August 17, 2020

CFTC SETTLES ITS FOURTH INSIDER TRADING ACTION

To Our Clients and Friends:

On August 4, 2020, the Commodity Futures Trading Commission ("CFTC") announced that the U.S. District Court for the Southern District of New York entered a consent order resolving the CFTC's seven-year old charges against the New York Mercantile Exchange ("NYMEX") and its two former employees for the two employees' repeated disclosure of material non-public information in violation of the Commodity Exchange Act ("CEA") and CFTC regulations.[1] Neither NYMEX nor its former employees admitted or denied the CFTC's allegations. The CFTC's enforcement action against NYMEX and its former employees is the first time the CFTC has charged an exchange with violations of the CEA and CFTC regulations' proscriptions against disclosures of material non-public information by exchange employees.[2] It also represents one of the few actions that the CFTC has taken against a party for violating its insider trading rules in the commodity futures, options, and swap markets. And it provides guidance as to what the CFTC considers to be material, nonpublic information relating to order flow.

CFTC's Expanded Scope of Enforcement

The Dodd-Frank Wall Street Reform and Consumer Protection Act[3], signed into law in 2010, amended the Commodity Exchange Act and granted the CFTC authority to devise enforcement to promulgate such "rules and regulations… are reasonably necessary to prohibit … trading practice that is disruptive of fair and equitable trading[.]"[4] On July 7, 2011, the CFTC adopted new antifraud regulation – Rule 180.1 which is expressly modeled on Section 10b-5 of the Securities Exchange Act of 1934. The new Rule prohibits "trading on the basis of material nonpublic information in breach of a pre-existing duty (established by another law or rule, agreement, understanding or some other source) and trading on the basis of material nonpublic information that was obtained through fraud or deception."[5]

On December 2, 2015, the CFTC settled on consent with Arya Motazedi, for various violations of CFTC Rules[6]. This was the CFTC's first enforcement of its anti-manipulation rules in an insider trading case. Motazedi was a gasoline and energy trader at a large, unmade, public traded company. The CFTC alleged that Motazedi committed fraud by (a) trading in his personal account against the company without the company's knowledge, and (b) trading ahead of company orders in his personal account, taking advantage of the material, nonpublic information of his employer. Specifically, the CFTC alleged that Motazedi stole material, nonpublic information concerning the times, volumes, and prices at which his company intended to trade energy commodities futures. Instead of solely basing Motazedi's liabilities on general antifraud provisions of the CEA, the CFTC focused on Section 6(c)(1) of the CEA and Rule 180.1 and Motazedi entered into a settlement, neither admitting nor denying that he breached his duty to his employer in violation of both Section 6(c)(1) and Rule 180.1.[7]

Similar to the Motazedi enforcement action, in September 2016, the CFTC filed a case against and reached a settlement with Jon P. Ruggles to pay a $1.75 million penalty and to forego more than $3.5 million in gains and banned him from trading and registration. Neither admitting nor denying liability, Ruggles allegedly traded in the same NYMEX products in personal accounts in his wife's name with material nonpublic information of his employer.[8]

On September 28, 2018, the CFTC filed a civil complaint in the Southern District of Texas against EOX Holdings and Andrew Gizienski alleging violations of the CEA and CFTC insider trading regulations.[9] In this case, which remains ongoing, the CFTC alleges that Gizienski disclosed material, nonpublic information about EOX Holdings' customer identities, block trades, and security positions, in breach of Gizienski's duties to those customers, to profit in a friend's trading account. The CFTC further alleges that EOX approved Gizienski's trading in a friend's account, but failed to implement reasonable procedures to monitor trading in that account. On the date that the CFTC charged EOX and Gizienski, the CFTC announced the formation of an Insider Trading and Information Protection Task Force.

