I. Summary.

The Associations appreciate the opportunity to comment on the Commission's proposed rulemaking on the prohibition of market manipulation. First, we wish to emphasize that we share the Commission's commitment to open, fair and competitive markets and look forward to working closely with the Commission to promulgate effective rules which preserve the integrity of the markets.

In adopting rules under its new authority pursuant to Dodd-Frank to prevent abusive financial practices in the futures and derivatives markets, we urge the Commission to provide clear and straightforward guidance to market participants as to what constitutes prohibited conduct. Such guidance should give adequate notice to market participants that transact in the futures and derivatives markets and identify clear principles to market participants by which to distinguish legitimate competitive trading practices from prohibited manipulative conduct. Failure to provide clear and straightforward guidance will only serve to add confusion to the markets and potentially chill legitimate trading activities in a competitive market where traders must make real-time trading decisions in dynamic markets without the benefit of hindsight. The Associations make the following recommendations to the Commission:

- The Commission should not incorporate the standards and case law under Rule 10b-5;
- No new duties of disclosure, inquiry or diligence should be imposed between two sophisticated parties to a bilateral transaction. Such new duties may discourage legitimate trading activities, increase transaction costs and as a result reduce the liquidity and depth of the markets;
- The Commission should clarify that nothing in the proposed rule under Section 6(c)(1) will impede the ability of market participants to take positions and trade on the basis of material, nonpublic information they obtain legitimately;
- Extreme recklessness, not recklessness alone, should be the scienter standard under the Commission's proposed rule under Section 6(c)(1);
- The Commission should clarify the scope of the proposed rule under 6(c)(1) and the Commission's already existing anti-manipulation authority under CEA Section 9(a)(2); and

- The Commission should clarify that, aside from extending its enforcement authority to cover swaps, Section 6(c)(3) does not extend its enforcement authority beyond the *DiPlacido* precedent.

II. The Commission's Proposed Rule Under Section 6(c)(1) of the CEA.

A. The Commission Should Not Incorporate the Standards and Case Law Under Rule 10b-5 as They Are Inapplicable to the Futures and Derivatives Markets.

Pursuant to Section 6(c)(1) of the CEA, as added by Section 753(a) of Dodd-Frank, the Commission has proposed regulations to address fraud-based manipulations that are based on Rule 10b-5, promulgated by the Securities Exchange Commission (the "SEC") under the Securities Exchange Act of 1934 (the "Exchange Act"). The Commission's proposed regulations would apply concepts and standards developed under Rule 10b-5 to the futures and derivatives markets regulated by the Commission.

We urge the Commission not to incorporate the securities standards and case law under Rule 10b-5 that are largely inapplicable and cannot easily be adapted to the futures and derivatives markets, due to the fundamental differences in the structures of the two market frameworks. We are pleased that in the Commission's Notice of Proposed Rulemaking, the Commission recognized that there are significant differences in the futures and derivatives markets, when it stated in its proposing release that judicial precedent developed under the securities laws will "guide, but not control" the Commission and that the Commission intends to take into account the "purposes of the CEA and the functioning of the markets regulated by the Commission."⁴

The securities laws are designed to promote the raising of capital by corporations and to protect the public retail investors who may purchase or sell securities. Rule 10b-5 functions as part of a system developed to protect against fraud largely through disclosure of issuer-specific information to ensure that all market participants, including retail investors, have equal access to material information. Underlying securities regulations is the concern that retail investors (except in special contexts involving sophisticated market participants) will not have the resources, capability or bargaining power to independently gather firm-specific or industry-specific material, nonpublic information compared to corporate insiders or market professionals. This is reflected in the structure and practices of securities regulations as enforced by the SEC.⁵

⁴ Prohibition of Market Manipulation, 75 Fed. Reg. 67657, 67659 (2010).

⁵ For example, the SEC requires issuers to write the front and back cover pages, the summary and the risk factors section following a specific set of plain English writing principles such as using: "short sentences," "definite, concrete, everyday words," "no legal jargon or highly technical business terms," and "no multiple negatives." See Plain English Disclosures, Securities Act Release No. 7497, Exchange Act Release No. 23011, Investment Company Act Release No. 23011 (Jan. 28, 1998), see also Rule 421(b), 17 C.F.R. §230.421.

In addition, the applicability of the securities laws, antifraud provisions, and Rule 10b-5 in particular, is premised on the existence of certain legal duties between the parties to a transaction that may be breached if one party makes material misrepresentations or is responsible for material omissions. Indeed, we submit that the framework established by Rule 10b-5 can only be applied to a market that is similarly structured.

In contrast, participants in the futures and derivatives markets do not rely on analogous issuer-specific information when deciding whether to transact. As an initial matter, there is no "issuer" in the futures and derivatives markets. Rather, market transactions are typically executed between two counterparties based on market information that is generally equally available to both parties. Futures contracts or swaps do not represent investments made on a particular issuer's equity and prospects for growth. Moreover, counterparties dealing with each other as equals in the futures and derivatives markets typically do not have duties to each other that would be violated by the failure to make certain disclosures, absent the assumption of such a duty by agreement or course of conduct. We believe that the Commission should adopt an antifraud rule that is appropriately crafted to take into account the nature of material information in these markets and the types of duties that may exist. Unlike the securities antifraud laws and rules, which are designed primarily for investor protection, the antifraud provisions in the futures markets are focused in large part, although not exclusively, on protections against manipulation. This, as well, argues for a separate rule that is designed to address futures and derivatives market practices and relationships, not the wholesale adoption of a rule designed for a different regime.

Incorporating concepts from securities law to a market where such concepts do not apply will subject market participants to increased uncertainty as to their obligations and standards. It is difficult to understand, much less predict, how Rule 10b-5 judicial precedent will translate to the futures and derivatives markets. The danger of importing legal standards from a completely different market that operates on different principles and assumptions will only serve to frustrate the efficient functioning of the futures and derivatives markets. Without clear guidance as to the standards and duties of the proposed rule, market participants will be less willing and less able to compete vigorously in these markets. This, in turn, will adversely impact the liquidity and depth of markets generally, a detrimental and unintended consequence that Congress did not sanction and the Commission should seek to avoid.

B. The Commission Should Clarify that Its Proposed Rule Will Not Impose Any New Duties

The proposed rule should not impose new duties of disclosure, inquiry or diligence as this was not mandated or intended under Dodd-Frank and will serve only to increase the transaction and operational costs of legitimate trading activities. Section 747 of Dodd-Frank makes it "unlawful for any person to enter into a swap knowing, or acting in reckless disregard of the fact, that its counterparty will use the swap as part of a device, scheme or artifice to defraud any third party" under the new Section 4c(a)(7) of the CEA. The Commission's intention to adopt Rule 10b-5 precedent under its proposed rule in addition to Section 4c(a)(7) potentially creates new duties of inquiry and diligence on parties to bilateral transactions to limit exposure to fraud claims. We urge the Commission to make it explicit that the regulation will be

violated only if a party violates a pre-existing duty arising under contract, common law or some other non-CEA source.

The Associations support the Commission's clarification that:

Nothing in [the proposed rule] shall be construed to require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect.⁶

We further urge the Commission to similarly clarify that no additional implied duties should be inferred from the proposed rule.

The Associations seek clarification from the Commission that its proposed rule will not impede the ability of market participants to take positions and trade on the basis of nonpublic information that they obtain legitimately (i.e., not through the breach of a pre-existing duty to keep such information confidential or through another party's similar breach of a pre-existing duty). The Commission's proposed rule should not change the current state of the law, which does not require the disclosure of such information to a counterparty or to the market at large, nor should it prohibit legitimate trading based on such information.

Additional clarification should be provided with respect to entities trading on their own information. This is a critical point for commercial entities engaged in trading activities; these entities will simply not be able to function if they cannot trade on the basis of their own nonpublic information regarding the assets or liabilities being hedged. These entities cannot conduct their businesses in light of the uncertainty with respect to the legal standards governing their trading which will result from the Commission's incorporation of securities law concepts and case law. This will serve only to prevent commercial entities from engaging in legitimate and necessary trading activity.

In 1984, the Commission, based upon an extensive study of the nature, extent and effects of futures trading while in possession of material, nonpublic information, observed that:

The ability of any person to capture the value of his or her proprietary information is a traditional prerogative of commercial enterprise. Because the futures markets are derivative, risk-shifting markets, it would defeat the market's basic economic function of the hedging of risk if to question whether trading based on knowledge of one's own position were permissible.⁷

⁶ Prohibition of Market Manipulation, 75 Fed. Reg. 67657, 67662 (2010).

