CFTC issues final Dodd-Frank anti-manipulation rule

On 7 July 2011, the Commodity Futures Trading Commission (CFTC or Commission) unanimously approved five final Dodd-Frank rules. Importantly, the Commission adopted the final anti-manipulation rule (17 C.F.R. § 180.1 and 17 C.F.R. § 180.2). The final anti-manipulation rule is almost exactly the same as the proposed rule. The rule will become effective 30 days from its publication in the Federal Register. The text of the final rule is available and discussed in more detail below.

Anti-manipulation rule

The Dodd-Frank Act amendments to the Commodity Exchange Act (CEA) expand the CFTC's current authority, which prohibits price manipulation and fraudulent statements in certain contexts, to prohibit fraud more generally. Based on the Securities Exchange Act Section 10b model, and informed by comparable regulatory authority given to the Federal Energy Regulatory Commission (FERC) and the Federal Trade Commission (FTC), Section 753(a) of the Dodd-Frank Act makes it unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any 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, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate . . .

In addition, Section 753(a) of the Dodd-Frank Act adds prohibitions against price manipulation in the swaps markets, expands the prohibition on delivering false or misleading reports of information that affect or tend to affect the price of a commodity through the mails or interstate commerce to include swaps, and expands the prohibition on making false or misleading statements to the CFTC.

Besides covering swap transactions, the final rule expands the CFTC's pre-Dodd-Frank enforcement authority two
ways: it gives the CFTC the authority to prohibit market manipulation that is not directly related to the price of a commodity and it expands the CFTC’s anti-fraud authority beyond prohibiting fraud associated with specific transactions or activities to cover all behavior intended to defraud the market.

17 C.F.R. § 180.1

Final Rule 180.1(a) prohibits fraud, fraud-based manipulations, and attempts: (1) by any person (2) acting intentionally or recklessly (3) in connection with (4) any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity. The CFTC intends to interpret and apply Final Rule 180.1 “not technically and restrictively, but flexibly to effectuate its remedial purposes.” A violation of Final Rule 180.1 will not “necessarily require [] proof of a market or price effect.” Fraud by partial omission and half-truths may constitute violations of Final Rule 180.1. The CFTC also stated that, consistent with SEC 10b-5 precedent, the CFTC would not interpret the Final Rule as requiring “a showing of reliance or harm to market participants.” Finally, the CFTC clarified that it would interpret the term “in connection with” broadly.

The final rule does not impose “any new affirmative duties of inquiry, diligence, or disclosure,” but, depending on the facts and circumstances, a violation of a pre-existing legal duty may constitute a violation of the rule. Also, “silence, absent a pre-existing duty to disclose,” is not a violation of Final Rule 180.1. However, under Final Rule 180.1(b) disclosure may be required to make “any statement made to the other person in or in connection with [a] transaction not misleading in any material respect.”

The Commission stated in the preamble to the final rule that it received many comments relating to “insider trading” in the derivatives markets. The CFTC clarified that market participants are permitted to trade on lawfully obtained material nonpublic information.

Importantly, the Commission clarified that the requisite scienter, at minimum, is recklessness. Recklessness, according to the CFTC, is “an act or omission that ‘departs so far from the standards of ordinary care that it is very difficult to believe the actor was not aware of what he or she was doing.’” (quoting Drexel Burnham Lambert Inc. v. CFTC, 850 F.2d 742, 748 (D.C. Cir. 1998)). The Commission also stated that it was not foreclosing use of the “collective knowledge theory of alleging and proving scienter against corporate defendants.” But it would “follow the law of the various circuits and, in all cases, consider the totality of the facts and circumstances” when determining whether to take enforcement action against a corporate defendant.

With respect to penalties, the CFTC stated that it will follow CEA Section 6(c)(10)(C)(ii), that allows the CFTC to assess civil penalties up to an amount equal to the greater of US$
1 million or triple the monetary gain from each violation. The CFTC clarified that the penalties section will apply equally to all provisions of Final Rule 180.1, including false, misleading, or inaccurate reporting.13

Finally, the CFTC declined to adopt commenters’ requests to hold a technical conference on the rulemaking.

17 C.F.R. § 180.2

The CFTC proposed 180.2 under both the Dodd-Frank Act and its general rulemaking authority under the CEA. Rule 180.2 states that "it shall be unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity." The Commission clarified that it "will be guided by the traditional four-part test for manipulation" that it developed under its pre-Dodd-Frank authority.14 That is, (1) the accused had the ability to influence prices; (2) the accused had specific intent to influence prices; (3) the existence of an artificial price; and (4) causation.15 Specific intent, not recklessness, will be required to show a violation of Final Rule 180.2.16 The CFTC further clarified that an artificial price may be "conclusively presumed" in some, but not in all, cases.17

Other final rules

The CFTC also approved four final rules relating to consumer privacy protections, affiliate marketing and disposal of consumer information, the definition of agricultural commodity, and large trader reporting. The proposed rules are now available.

1 See Final Rule at 8.
2 See id. at 14.
3 Id. at 15.
4 Id. at 23.
5 Id. at 21-22.
6 Id. at 31.
7 See id. at 19 & n.55.
8 Id. at 20.
9 Id.
10 Id. at 27
11 Id. at 29-30.
12 Id. at 30.
13 Id. at 34.
14 Id. at 39.
15 Id.
16 Id.
17 Id. at 40.

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