Enforcement Against NYMEX and Its Former Employees

Over seven years ago, on or about February 21, 2013, the CFTC charged NYMEX, which is owned and operated by the CME Group, and the two former employees (William Byrnes and Christopher Curtin) with repeatedly disclosing customer trading information transmitted through the CME ClearPort Facilitation Desk to a commodity broker on at least in total approximately seventy-six occasions. The ClearPort Facilitation Desk provided clearing and settlement services for exchange-traded contracts and over-the-counter derivatives transactions. ClearPort customers were allegedly told that the trades they submitted would not be made public and would be deemed to be confidential; the customer user agreements, for example, allegedly stated that all "Exchange Data shall be deemed to be confidential" which the CFTC alleged included all price and other trade-related data, and such information could not be disclosed to third parties for any purpose other than to facilitate the transactions. At the time of the disclosures, Byrnes was a supervisor on the ClearPort Facilitation Desk and Curtin was the Associate Director of the Globex Control Center. The CFTC alleged that the disclosures were often captured on tape, and that NYMEX had failed to investigate an anonymous complaint about improper disclosures for over a year before terminating Byrnes.[10]

In the consent order against NYMEX and its two former employees, the CFTC alleged that, on numerous occasions between 2008 and 2010, the two former employees (William Byrnes and Christopher Curtin) disclosed material, nonpublic information about derivatives trading activity that they obtained through their employment at the NYMEX.[11] The material and nonpublic information Byrnes and Curtin allegedly disclosed includes "the identifies of counterparties, whether a particular counterparty purchased or sold the option, whether it was a call or a put, the volume of contracts traded, the expiry, the strike price and the trade price."[12] The disclosures were allegedly made to a commodities broker who was apparently not authorized to receive the information.

The CFTC alleged that Byrnes and Curtin were directly liable for the alleged disclosures of material, nonpublic information of trading activity, and that NYMEX was vicariously liable for the conduct of its former employees.[13] Both employees are permanently banned from trading commodity interests and registering with the CFTC. The order also enjoins NYMEX to the extent the CEA and CFTC regulations apply under the vicarious liability provision of the CEA.[14] The order imposes a $4 million joint and several monetary penalty on NYMEX, Byrnes and Curtin, capping the liability of Byrnes and Curtin at $300,000 and $200,000 respectively.[15]

In 2016, NYMEX submitted a motion for summary judgement arguing that it was not vicariously liable for the violations of Byrnes and Curtin. On September 19, 2019, Judge Broderick denied NYMEX's motion stating that "Plaintiff [CFTC] identifies several facts that could permit a jury to find that Byrnes and Curtin intended to serve some purpose of NYMEX and were acting within the scope of their employment."[16] Judge Broderick quoted several allegations in the CFTC's complaint that precluded the Court from granting the defense motion including: (1) Curtin's 2007 NYMEX self-evaluation where he wrote one of his goals was to "continue to grow facilitation desk knowledge base and increase the business"; (2) Byrnes and Curtin allegedly knew that the broker whom they allegedly tipped was on NYMEX's list of 'Top 50' Brokers for ClearPort; and (3) NYMEX earned fees as a result of the broker's trades.[17]

Takeaways

There are multiple, important takeaways from this civil action that the CFTC took against NYMEX and its two former employees for violating the CFTC's insider trading rules.

First, the CFTC set forth again its position that certain customer trading information which is supposed to be kept confidential pursuant to user agreements is material, nonpublic information. The CFTC's position will not be tested in this case, because NYMEX and its two former employees reached a settlement resolving the matter, without admitting or denying the allegations.

Second, for purposes of alleging that the former NYMEX employees had a duty not to disclose the customer trading information, the CFTC relied on the employer's code of conduct, the employee handbook, the employment agreements, and the customer user agreements. Often such codes of conduct, handbooks, and agreements are highly general and fail to provide clear notice as to what can and cannot be disclosed. It is important for all market participants to be aware of the non-disclosure provisions in the agreements available to them, and certainly the ones which each individual signs and agrees to follow.