⁷ Commodity Futures Trading Commission, *A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information*, Submitted to H.R. Comm. on Agriculture and Sen. Comm. on Agriculture, Nutrition and Forestry, at 8 (Sept. 1984).

This remains equally true, if not more so, today. It would clearly be inimical to the risk-shifting function of the futures and derivatives markets if market participants were not allowed to continue to trade in such circumstances, or if they were uncertain about their ability to trade, under the Commission's proposed rule. As the 1984 report makes clear, contrary to the securities markets and laws, in which an "insider" with material, nonpublic information about his or her corporation is expressly prohibited from trading while in possession of that information, commercial hedgers routinely trade in the futures markets based precisely on that type of information. In fact, that is what defines commercial hedging in these markets. Prohibiting this activity, or casting uncertainty on its permissibility, will severely undermine the performance by these markets of their central function.

C. Extreme Recklessness, Not Recklessness Alone, Should Be the Scienter Standard Under the Commission's Proposed Rule.

In enacting Dodd-Frank Section 753, Congress used the same language (i.e., making it unlawful for any person "to use or employ . . . any manipulative device or contrivance") that it has used in other contexts and that courts have consistently interpreted to require scienter (i.e., intent to deceive, manipulate or defraud). As the Supreme Court held, in interpreting identical language in Section 10(b) of the Exchange Act, "The words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that [Congress] intended to proscribe knowing or intentional conduct . . ." because it "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."⁸

In terms of the type of "recklessness" that satisfies this standard, the only appropriate level of scienter for the futures and derivatives markets is "extreme recklessness," because this is the form of recklessness that effectively constitutes an affirmative intention.⁹ The Commission's proposed rule, therefore, should require "an extreme departure from the standards of ordinary care . . . to the extent that the danger [of misleading buyers or sellers] was either known to the defendant or so obvious that the defendant must have been aware of it," as the Seventh Circuit has held to be necessary for a violation of Rule 10b-5.¹⁰

By adopting the extreme recklessness standard, the Commission will join almost all the circuit courts which have considered the same question in the securities context, including Judge Posner from the Seventh Circuit.¹¹ The Associations recommend that the Commission be

⁸ *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197-99 (1976).

⁹ For an excellent discussion of intent as the only factor that distinguishes manipulative trading see Daniel R. Fischel & David J. Ross, *Should the Law Prohibit "Manipulation" in Financial Markets*, 105 Harv. L. Rev. 503, 510-512, 544-547 (1991).

¹⁰ See *SEC v. Lyttle*, 538 F.3d 601, 603, quoting *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 704 (7th Cir. 2008).

¹¹ See *id.*, see also *Phillips v. LCI Int'l, Inc.*, 190 F.3d 609, 621 (4th Cir. 1999); *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990) (*en banc*); *Ross v. Bank South, N.A.*, 885 F.2d 723, 730 n.10 (11th Cir. 1989); *Hackbert v. Holmes*, 675 F.2d 1114, 1118 (10th Cir. 1982); *Broad v. Rockwell*, 642 F.2d 929, 961 (5th Cir. 1981) (*en banc*); *McLean v.*

guided by the Federal Trade Commission's (the "FTC") experience when considering what the appropriate threshold level of scienter should exist for a violation of its anti-manipulation rules. In 2009, the FTC announced its final rule on the prohibition of market manipulation promulgated pursuant to Section 811 of Subtitle B of Title VIII of the Energy Independence and Security Act of 2007.¹² The FTC's rule requires that "a showing of *extreme recklessness* is, at a minimum, necessary to prove the scienter element."¹³ As such, the FTC concluded that proving scienter in market manipulation cases in the wholesale petroleum markets requires a showing that a person's conduct presents a danger of misleading buyers or sellers that is either known to the actor or is so obvious that the actor must have been aware of it.¹⁴ The Associations agree with the FTC that "whereas standards of ordinary care are well developed in the context of securities markets, they are less well defined in the context of wholesale petroleum markets," and would submit that the same applies equally to all other futures and derivatives markets.¹⁵

The extreme recklessness standard is the only appropriate level of scienter because it provides for both effective rule enforcement and clarity to market participants. Congress sought to protect the integrity of competitive markets but not at the expense of discouraging legitimate competition. The most appropriate way to ensure that the Commission's proposed rule punishes wrongdoers in the futures and derivatives markets, involving sophisticated commercial parties making decisions in real time and in many instances without perfect information, is to target those parties whose goal it is to create artificial prices through manipulative or other intentional conduct. In some cases, "scienter is the only factor that distinguishes legitimate trading from improper manipulation."¹⁶ Indeed, one commentator has noted that there is no objective definition of manipulation, and that therefore, "[e]verything turns on the intent of the trader."¹⁷ While a lower standard of scienter might be appropriate in the retail securities markets, the futures and derivatives markets involve sophisticated entities that can negotiate on an arm's-length basis to protect their own interests, and hence the Commission should require an extreme recklessness standard for a violation of its proposed rule.

The Associations urge the Commission to adopt the extreme recklessness standard to ensure that its proposed rule does not sweep too broadly and prohibit routine and legitimate trading strategies.¹⁸ Implementing a mere "recklessness" standard for the imposition of

Alexander, 599 F.2d 1190, 1197 (3d. Cir. 1979); *Mansbach v. Prescott, Ball, & Turben*, 598 F.2d 1017, 1025 (6th Cir. 1979); see also *Greebel v. FTP Software*, 194 F.3d 185, 198 (1st Cir. 1999); *Camp v. Dema*, 948 F.2d 455, 461 (8th Cir. 1991).

¹² Prohibitions on Market Manipulation, 74 Fed. Reg. 40686 (Aug. 12, 2009).

¹³ *Id.* at 40691 (emphasis added).

¹⁴ *Id.* at 40692 (Aug. 12, 2009).

¹⁵ *Id.*

¹⁶ *ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 102 (2d. Cir. 2007).

¹⁷ See Fischel & Ross, *supra* note 9, at 512.

¹⁸ See *ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 102 (2d Cir. 2007) (stating "in some cases scienter is the only factor that distinguishes legitimate trading from improper manipulation").

substantial civil penalties could have myriad unintended adverse consequences. Traders may find it necessary to reduce their participation for fear that competitive trading strategies currently adopted may be misconstrued by the regulators with the benefit of hindsight. Similarly, potential entrants may decide that regulatory risks outweigh potential benefits and not enter the market at all, significantly reducing the liquidity and depth of markets. By requiring a showing of extreme recklessness, rather than ordinary recklessness, the Commission will provide assurance that the final rule does not capture inadvertent conduct or mere mistakes and is consistent with legal standards in other similar contexts. We urge the Commission not to go beyond Congress's intent in Dodd-Frank and to prevent any unintended detrimental effects on the liquidity of the markets.

Additionally, we note that the rule proposed by the Commission is much broader than Rule 10b-5 and the anti-manipulation rules of the FTC and the Federal Energy Regulatory Commission ("FERC"). The Commission's proposed rule imposes liability on the intentional or reckless "use or employ[ment], or attempt[ed] . . . use or employ[ment of], any manipulative device, scheme, or artifice to defraud."¹⁹ Neither Rule 10b-5 nor the FTC's rule contain the language regarding "attempts." Similarly, FERC declined to add "attempts" in its rule on the prohibition of energy market manipulation.²⁰ Under current law, to satisfy a claim for attempted manipulation the CFTC must show: (1) an intent to affect market prices and (2) an overt act in furtherance thereof.²¹ It is not entirely clear what set of facts would constitute a reckless attempt within the meaning of the Commission's proposed rule. The Associations urge the Commission to remove this language and clarify that the requirements for attempted manipulation remain consistent with current law, and that the prohibitions under the Commission's antifraud rule do not sweep more broadly than other comparable antifraud rules.

The Associations stress that they disagree with the final promulgated rules by both the FTC and FERC. The rules promulgated by both the FTC and FERC are not sufficiently tailored to reflect the futures and derivatives markets' distinct features from the securities markets. We note that the Commission's jurisdiction in the futures markets is far more expansive than that of the FTC and FERC, and thus, the potential for damaging the efficient functioning of an entire financial segment is much greater than either the FTC's or FERC's rules. The Commission's expansive jurisdiction requires that it seriously undertake an effort to tailor the final rule to the distinct characteristics of the futures and derivatives markets.

Nevertheless, the Associations endorse the FTC's approach insofar as it makes it a violation of its rule to

intentionally fail to state a material fact that under the circumstances renders a statement made by such person

¹⁹ Prohibition of Market Manipulation, 74 Fed. Reg. at 67658 (Nov. 3, 2010).

²⁰ Prohibition of Energy Market Manipulation, 71 Fed. Reg. 4244, 4258 (Jan. 26, 2006) (codified 18 C.F.R. 1c).

²¹ *U.S. Commodity Futures Trading Comm'n v. McGraw-Hill Cos.*, 507 F. Supp. 2d 45, 51 (D.D.C. 2007) (stating "Attempted manipulation is demonstrated by the intent to affect market prices and some 'overt act' in furtherance thereof.") (internal citations omitted).

misleading, provided that such omission *distorts or is likely to distort market conditions for any product* (emphasis added).²²

We urge the Commission to require a similar showing that its rule would prohibit only those misrepresentations or omissions that can be expected to have a distorting effect on the market. We submit that similar to the FTC's rule, the Commission should include the language "that affect or tend to affect the price of any commodity" that is currently in Section 180.1(a)(4) of its proposed rule to each of the other prongs of its proposed rule under Section 6(c)(1). In so doing, it would give market participants the certainty that representations or statements with material omissions will not be challenged if they do not have a distorting effect on the market.

D. The Commission Should Clarify the Scope of the Proposed Rule Under Section 6(c)(1) and the Commission's Already Existing Anti-Manipulation Authority Under CEA Section 9(a)(2) and Broad Antifraud Authority Under CEA Section 4b.

The Associations seek clarity and additional guidance from the Commission regarding the scope of the proposed rule under Section 6(c)(1) and how it relates to the Commission's anti-manipulation authority under Section 9(a)(2) and broad antifraud authority under Section 4b.

The Commission has historically relied on other provisions of the CEA, including Section 9(a)(2) and the prior Section 6(c), in its administrative and civil enforcement actions against fraud-based manipulation and attempted manipulation, requiring some form of deception, such as reporting of false prices or the making of false statements. Section 6(c)(1) of the CEA now grants the Commission anti-manipulation authority over swap transactions. It also significantly broadens the Commission's anti-fraud authority to include any kind of materially false or deceptive conduct that is intended to create an artificial price. While Section 9(a)(2) is limited to "false or misleading or knowingly inaccurate reports concerning crop or market information or conditions," Section 6(c)(1) of the CEA now extends the prohibition to "any untrue or misleading statement" which significantly augments the Commission's authority in this area. Dodd-Frank subsection 6(c)(1)(B) states that nothing in the new law shall affect, or be construed to affect, the applicability of CEA Section 9(a)(2).

While Section 6(c)(1) expands and clarifies the Commission's anti-fraud authority, it is unclear to market participants whether or to what extent the proposed rule under Section 6(c)(1) of the CEA, will grant to the Commission any new antifraud authority that it did not already have either under Section 9(a)(2) of the CEA or the broader antifraud provision Section 4b of the CEA. The Commission has expressly stated in its proposing release that its authority under Section 9(a)(2) remains unaffected by the proposed rule and thus will remain available as an enforcement mechanism which may be used in concert with the proposed rule.²³

²² Prohibition of Energy Market Manipulation, 71 Fed. Reg. 4244, 4258 (Jan. 26, 2006) (codified 18 C.F.R. § 317.3(b)). § 317.3(b) is limited to omissions; nonetheless, we believe the Commission should apply this limitation to misrepresentations as well omissions.

²³ Prohibition of Market Manipulation, 75 Fed. Reg. at 67658 (Aug. 12, 2009).

This causes confusion and uncertainty to market participants who require straightforward guidance about the types of behavior that are prohibited. Market participants faced with overlapping and potentially inconsistent rules relating to the same activities are likely to reduce their participation because of the risk that activity permitted by one provision may be penalized under another. Therefore, the Commission should clearly delineate the differences between the relevant provisions and provide unequivocal guidance as to the type of conduct prohibited under each.

III. The Commission's Proposed Rule Under Section 6(c)(3) of the CEA.

Because the CEA was only recently amended to extend the antifraud prohibition in Section 4b of the CEA to certain principal-to-principal transactions in 2008²⁴ and to grant the Commission authority over swaps by the elimination of Section 2(g) in 2010,²⁵ the Commission should examine whether its existing authority is sufficiently broad and clear enough before it pursues any new and vague rulemaking under Section 6(c)(3). Unlike Section 6(c)(1) of the CEA, Section 6(c)(3)'s own terms do not require that the Commission promulgate rules. The Commission has nonetheless proposed to exercise its general rulemaking authority under Section 8(a)(5) to promulgate a rule under Section 6(c)(3). This decision is unwarranted, given the Commission's already expansive and well-developed authority under Section 9(a)(2) of the CEA.

While it is unclear what Section 6(c)(3) adds to the Commission's enforcement authority beyond an already expansive authority under Section 9(a)(2), the Commission should not use Section 6(c)(3) as a springboard from which to lower the specific intent standard traditionally required in manipulation cases. Instead, the Commission should issue clarifying guidance that conforms to the traditional framework of enforcement. Most importantly, specific intent should remain a required element for enforcement actions under Section 6(c)(3), because nothing in Section 6(c)(3)'s plain terms implies that a lesser level of intent is necessary than the comparable Section 9(a)(2) authority. And as was explained above, "[d]efinitions that do not include intent fail to distinguish manipulative conduct from legitimate market activity."²⁶

Should the Commission nonetheless decide to promulgate a rule under Section 6(c)(3) of the CEA, it should do so consistently with recent judicial precedent. Rulemaking under Section 6(c)(3) should clarify that it is limited to the theory of liability that was upheld by the Second Circuit in *DiPlacido*.²⁷ Moreover, the Commission should clarify that, aside from extending its enforcement authority to cover swap transactions, it is not articulating any new

²⁴ CFTC Reauthorization Act of 2008 §13001 (Title XIII of the Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-234, 122 Stat. 923, 1428-29) (2008).

²⁵ Dodd-Frank § 723(a)(1)(A).

²⁶ Fischel & Ross, *supra* note 9, at 545.

²⁷ *In re DiPlacido*, Comm. Fut. L. Rep. (CCH) ¶ 30970, 2008 WL 4831204 (CFTC 2008), *aff'd* in pertinent part, *DiPlacido v. Commodity Futures Trading Comm'n*, Comm. Fut. L. Rep. (CCH) ¶ 20,271 at 21,477, 364 Fed. Appx. 657, 2009 WL 3326624 (2d Cir. 2009).

standards or expanding beyond any of its existing authority relating to manipulative conduct, given the *DiPlacido* precedent.

The Associations support the Commission's statement reaffirming that the traditional four-part test, developed from manipulation cases involving "corners" and "squeezes," needed to impose liability under its proposed rule, which requires the Commission to establish that: (1) the alleged manipulator had the ability to influence market prices; (2) the alleged manipulator specifically intended to do so; (3) artificial prices existed; and (4) the alleged manipulator caused the artificial prices. This is a long-standing test that market participants are familiar with and provides some guidance for their trading activities. The Commission further correctly recognizes that nothing in Dodd-Frank changes the Commission's authority with respect to the Commission's anti-manipulation authority under Section 9(a)(2) over manipulative conduct that exploits market power, such as a "corner" or a "squeeze."

However, the Associations are concerned that the Commission may be misreading Section 6(c)(3) to provide the Commission with authority that Congress did not intend it to have. The Associations believe that the Commission's statement "the conclusion that prices [are] affected by a factor not consistent with normal forces of supply and demand will often follow inescapably from proof of the actions of the alleged manipulator" is an overly aggressive reading of judicial precedent like *DiPlacido*. To the extent that the Commission's proposed rule attempts to create a presumption that a price is artificial merely because one or more isolated transactions are deemed uneconomic, without proof of specific intent to create artificial prices, it would constitute an over-reading of judicial precedent and is unwarranted.