Third, the CFTC partially built its case against the former NYMEX employees through recorded lines during which there was disclosure of customer information to a commodities broker and the employees were captured trying to avoid the recorded line by agreeing on the recorded line to call each other on their mobile devices. Regulators will often look for evidence that market participants are trying to avoid discussions over recorded lines such as the commodities broker's statements "Do you want me to call you on your cell" and "Bring your cell phone tomorrow" so we can discuss customer trading.

Fourth, upon receipt of an anonymous complaint of improper activity, it is incumbent on the firm to investigate expeditiously and to be prepared to defend that investigation to regulators later. In this case, upon receipt of confidential information regarding trades cleared through CME ClearPort had been disclosed to a brokerage firm improperly, NYMEX's manager of the ClearPort Facilitation Desk allegedly conducted a belated and cursory investigation by reviewing phone calls and emails from one day, and did not question the employees allegedly involved in the disclosures. Moreover, although the manager directed all employees on the CME ClearPort Facilitation Desk not to use mobile devices for business, the employees allegedly used their personal cell phones in the open at their desks.

Fifth, the CFTC's theory of vicarious liability against NYMEX will unfortunately not be tested at trial. It was an aggressive theory given that Curtin and Byrnes appeared to have acted contrary to NYMEX's policies and agreements, and against their employer's interests. In demonstrating that the conduct of rogue employees should not be vicariously liable to their employer, it is critical to develop facts to demonstrate that the employees acted outside the scope of their employment, contrary to training and instructions, and for the purpose of benefitting themselves at the expense of the employer.

Sixth, the CFTC charged the recipient of the allegedly material, nonpublic information with aiding and abetting the primary violations of the former NYMEX employees. The CFTC alleged that the broker "repeatedly solicited Byrnes and Curtin for the specific material nonpublic information they disclosed to him and providing Byrnes and Curtin with information they needed to identify and locate information about the specific trades in which Eibschutz was interested."[18] Whether the CFTC will be able to prove aiding and abetting liability against the broker will test the regulator's ability to go after the recipients of material, nonpublic information.

Finally, the CFTC's civil action took approximately seven years and six months since filing of the complaint, and over ten years since the alleged underlying misconduct took place, to resolve the matter against NYMEX and its former employees. There are many reasons for this long delay including the time taken to submit and resolve a motion to dismiss, discovery disputes, and the submission and resolution for summary judgment. That extensive stretch of time presents serious challenges to regulators and market participants in terms of the burden on regulators to prove their actions, the costs of litigating, and the distraction and other collateral consequences of a never-ending civil action to market participants. Of course the civil action against the recipient broker remains ongoing, and it's unclear whether that will also result in a settlement or go to trial.

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[1] NYMEX and Two Former Employees to Pay $4 Million for Disclosing Material Non-Public Information, Release Number 8216-20 (Aug 4, 2020). Please see here.

[2] *Id.*

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L No. 111-2031, § 753, 124 Stat. 1376 (2010).

[4] 7 U.S.C § 6c(a)(6) (2018).

[5] Commodity Futures Trading Commission Q&A – Anti-Manipulation and Anti-Fraud Final Rules (2011), please see here.

[6] *In re Arya Motazedi*, CFTC Docket No. 16-02 (Dec 2, 2015).

[7] *Id*.

[8] *In re Jon P. Ruggles*, CFTC Docket No. 16-34 (Sept. 29, 2016).

[9] Complaint, *U.S. Commodity Futures Trading Commission v. EOX Holdings LLC et al.*, Case No.: 1:18-cv-08890 (S.D.N.Y. filed Sept. 28, 2018).

[10] Complaint, *U.S. Commodity Futures Trading Commission v. William Byrnes et al.*, Case No.: 1:13-cv-01174 (S.D.N.Y. filed Feb. 21, 2013).