Moreover, there are a variety of *bona fide* commercial reasons for conducting trades that may appear on their face to lack economic rationale but which are not specifically intended to create artificial prices (e.g., hedging activities during the closing period). These legitimate trading activities can be distinguished from the concentrated, aggressive and unusual pattern of trading that the defendants in *DiPlacido*²⁸ or in *Henner*²⁹ had engaged in, and the Commission should clarify that these activities are not prohibited by the Commission's proposed rule.

* * * *

²⁸ *In re DiPlacido*, Comm. Fut. L. Rep. (CCH) ¶ 30970, 2008 WL 4831204, at *2-4 (CFTC 2008).

²⁹ *In re Henner*, 30 Agric. Dec. 1151, 1157 (1971).

We appreciate the opportunity to provide comments to the Commission regarding the proposed rules on the prohibition of market manipulation, and we would be pleased to discuss any questions the Commission might have with respect to this letter.

Very truly yours,



John M. Damgard
President, FIA



Robert G. Pickel
Executive Vice Chairman, ISDA



Kenneth E. Bentsen, Jr.
Executive Vice President, Public Policy and Advocacy, SIFMA

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Robert Pease, Counsel to the Director of Enforcement
Mark D. Higgins, Counsel to the Director of Enforcement

Exhibit E



Craig S. Donohue
Chief Executive Officer

VIA ELECTRONIC MAIL

January 3, 2011

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
secretary@cftc.gov

Re: Notice of Proposed Rulemaking on Prohibition of Market Manipulation – RIN #: 3038-AD27

Dear Mr. Stawick:

CME Group Inc. ("CME Group"), on behalf of its four designated contract markets ("Exchanges"), appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Notice of Proposed Rulemaking ("NOPR" or "*Release*") with respect to Section 753 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") – titled Anti-Manipulation Authority.

CME Group shares Congress' and the Commission's objective of promoting transparency and integrity in financial markets, and doing so in a manner that preserves the vibrancy and competitiveness of U.S. markets in the global economy. Market integrity is one of the cornerstones of CME Group's business model, and the company employs substantial human resources and technological capabilities to protect and continually enhance the integrity of its markets and mitigate the potential for market disruptions. We recognize that our customers' confidence in that commitment is essential to our ability to draw participants and liquidity to our markets and allows us to effectively serve the risk management and price discovery needs of users around the globe.

CME Group is the world's largest and most diverse derivatives marketplace. CME Group includes four separate Exchanges, including Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products.

CME includes CME Clearing, one of the largest central counterparty clearing services in the world, which provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives transactions through CME ClearPort®.

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The CME Group Exchanges serve the hedging, risk management and trading needs of our global customer base by facilitating transactions through the CME Globex® electronic trading platform, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions.

I. INTRODUCTION

We believe that there is a shared interest among market participants, exchanges, and regulators in having market and regulatory infrastructures that promote fair, transparent and efficient markets and that mitigate exposure to risks that threaten the integrity and stability of markets. We believe that there is also a shared interest among market participants, exchanges, and regulators in operating under a set of rules that clearly define impermissible conduct and having confidence that the governing disciplinary regime is applied fairly and rationally. Indeed, if market participants do not know the rules of the road in advance and lack confidence that the disciplinary regime will operate fairly and rationally, market participation will be chilled because there is significant risk that legitimate trading practices will be arbitrarily construed, post-hoc, to be unlawful.

In the NOPR, the Commission proposes two rules. The first rule, Rule 180.1, is being proposed pursuant to Section 753 of Dodd-Frank, which grants the Commission general manipulation authority. Section 753 is based on Section 10(b) of the Securities Exchange Act, and the Commission's proposed Rule 180.1 is based on the Securities Exchange Commission's Rule 10b-5. The second rule, Rule 180.2, is being proposed pursuant to the Commission's general rulemaking authority, and mirrors the language in CEA Section 6(c)(3), which specifically prohibits price manipulation. As written, proposed Rules 180.1 and 180.2 are vague and fail to provide market participants with sufficient notice of whether contemplated trading practices run afoul of these Rules.

With respect to proposed Rule 180.1, the Commission relies completely on Rule 10b-5 and the body of case law that exists interpreting that Rule. Although the language in Section 753 is based on Section 10(b) of the Securities Exchange Act and the Securities Exchange Commission's Rule 10b-5, Rule 10b-5 was adopted and applied in a totally different market and, consequently, different regulatory context. The securities markets focus on capital raising investments where disclosure of all material market information is the desired outcome and where special regulatory structures have been established for those disclosures. Moreover, the regulation of securities markets is focused to a substantial extent on protecting retail investors and is intended to provide a forum to trade securities on a level playing field where insiders and those they "tip" are precluded from trading on the basis of inside information.

In contrast, nothing in the CEA mandates disclosure of market conditions or facts pertaining to the markets for commodities, including energy, interest rates and corn.¹ As the Commission

¹ Commission Rule 1.59(d) prohibits exchange governing board members, committee members, members, employees and consultants from disclosing or trading in any commodity interest on the basis of material, nonpublic information obtained through their official exchange duties. Furthermore, this rule also prohibits any person from trading in any commodity interest, whether for such person's own account or on behalf of another person, on the basis of material, nonpublic information that such person knows was obtained in violation of Commission rule from an exchange governing board member, committee member, member, employee or consultant. See also CEA §9(e).

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knows, the markets it regulates serve a price discovery function for the underlying commodities. An effective forum for the efficient discovery of prices requires that hedgers, who have information based on their operations, and speculators, who accumulate information in order to profit, be encouraged to bring that information to the market in the form of bids and offers. Indeed, the price discovery function is optimized when all market information known to hedgers or to speculators is reflected in the market price of a given contract. In addition, these markets, which react to world-wide supply and demand factors, have different "material information" considerations than markets that focus on the fortunes of a single company. Thus, futures, options, swaps and physical commodity markets are quite different than securities markets. As discussed in more detail below, the proposed rule's failure to account for these differences results in a lack of clarity for market participants.

With respect to proposed Rule 180.2, the Commission also states in the Release that it will continue to interpret price manipulation and attempted price manipulation prohibitions "to encompass every effort to improperly influence the price of a swap, commodity or commodity futures contract. (75 FR 67658.) Even if this statement did not conflate an "attempt" with actual price manipulation (as it clearly does), it provides no guidance to market participants as to what types of conduct would qualify as an "effort to influence", nor does it explain how market participants can distinguish an "improper" effort from a "proper" effort.

Is it improper for a market participant to seek legislation from Congress to increase the use of natural gas while he holds natural gas interests? Is he required to disclose his interests in natural gas in connection with his statements? What if the market participant merely is interviewed by the media and expresses a view that natural gas is under-utilized and under-valued today? Is it improper for a farmer, to make public statements regarding potential shortages in a years' supply of corn if the farmer holds an interest in an ethanol refinery? Would the farmer be required to disclose any financial interests in that refinery in conjunction with these statements? As discussed in more detail below, additional elements of this rule require additional clarity from the Commission.

To promote fair and efficient markets and protect market liquidity and the price discovery and risk management functions served by the futures markets, the Commission must revise its proposed rules and provide greater clarity to market participants regarding the scope of prohibited conduct. Additionally, without further guidance from the Commission, the proposed rules are susceptible to constitutional challenge because due process precludes the government from penalizing a private party for violating a rule without first providing adequate notice that his contemplated conduct is forbidden by the rule.² As a result, courts will dismiss prosecutions, frustrating the Commission's enforcement efforts. Set forth below are our detailed comments for the Commission's consideration in promulgating final rules to address its new anti-manipulation authority under Dodd-Frank.

II. DETAILED COMMENTS

² See, e.g., *U.S. v. Radley*, 659 F.Supp.2d 803, (S.D. TX. 2009) (finding that the CEA's prohibition of price manipulation was unconstitutionally vague as applied to defendants); see also *Satellite Broad. Co. v. FCC*, 824 F.2d 1, 3 (D.C. Cir. 1987) ("Traditional concepts of due process incorporated into administrative law preclude an agency from penalizing a private party for violating a rule without first providing adequate notice of the substance of the rule.").

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A. Proposed Rule 180.1, unlike SEC Rule 10b-5 on which it is modeled, should not prohibit any market participant from trading on non-public “inside” information

In its *Release*, the Commission proposes implementing a rule modeled on SEC Rule 10b-5, but “with modification to reflect the CFTC’s distinct regulatory mission and responsibilities.” CME Group agrees with the Commission’s assessment that fundamental differences exist between the securities and futures markets and believes that, in accordance with the CFTC’s distinct regulatory mission and responsibilities in regulating futures markets – which are much different from securities markets – the Commission should confirm that it will not import insider trading law from SEC Rule 10b-5 into its regulatory framework. Such rules are and should be inapplicable to futures markets.

“Insider Trading” refers to buying or selling securities on the basis of material, nonpublic information in breach of a duty; in securities markets, insider trading violates Section 10(b) of the Exchange Act and SEC Rule 10b-5. The CEA does not prohibit and has never prohibited market participants from trading on the basis of material nonpublic information, unless the participant has received a tip from a government or self-regulatory official. The reason for this difference in futures and securities regulation lies in the basic differences in futures and securities markets. As recognized in “A Joint Report of the SEC and the CFTC on Harmonization of Regulation” (October 16, 2009) (“2009 Report”), securities markets are concerned with the formation of capital, and this capital formation role gives rise to the interest in promoting disclosure in securities regulations. That is, a central principle in equity markets is ensuring that all market participants have equal access to material information. Insider trading prohibitions are intended to prevent corporate insiders from misusing of inside information at the expense of their shareholders.

As the Commission knows, the purpose of futures markets is not capital formation but rather to facilitate the management and transfer of risk. Commodities regulation does not provide a regulatory regime for the disclosure of the macro-economic information that concerns the supply and demand dynamics that affect commodity prices and is designed, in part, to promote the interests of hedgers to protect themselves against commodity price risks based on their own knowledge of material nonpublic information about supply and demand conditions and the needs of their businesses. *See also, Chicago Mercantile Exch. v. SEC*, 883 F.2d 537, 543 (7th Cir. 1989) (“securities usually arise out of capital formation and aggregation (entrusting funds to an entrepreneur) while futures are means of hedging, speculation, and price revelation without transfer of capital. The distinction between the jurisdiction of the SEC and that of the CFTC can be described as the difference between regulating capital formation and regulating hedging”).

The use of inside information by a company to hedge its risks is integral to futures markets. Many key participants in futures markets have legitimate access to what could be described as “superior” information. (“A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information” (September 1984) at 53) (“1984 Study”). Hedgers are privy to nonpublic information that may be material to the futures markets. (*Id.*) Speculators have knowledge of their own positions and may also have superior resources with which to purchase or develop information. (*Id.*) This superior access to information is inherent in futures markets, and market participants voluntarily accept this situation if they choose to trade. (*Id.* at 54.)

Moreover, the relationships and duties that give rise to insider trading liability in the securities markets simply do not exist in the futures markets. Insider trading liability is reliant on the

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fiduciary relationship between corporate insiders and their shareholders. *Chiarella v. United States*, 445 U.S. 222, 228 (1980) (citing *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961)). That is, "application of a duty to disclose prior to trading guarantees that corporate insiders, who have an obligation to place the shareholder's welfare before their own, will not benefit personally through fraudulent use of material, nonpublic information." *Id.* This fiduciary duty, which gives rise to liability for insider trading, does not exist in futures markets. No fiduciary relationship exists between an "insider" and a person on the opposite side of a trade in a futures market. See 1984 Report at 56; 2009 Report at 7. Rather, corporate insiders' duties are to ensure that the company properly manages its risks by trading on the best available information. (2009 Report at 7.) As such, there is no basis for general insider trading liability in futures markets, because trading by persons with "inside information" does not raise the same concerns it raises in the securities market. (2009 Report at 60.) In fact, the Commission has found that insider-type trading is, at least in part, what causes the futures market's price discovery process to work. In its 1984 study on insider trading in futures markets, the Commission did not even consider the possibility of applying insider trading law to a hedger. (1984 Report at 8.) To the contrary, it stated:

The ability of any person to capture the value of his or her proprietary information is a traditional prerogative of commercial enterprise. Because the futures markets are derivative, risk-shifting markets, it would defeat the market's basic economic function – the hedging of risk – to question whether trading based on knowledge of one's own position were permissible. Accordingly, consistent with the Congressional mandate, trading on the basis of one's own cash or futures markets positions is exempt from any discussion of insider trading.

(*Id.* at 8.) In that same study, the CFTC recognized that insider trading may provide "a vehicle to enhance the pricing efficiency of futures markets." (*Id.* at 52.) Trading on the basis of material nonpublic information in futures causes the transmission of information regarding accurate pricing for a commodity into the futures market, therefore allowing more accurate commodity prices to be reflected in the market even absent disclosure of the nonpublic information available to the trader. (*Id.* at 44, 47.) Futures trading based on nonpublic material information actually enhances the informational efficiency of the market by expediting the incorporation of new information in the market price via the bids and offers of an insider. (*Id.* at 48.) For all of these reasons, the CFTC did not recommend full insider trading liability under the CEA in either its 1984 Study or its recent 2009 Report. Specifically, in that most recent report, the SEC and CFTC recommended only that the CEA be amended "to make unlawful the misappropriation and trading on the basis of material non-public information from any governmental authority." (2009 Report at 13.) In Dodd-Frank, Congress adopted that recommendation into the CEA. See CEA § 4c(a)(3) and (4).

In addition to "traditional" SEC insider trading liability, courts have also recognized fairly recently a "misappropriation" theory of insider trading. The relatively new "misappropriation" theory should not be applied to commodities markets or, at most, should be applied only in extremely limited circumstances. Under the misappropriation theory, a person commits fraud in connection with a securities transaction and thereby violates § 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information." That is, "in lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information." *United States v. O'Hagan*, 521 U.S. 642, 652 (1997). Misappropriation theory "is designed to 'protect the integrity of the securities

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markets against abuses by outsiders to a corporation who have access to confidential information that will affect the corporation's security price when revealed, but who owe no fiduciary or other duty to that corporation's shareholders." *Id.* at 653 (internal citation omitted).

Like traditional insider trading, liability based on misappropriation should not be applied to futures markets. Although not directly related to the fiduciary duty of a corporate insider to the corporation's shareholders, misappropriation liability still relies on the concern of equity markets that all participants have equal access to information. That concern, as discussed above, simply does not exist in futures markets and as such, misappropriation liability is not necessary to protect equal access to information. See, e.g., *O'Hagan*, 521 U.S. at 2207 (noting that misappropriation theory is "designed to 'protect the integrity of the securities markets against abuses by 'outsiders' to a corporation who have access to confidential information that will affect the corporation's security price when revealed'"); *SEC v. Rocklage*, 470 F.3d 1, 11 (1st Cir. 2006) (noting the investor protection purposes of 10(b) in the context of misappropriation). Other concerns addressed by misappropriation liability, such as breaches of fiduciary duty, are easily and best dealt with through other actions, such as state law actions for breach of fiduciary duty and unjust enrichment. Indeed, in the 2009 Report, the Commission recommended that misappropriation liability only be applied to futures markets in one extremely limited context: when an individual acquires material non-public information from a government authority. (2009 Report at 92.)

B. The Commission should not impose an affirmative duty to provide market-wide disclosure nor an expansive duty to correct upon participants in futures markets

Section 6(c)(1) provides that no CFTC rules "shall require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in connection with the transaction not misleading in any material respect." The CFTC adopts this language in its proposed Rule 180.1(b). It is unclear from the *Release*, however, whether the CFTC intends this language to prohibit an affirmative duty to disclose as applied to only bilateral negotiations or also to multiple party and market-wide disclosures. CME Group believes that the statute's bar on affirmative disclosure and the CFTC's rules should apply to both.

The statutory language indicates that proposed Rule 180.1(b) should apply to both bilateral negotiations and market-wide disclosure. Proposed Rule 180.1 is promulgated under Section 6(c)(1), which is not limited by its terms to bilateral negotiations. Indeed, similar provisions directly applied to bilateral negotiations already appear in Section 4b. Regardless, imposing any duty to affirmatively disclose information is improper because in futures markets, there is no right to any information before trading, let alone roughly equal, issuer-sponsored, material information.