[11] *U.S. Commodity Futures Trading Commission v. William Byrnes, Christopher Curtin, The New York Mercantile Exchange, Inc., and Ron Eibschutz*, No. 13 Civ. 1174 (Aug 4, 2020).

[12] *Id*.

[13] *Id*.

[14] *Id*.

[15] *Id*.

[16] *U.S. Commodity Futures Trading Commission v. William Byrnes, Christopher Curtin, The New York Mercantile Exchange, Inc., and Ron Eibschutz*, No. 13 Civ. 1174 (S.D.N.Y., Sep. 19, 2019).

[17] *Id*.

[18] CFTC Charges Ron Eibschutz with Aiding and Abetting Disclosures of Material Nonpublic Information about Customer Trades in its Case Against the CME Group's New York Mercantile Exchange and Two Former Employees, Release Number 6584-13 (May 8, 2013). Please see: https://www.cftc.gov/PressRoom/PressReleases/6584-13.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these developments. For additional information, please feel free to contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Securities Enforcement Group, or the following authors:

Reed Brodsky - New York (+1 212-351-5334, rbrodsky@gibsondunn.com)
Dan Li - New York (+1 212-351-6310, dli@gibsondunn.com)

GIBSON DUNN

Securities Enforcement Group:

New York

Matthew L. Biben (+1 212-351-6300, mbiben@gibsondunn.com)
Reed Brodsky (+1 212-351-5334, rbrodsky@gibsondunn.com)
Joel M. Cohen (+1 212-351-2664, jcohen@gibsondunn.com)
Lee G. Dunst (+1 212-351-3824, ldunst@gibsondunn.com)
Barry R. Goldsmith (+1 212-351-2440, bgoldsmith@gibsondunn.com)
Laura Kathryn O'Boyle (+1 212-351-2304, loboyle@gibsondunn.com)
Mark K. Schonfeld (+1 212-351-2433, mschonfeld@gibsondunn.com)
Alexander H. Southwell (+1 212-351-3981, asouthwell@gibsondunn.com)
Avi Weitzman (+1 212-351-2465, aweitzman@gibsondunn.com)
Lawrence J. Zweifach (+1 212-351-2625, lzweifach@gibsondunn.com)
Tina Samanta (+1 212-351-2469, tsamanta@gibsondunn.com)

Washington, D.C.

Stephanie L. Brooker (+1 202-887-3502, sbrooker@gibsondunn.com)
Daniel P. Chung (+1 202-887-3729, dchung@gibsondunn.com)
Stuart F. Delery (+1 202-887-3650, sdelery@gibsondunn.com)
Richard W. Grime (+1 202-955-8219, rgrime@gibsondunn.com)
Patrick F. Stokes (+1 202-955-8504, pstokes@gibsondunn.com)
F. Joseph Warin (+1 202-887-3609, fwarin@gibsondunn.com)

San Francisco

Winston Y. Chan (+1 415-393-8362, wchan@gibsondunn.com)
Thad A. Davis (+1 415-393-8251, tadavis@gibsondunn.com)
Charles J. Stevens (+1 415-393-8391, cstevens@gibsondunn.com)
Michael Li-Ming Wong (+1 415-393-8234, mwong@gibsondunn.com)

Palo Alto

Michael D. Celio (+1 650-849-5326, mcelio@gibsondunn.com)
Paul J. Collins (+1 650-849-5309, pcollins@gibsondunn.com)
Benjamin B. Wagner (+1 650-849-5395, bwagner@gibsondunn.com)

Denver

Robert C. Blume (+1 303-298-5758, rblume@gibsondunn.com)
Monica K. Loseman (+1 303-298-5784, mloseman@gibsondunn.com)

Los Angeles

Michael M. Farhang (+1 213-229-7005, mfarhang@gibsondunn.com)
Douglas M. Fuchs (+1 213-229-7605, dfuchs@gibsondunn.com)
Debra Wong Yang (+1 213-229-7472, dwongyang@gibsondunn.com)