Additionally, the language of Dodd-Frank and the proposed rule leave open the possibility of a requirement that a participant in the futures markets be required to disclose information "necessary to make any statement made to the other person in or in connection with a transaction not misleading in any material respect." First, CME Group asks that the Commission confirm that it is not placing any new duty of disclosure akin to that in securities markets upon participants in futures markets in promulgating this rule. Second, CME Group suggests that the Commission narrowly circumscribe any potential requirement to correct an inaccurate statement. Such a requirement could best be circumscribed to require only disclosure to correct a statement that a futures market participant realizes was incorrect when

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that participant made a statement if the participant realized that the statement was incorrect within a reasonable time after making it. If such requirement to correct is not properly circumscribed, it could very quickly morph into a general affirmative duty to disclose, which, as discussed at length above, has no place in the regulation of the futures markets. Assume, for example, that a market participant is asked whether it has a contract to export, and it truthfully answers that it does not. Does it then have to correct that statement if circumstances change before it hedges a contract entered into a week later? What about a month or a year later? This situation, if not circumscribed, becomes an inappropriate ongoing duty to disclose proprietary information.

In sum, CME Group is concerned that the Commission may, through its proposed Rules, apply securities laws to futures markets that are first, inapplicable to futures markets and second, clearly detrimental to the proper functioning of futures markets. More specifically, CME Group suggests that the application of insider trading law to futures markets would, most notably, inhibit the ability of hedgers to protect against risk based upon their knowledge of their own businesses and positions and would, consequently, inhibit the price discovery function of futures markets. Additionally, a broad application of a duty to correct could become a general affirmative duty to disclose which, like insider trading laws, is not warranted in futures markets. As such, CME Group suggests that the Commission confirm that: 1) it does not intend, through proposed Rule 180.1, to impose insider trading liability, either under the traditional or misappropriation theory, upon participants in futures markets; 2) it does not intend to impose a duty to disclose nonpublic information either in the context of an individual transaction or in the context of a multi-party or market-wide disclosure. Further, CME Group suggests that the Commission very narrowly circumscribe any potential duty to correct a statement in order to render it not materially misleading.

In seeking to clarify the nature and scope of the prohibitions under its proposed Rule 180.1, the Commission should refrain from blanket application of SEC Rule 10b-5 concepts and standards to the commodities and derivatives markets. CME Group has long maintained, consistent with positions the Commission itself has taken, that the precedent developed in the securities fraud context is *largely* inapplicable to CFTC-regulated markets due to key differences in the market structures discussed earlier (i.e. types of market participants, applicable duties, material information considerations). However, CME Group believes that the Commission can and should borrow concepts from the SEC's anti-fraud and anti-manipulation framework, as well as that of other agencies, where doing so would allow for sensible regulation of the commodities and derivatives markets. For the reasons stated below, CME Group particularly supports the Commission being "guide[d], but not control[led],"³ by other agencies', including the SEC's, standards for scienter and the "in connection with" requirement.

C. The Commission Should Adopt a Scienter Standard that Requires, at Minimum, a Showing of "Extreme Recklessness"

³ The Commission uses this specific phrase in its Notice of Proposed Rulemaking when discussing the weight to be given judicial precedent from the securities context, and further comments that its proposed rule 180.1 (particularly the scienter standard) must be applied "in a manner that comports with the purposes of the CEA and the functioning of markets regulated by the CFTC." 75 Fed. Reg. 67657, 67659 (Nov. 3, 2010).

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The proposed rule fails to define with sufficient particularity the conduct that is prohibited. That failure creates significant issues as to the validity of the rule, which may be slightly mitigated if the intent or knowledge prerequisite to a violation is carefully defined. In its NOPR, the Commission states that “scienter” in the context of proposed Rule 180.1, just as with the similarly worded SEC Rule 10b-5, “refers to a mental state embracing intent to deceive, manipulate or defraud, and [] includes recklessness” but excludes negligent and grossly negligent conduct. (75 Fed. Reg. at 67659.) CME Group urges the Commission to clarify what it considers to be “recklessness” for purposes of its proposed rule. Further, CME Group recommends that the Commission model its standard for recklessness on the thresholds adopted by courts in the securities fraud context and by the FTC. At the very least, “recklessness” should require conscious disregard for the near certainty that one’s actions will result in deception, manipulation or fraud.

Even in securities law cases, where one might think that a lower scienter standard would be used in the interest of protecting retail investors, the requisite level of “recklessness” is very high. All of the Circuit Courts of Appeal have decided that, in addition to intentional misconduct, only recklessness that is “extreme” or “severe” will satisfy the scienter standard under Exchange Act Section 10(b) and SEC Rule 10b-5.⁴ “Extreme recklessness” is generally defined in the applicable case law as conduct that “involves an extreme departure from the standards of ordinary care and which presents a danger of misleading buyers and sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.” See, e.g., *Sundstrand Corp.*, 553 F.2d at 1045. In *In re Silicon Graphics Inc.*, the Ninth Circuit observed that the words “known” and “must have been aware” suggest that extreme recklessness involves consciousness or deliberateness and therefore is a degree of intentional misconduct. 183 F.3d at 977.

The rationale behind adopting this high threshold for recklessness in the securities context is compelling and applies with equal or greater force to CFTC-regulated markets: an ordinary recklessness standard, capturing inadvertent conduct or mistakes, would discourage legitimate market activity. Indeed, in *Novak v. Kasaks*, the Second Circuit explicitly identified several types of legitimate practices that would not come within the understanding of “extreme recklessness.” 216 F.3d at 309. For one, the court noted that a defendant would not be liable for securities fraud based on reckless conduct if he commits “fraud by hindsight” – i.e. makes projections or forward-looking statements that are shown *after the fact* to have been unwarranted. *Id.* The basic principle underscored by the Second Circuit in *Novak* (and echoed by every other circuit court) that a person should only be punished for knowing or intentional wrongdoing is not only relatively easy for regulators to apply, but is also readily grasped by market participants.

⁴ See *Rockies Fund v. SEC*, 428 F.3d 1088 (D.C. Cir. 2005); *Ottmann v. Hanger Orthopedic Group, Inc.*, 352 F.3d 338 (4th Cir. 2003); *City of Philadelphia v. Fleming Cos.*, 264 F.3d 1245 (10th Cir. 2001); *Florida State Board of Administration v. Green Tree Financial Corp.*, 270 F.3d 645 (8th Cir. 2001); *Nathenson v. Zonagen Inc.*, 267 F.3d 400 (5th Cir. 2001); *Howard v. Everex Systems, Inc.*, 228 F.3d 1057 (9th Cir. 2000); *Novak v. Kosaks*, 216 F.3d 300 (2d Cir. 2000); *Bryant v. Avarado Brands, Inc.*, 187 F.3d 1271 (11th Cir. 1999); *In re Silicon Graphics Inc. Securities Litigation*, 183 F.3d 970 (9th Cir. 1999); *In re Comshare, Inc. Securities Litigation*, 183 F.3d 542 (6th Cir. 1999); *In re Advanta Corp. Securities Litigation*, 180 F.3d 525 (3d Cir. 1999); *Greebel v. FTP Software, Inc.*, 194 F.3d 185 (1st Cir. 1999); *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir. 1977).

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The Federal Trade Commission (FTC) has also adopted an “extreme recklessness” standard for its final rule on the prohibition of market manipulation. See 74 Fed. Reg. 40686, 40691 (Aug. 12, 2009). The FTC clarified, however, that its definition of extreme recklessness would not require a departure from “ordinary care” because “whereas standards of ordinary care are well developed in the context of securities markets, they are less well defined in the context of wholesale petroleum markets.” *Id.* at 40692. Thus, the FTC’s extreme recklessness standard “require[s] showing only that a person either knew or must have known that his or her conduct created a danger of misleading buyers or sellers.” *Id.* The FTC’s reason for adopting this high threshold is the same as the one underlying the securities fraud cases discussed above: to provide both for clarity to market participants and effective rule enforcement. In the FTC’s own words, the extreme recklessness standard “appropriately focuses [the broad anti-fraud prohibition] on conduct that presents an obvious risk of misleading buyers and sellers, and ensures that [the prohibition] does not reach inadvertent mistakes, which could have the unintended effect of curtailing beneficial market activity.” *Id.* at 40694.

CME Group encourages the Commission to adopt an “extreme recklessness” standard for the same reasons articulated by the FTC and by the courts in the securities case law addressing scienter under SEC Rule 10b-5. CME Group believes that such a standard strikes an appropriate balance between protecting the integrity of competitive markets and allowing for legitimate competition, thereby ensuring that the liquidity and depth of the CFTC-regulated markets, which promote the public interests served by these markets (CEA §3(a)), will not be impaired. In terms of the precise definition of “extreme recklessness,” CME Group suggests that the Commission use the FTC’s formulation, which does not require a showing of a departure from “ordinary care.” CME Group agrees with FIA that the FTC’s reasoning that standards of ordinary care are “not well developed,” in wholesale petroleum markets and should not be used in formulating applicable recklessness standards, “applies equally to all other commodities and derivatives markets.” See FIA Comments at 7.

D. The Commission Should Interpret the “In Connection With” Standard to Require a Nexus Between Transactions (or Offers to Transact) Subject to CFTC Jurisdiction and Prohibited Fraudulent or Deceptive Conduct

The “in connection with” language of the CFTC’s statutory authority for its anti-manipulation rules (new CEA Section 6(c)(1)) is noticeably different in scope from the parallel statutory language of other agencies. Whereas the SEC, FTC, and Federal Energy Regulatory Commission (FERC) have the authority to prohibit fraud-based manipulative schemes “in connection with the *purchase or sale of*” products subject to their jurisdiction,⁵ the CFTC has the authority to prohibit such schemes “in connection with” products themselves – namely, “any

⁵ For the full text of the SEC’s statutory anti-manipulation authority, including the “in connection with” language, see 15 U.S.C. § 78j (implementing provisions of the Securities Exchange Act of 1934, June 6, 1934, ch. 404, title I, Sec. 10, 48 Stat. 891, as further amended).

For the full text of the FTC’s statutory anti-manipulation authority, including the “in connection with” language, see 42 U.S.C.A. §§ 17301-17305 (implementing provisions of the Energy Independence and Security Act of 2007, Pub. L. No. 110-140, 121 Stat. 1723).

For the full text of the FERC’s statutory anti-manipulation authority, including the “in connection with” language, see 16 U.S.C. § 824v and 15 U.S.C. § 717c-1 (implementing provisions of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594).

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swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.” The sheer breadth of the CFTC’s “in connection with” language – absent the “purchase or sale of” limitation found in comparable agency statutes – creates a specter of serious unintended consequences. For example, the prohibition on fraud or deception “in connection with . . . any commodity” sweeps so broadly that, on its face, it could even subject someone to liability for putting out a deceptive weather forecast or supermarket advertisement.

To ensure that the CFTC’s “in connection with” standard does not cover conduct that Congress could not have meant to proscribe through the CEA’s new provision, some context or limitation must be read into the statute and the Commission’s proposed rule, which tracks the statutory language. In its NOPR, the Commission seems to import a limitation from the securities context, stating that “in connection with” under CEA Section 6(c)(1) should have the same meaning as the Supreme Court gave those words in *SEC v. Zandford*: “that is, where the scheme to defraud and the *transactions* subject to the jurisdiction of the Commission ‘coincide.’” 75 Fed. Reg. at 67659 (emphasis added). In *Zandford*, the Supreme Court found that the “in connection with” requirement was satisfied because the defendant’s fraudulent scheme “coincided” with the sale of securities. 535 U.S. 813, 822 (2002). CME Group supports the Commission’s use of this precedent to add necessary gloss to the “in connection with” language in its statutory authority and proposed rule. Given that CEA Section 6(c)(1) and proposed Rule 180.1 also cover “attempts” to use or employ fraudulent schemes, CME Group would add the caveat that the “in connection with” test could be satisfied when fraud coincides with an *offer* to transact as well as when it coincides with an actual transaction (e.g. purchase or sale of futures contracts).

CME Group does not agree, however, with the Commission’s reliance on other SEC precedent in proposing that the “in connection with” requirement would be met “whenever misstatements or other relevant conduct are made in a manner reasonably calculated to influence market participants.” 75 Fed. Reg. at 67659-60. The securities case law cited by the Commission actually refers to how SEC Rule 10b-5 is violated when false or misleading “assertions are made . . . in a manner reasonably calculated to influence the *investing public*.” See, e.g., *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968) (emphasis added). This broad, flexible interpretation of “in connection with” in SEC enforcement actions stems from the need to accomplish a fundamental purpose of the *Exchange Act* – that is, to protect *investors* from fraud, which is often perpetrated by a corporation’s issuance of misleading statements. See *SEC v. Rana Research*, 8 F.3d 1358, 1362 (9th Cir. 1993). Unlike CFTC-regulated markets, the securities markets are composed almost exclusively of such investors who will flee if they are purposefully disadvantaged through fraud, deceit, or other abuse. In light of the different structure of the CFTC-regulated markets (very little retail investor participation) and distinct purposes of the CEA, which largely focus on protection of price integrity, rather than retail investor protection, CME Group submits that the Commission should not apply this SEC precedent in interpreting the “in connection with” requirement under CEA Section 6(c)(1) and proposed Rule 180.1. In futures and other derivative trading, conduct by market participants may be undertaken to influence other market participants for perfectly legitimate reasons, with no motive to deceive or harm others.

E. The Commission Should Clarify the Prohibition on False Reporting in Proposed Rule 180.1(a)(4)

The Commission’s proposed Rule 180.1(a)(4) prohibits any person from delivering or attempting to deliver “a false or misleading or inaccurate report concerning crop or market conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in

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reckless disregard of the fact that such report is false, misleading or inaccurate.” This “false reporting” prohibition is similar to the one found in CEA Section 9(a)(2),⁶ but raises an issue that requires clarification. Specifically, the Commission should provide clarification regarding the interplay between the proposed false reporting prohibition under new CEA Section 6(c)(1) and the false reporting prohibition in Section 9(a)(2). The former proscribes knowing *or* reckless conduct while the latter criminalizes only knowing conduct. New CEA Section 6(c)(1)(B) states, and the Commission reaffirms in its NOPR, that the Commission’s authority under Section 9(a)(2) is not affected by new Section 6(c)(1). Thus, CME Group seeks the Commission’s confirmation that only false reporting done *knowingly* will continue to be subject to the criminal penalties under Section 9(a)(2).

F. The Commission Should Clarify its Interpretation of the Concept of Price Manipulation and of the Traditional Four-Part Price Manipulation Framework

The Commission’s proposed Rule 180.2 prohibiting price manipulation and attempted price manipulation codifies new CEA Section 6(c)(3), which extends the pre-Dodd Frank price manipulation prohibition to cover swaps in addition to commodities and commodity futures contracts. In applying the proposed rule, CME Group believes that the Commission should employ a bright-line test that distinguishes prohibited manipulative conduct from legitimate competitive trading activities. CME Group supports the Commission’s statement reaffirming the continued applicability of the four-part traditional framework for price manipulation. See 75 Fed. Reg. at 67660. That analytical framework is both familiar to market participants and relatively focused in that it requires proof that: 1) the alleged manipulator had the ability to influence market prices; 2) the alleged manipulator specifically intended to do so; 3) artificial prices existed; and 4) the alleged manipulator caused the artificial prices.

However, similar to FIA, CME Group finds that the Commission’s *interpretation* of the general concept of “manipulation” and the specific four-part test – particularly the “existence of artificial prices” element – requires further clarification. The Commission itself acknowledges that its reading of the term manipulation is “broad,” encompassing “every effort to influence the price of a swap, commodity, or commodity futures contract that is intended to *interfere with legitimate forces of supply and demand in the marketplace*.” 75 Fed. Reg. at 67660 (emphasis added). Although CME Group appreciates that manipulation cases are fact-intensive and that the relevant law will “evolve largely on a case-by case basis,” *Id.*, CME Group maintains that market participants must be provided with some clear ex ante guidance or line-drawing for the manipulation prohibition to be meaningful. Hence, CME Group urges the Commission to clarify what factors or types of activity the Commission considers to be “intended to interfere with the legitimate forces of supply and demand.”

For the Commission’s consideration, CME Group posits the following examples of market activities that have been criticized by others as *interfering* with the forces of supply and demand,

⁶ CEA Section 9(a)(2) makes it “a felony punishable by a fine of not more than \$1,000,000 or imprisonment of not more than 10 years, or both, together with the costs of prosecution, for: [a]ny person . . . knowingly to deliver or cause to be delivered for transmission through the mails or interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce.”

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but could be viewed as simply forming *part* of the supply and demand dynamic in the marketplace:

- Commodity index fund trading: Such trading has been seen by some in the private and public sectors as blunting the effects of supply and demand through passive, "long only" investments. In the September 2008 CFTC Staff Report on Commodity Swap Dealers and Index Traders, however, staff noted that commodity index investors' objective is to "capture a commodity exposure" that serves the important purpose of portfolio diversification. See CFTC Staff Report at 40.
- Exchange-traded funds (ETFs): ETFs that buy and hold physical commodities could be said to be designed by "longs" to take supply out of the supply and demand equation and therefore boost prices. On the other hand, investors in ETFs or any other market participants employing a buy and hold commodity strategy, should be considered to be merely taking a "long" market view based on their assessment of the forces of supply and demand.
- Block Trading: This type of trading, which involves large private purchase or sale orders which if they had been entered directly on even the most liquid market could have had a perceptible short term effect on prices. Yet, block trades are completely legal when undertaken in accordance with exchange rules and actually *avoid* influencing prices given that the customer initiating the block and seeking "size" does not want to pay more as the market "runs away."

As the Commission assesses the legitimacy of the aforementioned activities and others, CME Group urges the Commission to bear in mind that a market participant's desire to seek the best available price should not be confused with an intention to interfere with the basic forces of supply and demand. See *In re Hohenberg Bros.*, [1975-1077 Transfer Binder] No. 75-4, Comm. Fut. L. Rep. (CCH) ¶10,025, ¶10,065, ¶10,175 and ¶10,310 (intent requirement not met where respondents decided to tender large delivery of certified cotton on futures market, as opposed to selling commercially, in order to obtain best price for cotton, notwithstanding that large tender generally has depressant effect on futures price); see also *United States v. Reliant Energy Services, Inc.*, 420 F. Supp. 2d 1043, 1059 (N.D. Cal. 2006) ("A seller of a commodity is acting quite rationally *and legally* to withhold his supply from the market if he believes that in the future the commodity will command a higher price – assuming, of course, the seller is under no legal duty to sell.") (emphasis in original).

With respect to the specific four-part manipulation test, the Commission also should clarify how to determine whether a price has been affected by illegitimate factors – in other words, whether a price is "artificial" as required by the third element of the test. The NOPR expresses the Commission's intent to adopt what is essentially a "we-know-it-when-we-see-it" approach "in various circumstances." See 75 Fed. Reg. at 67660. That is, the Commission would "often" conclusively presume an illegal effect on price based on "the actions of the alleged manipulator." See *id.*

The case law cited in the Commission's proposal, however, does not uniformly support such an approach. Rather, the courts and the CFTC (as well as its predecessor agency) in those cases have conducted a more searching review to determine price artificiality. And, notably, none of

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those cases – including *In re DiPlacido* – deem economic analyses (e.g. historical and contemporaneous price comparisons) irrelevant to an artificiality determination.⁷

In re Eisler and First West Trading, Inc., for example, is cited by the Commission as a case where “distorted prices foreseeably follow from the device employed by the manipulator” so that “detailed economic analysis of effect on price” is not required. See 75 Fed. Reg. at 67661. Yet, the CFTC in *Eisler* did perform a relatively detailed economic analysis to figure out whether the settlement prices at issue were artificial. More specifically, the CFTC compared the settlement-price volatilities of P-Tech options during the period in question with: i) the settlement-price volatilities of those options in different months, ii) the historical volatilities for the P-Tech futures contract, and iii) the closing trade-price volatilities from options on two other technology-based stock indices. [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,664 at , 2004 WL 77924 (CFTC Jan. 20, 2004). Finding that there was “no rational market-based explanation” for the significant deviations of the settlement-price volatilities of the P-Tech options from the other economic data, the CFTC concluded that “the settlement prices of the P-Tech option contract, during the period analyzed were artificial.” *Id.*

Similarly, in *In re Henner*, the CFTC’s predecessor agency considered relevant economic data in addition to the conduct of the accused when assessing whether the November 1968 shell egg futures price on June 25 was artificial. 30 Agric. Dec. 1151 (1971). The agency’s review of the October-November and November-December price spreads on June 25 and the point range in the closing price for the November contract was actually quite thorough, spanning approximately thirteen pages of the opinion. *Id.* at 1208-1220. Ultimately, the agency determined that such price analyses offered “other convincing proof” of price artificiality. *Id.* at 1208. The Commission’s proposal fails to acknowledge that its predecessor agency undertook this comprehensive review of price artificiality in *Henner* rather than rely solely on the defendant’s conduct.

Though *In re Indiana Farm Bureau Cooperative Association, Inc.* – from which the Commission’s proposal takes a quote that it incorrectly attributes to *In re Hohenberg Bros.*⁸ – states that the “focus [in demonstrating price artificiality] should not be *as much* on the ultimate price,” it still supports undertaking a thorough price artificiality analysis. [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796 at (CFTC Dec. 17, 1982) (emphasis added). In that case, the CFTC looked to “the nature of the *factors* causing [the ultimate price],” not just proof of the actions of the alleged manipulator. *Id.* (emphasis added). After examining the relevant market factors – i.e. tight corn supply, the defendant’s standing for delivery, and the panic bidding of shorts – the CFTC determined that the price rise in the July 1973 corn futures contract was “reflective of the legitimate forces of supply and demand” and therefore not artificial. *Id.* A few years later, in *In re Cox*, the CFTC clarified that a price artificiality analysis should take into account the types of market factors considered in *Indiana Farm Bureau* as well

⁷ In *In re DiPlacido*, the CFTC observed that manipulation case law has looked at the following factors to determine whether prices are “artificial”: “relationship between an allegedly artificial price and historic trends, the relationship between cash market prices and futures prices, etc.” The CFTC went on to note that such factors are more relevant “in the context of traditional corners and squeezes” than in manipulation situations not involving market power. 2008 WL 4831204 (CFTC 2008), *aff’d in pertinent part*, *DiPlacido v. Commodity Futures Trading Comm’n*, Fed.Appx. 2009 WL 3326624 (2d Cir. 2009), at *30.

⁸ See 75 Fed. Reg. at 67661.

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as historical and contemporaneous price data because "all [such] considerations are relevant to determining price artificiality, [with] the weight to be given these factors var[ying] according to the circumstances of each case." [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786 at (CFTC July 15, 1987).

CME Group recommends that the Commission adopt the approach to determining price artificiality outlined in Cox, weighing all relevant factors according to the specific facts of a given case, rather than relying solely on inferences from an accused's actions. This more comprehensive review is not only consistent with the precedent cited in the Commission's proposal, but also maintains the integrity of the traditional four-part test. Indeed, if the Commission adopts a "we-know-it-when-we-see-it-approach," it will essentially be collapsing the third and fourth element of the traditional framework – that is, when the Commission sees certain conduct after the fact that it finds to raise some kind of "red flag," it can automatically conclude that such conduct *resulted in artificial* prices.

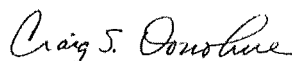
Moreover, the Commission's proposed "conclusive presumption" based on conduct alone – and the attendant watered-down manipulation test – would apply "often" according to the NOPR, leaving the traditional four-factor test to govern in an undefined universe of remaining cases. The potential applicability of two price manipulation frameworks (one of which relies solely on the nature of a defendant's conduct to satisfy artificiality and causation) will create uncertainty for market participants and may chill legitimate market behavior to the detriment of the liquidity and depth of CFTC-regulated markets. To avoid these unintended consequences, CME Group urges the Commission in any given case to undertake a comprehensive review of all considerations relevant to price artificiality.

III. CONCLUSION

CME Group supports the Commission's long standing efforts to police price manipulation and its attempts to implement its new statutory authority to prohibit conduct that constitutes a "manipulative or deceptive act or practice." No matter how well meaning, the Commission's proposals would be counter-productive in many ways if the final rules stated prohibitions that fail to afford market participants adequate and unambiguous notice of the kind of conduct the Commission would find to be prohibited. We urge the Commission to re-double its efforts to provide greater clarity to market participants. Given our mutual and shared interest in market integrity, CME Group would be pleased to work with the Commission to help to perfect its proposals in this area, at the Commission's request.

CME Group thanks the Commission for the opportunity to comment on this matter. We would be happy to discuss any of these issues with Commission staff. If you have any comments or questions, please feel free to contact me at (312) 930-8275 or via email at Craig.Donohue@cmegroup.com, or Christal Lint, Director, Associate General Counsel, at (312) 930-4527 or Christal.Lint@cmegroup.com.

Sincerely,



Craig S. Donohue

David Stawick
January 3, 2011

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cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia