

CFTC Brings Energy Market Insider Trading Case, Announces Insider Trading Task Force

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Key Points

- The CFTC has filed a new “insider trading” enforcement action involving the energy markets—the agency’s third energy market insider trading case since 2015.
- The CFTC also created an Insider Trading and Information Protection Task Force to focus on misuse of confidential information in commodities markets—which presumably will result in more insider trading enforcement actions.
- In certain contexts, CFTC insider trading risk can be mitigated through contractual provisions. However, given the lack of clarity in how broadly the CFTC intends to police this area, along with the absence of any guidance from federal court decisions and the differences between securities and commodities markets, uncertainty and risk remain.
- FERC, which also polices fraud in energy trading markets, so far has not taken any enforcement action relating to insider trading.

On September 28, 2018, the Commodity Futures Trading Commission (“CFTC”) filed a district court **enforcement action** against EOX Holdings LLC (“EOX”) and Andrew Gizienski, alleging, among other things, violations of the CFTC’s anti-fraud rule through Gizienski’s misuse of confidential information of certain clients for whom he brokered energy futures transactions.¹ On the same day, the CFTC announced it has created an Insider Trading and Information Protection Task Force to focus on misuse of confidential information in commodities markets. These recent actions make clear that two insider trading cases the CFTC brought in 2015 and 2016 were not aberrations, and that the CFTC intends to continue policing this area. At the same time, no court has yet affirmed the CFTC’s legal theory of insider trading-based fraud, and there are serious questions regarding how insider trading applies, if at all, in the context of energy and commodities markets as opposed to securities markets. Notably, the Federal Energy Regulatory Commission (“FERC”)—which has been more

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¹ CFTC v. EOX Holdings LLC, No. 18-cv-8890 (S.D.N.Y. filed Sept. 28, 2018) (“EOX Compl.”).

aggressive than the CFTC in recent years in prosecuting manipulation in energy markets—has not pursued a case under an insider trading-based theory.

The EOX Case

Gizienski brokered electricity futures transactions through Choice Power, an EOX affiliate. The CFTC alleges that for an approximately nine-month period beginning in August 2013, Gizienski misused confidential trading information of certain EOX customers to benefit a specific customer (“Customer A”) with whom Giezinski wanted to pursue business opportunities and curry favor. The CFTC alleges Gizienski misused client information by disclosing material non-public information, including other customers’ identities, trading activities and positions, to Customer A not for a legitimate purpose (i.e., to facilitate block trades with other customers) but rather to benefit Customer A in its own trading. The CFTC also alleges Gizienski had discretionary authority to trade Customer A’s account, and misused confidential information of other customers in his own trading for Customer A. The CFTC claims Gizienski breached a duty of confidentiality to EOX’s customers that arose from various sources, including EOX’s written customer agreements, CFTC Regulation § 155.4 (trading standards for Introducing Brokers (“IBs”)), and futures exchange rules (here, ICE Futures U.S.).

In addition to alleging violations of the CFTC’s anti-fraud rule, Regulation 180.1(a), the CFTC alleges EOX and Gizienski violated the Regulation 155.4(b) IB standards by improperly disclosing orders of other customers and by taking the other side of customer orders without the customer’s consent. The CFTC also alleges that EOX violated certain record retention and broker supervision requirements.

Insider Trading and Information Protection Task Force

The CFTC simultaneously **announced** the creation of an Insider Trading and Information Protection Task Force, which it noted was involved in bringing the EOX case. The CFTC describes the Task Force as follows:

“The CFTC’s Insider Trading & Information Protection Task Force is a coordinated effort across the Division [of Enforcement] to identify and charge those who engage in insider trading or otherwise improperly use confidential information in connection with markets regulated by the CFTC.

The Commission will thoroughly investigate and, where appropriate, prosecute instances in which individuals have abused access to confidential information—for example, by misappropriating confidential information, improperly disclosing a client’s trading information, front running, or using confidential information to unlawfully prearrange trades. In addition, the Commission will ensure that its registrants develop and enforce policies prohibiting the misuse of confidential information, as they are required to do under the law.”

The Task Force is composed of members of the CFTC’s Chicago, Kansas City, New York and Washington, D.C. offices.

Takeaways

Increased Emphasis on Insider Trading—But So Far Focus is on a Narrow, Specific Type of Conduct

The CFTC's enforcement actions against two energy traders for insider trading-based fraud in 2015 and 2016 were controversial and created significant uncertainty among many in the energy and commodities trading markets (where, unlike securities markets, trading on non-public information has been viewed as a common, accepted, lawful practice). The *Motazed* and *Ruggles*² cases both involved allegations that energy traders misappropriated confidential trading information of their employers to benefit their personal trading accounts in violation of company policies and general duties owed by employees to employers. Both cases (and this new case) were brought under the CFTC's relatively new anti-fraud authority under Dodd-Frank; the agency had previously not viewed its enforcement mandate to include insider trading conduct in commodities markets. Because they were settlements, no court opined on the CFTC's theory of fraud. And with only two insider trading cases, it was unclear to what extent these cases could be viewed as aberrations rather than a concerted effort by the CFTC to police insider trading.

The EOX case and Task Force announcement make clear that the CFTC is continuing (and increasing) its emphasis on insider trading. But all three cases focus on a narrow, specific fact pattern involving an allegedly clear misuse of confidential information in breach of a clear duty owed to the source of the information—the common fact pattern being, in essence, an employee taking advantage of knowledge gained through his employment to benefit himself at the expense of his company and its clients. Given that fact pattern, it is not clear how broadly the CFTC intends to police trading on non-public information obtained through commonly-accepted commercial activities in the energy (or other commodities) markets. And, we note, even if the CFTC intends to proceed beyond these fact patterns, as the EOX complaint sets forth and the governing regulation requires, the CFTC must prove the defendant's conduct amounts to “intentionally or recklessly trading on the basis of material, nonpublic information in breach of a pre-existing duty” or “intentionally or recklessly tipping material, nonpublic information ... in breach of a pre-existing duty.”³ Merely trading or transacting in energy markets based on non-public information, by itself, is not a violation—and certainly not when the information was obtained through market insight, observation and acumen that did not breach any duty to an employer, client or other market participant.

Application to Traditional Energy Management Relationships Unclear But May Be Mitigated Through Contractual Terms

The CFTC's insider trading enforcement has caused uncertainty for traditional energy management service companies, such as asset managers and energy managers in

² In re *Motazed*, No. 16-02, 2015 WL 7880066 (CFTC Dec. 2, 2015); In re *Ruggles*, No. 16-34, 2016 WL 5682206 (CFTC Sept. 29, 2016).

³ EOX Compl. 78.

the electricity and natural gas markets serving clients under Asset Management Agreements and Energy Management Agreements. Given the nature of their business, these service companies routinely obtain client-specific confidential information, some of which could potentially be advantageous in making trading decisions. Given the limited scope of the CFTC's insider trading enforcement to date and the legal hurdles of applying insider trading theories of fraud in the securities context to commodity markets, it is not clear to what extent, if at all, these traditional energy management arrangements could raise insider trading concerns. Still, until there is more clarity on the scope of the CFTC's insider trading enforcement initiatives, companies can mitigate risk with contractual language making clear that there is no duty of confidentiality owed under the relationship that prevents the service provider from using information obtained under the agreement for its benefit. Drafting and negotiating the right contractual language is likely to be a company-specific and customer-specific effort, depending on (for example) the type of information obtained through the service arrangement, client expectations about how that information may be used, and the potential uses of that information in trading or other energy market activity.

FERC Has Never Brought an Insider Trading Case—And No Sign It Plans to Start

As noted above, FERC has been more aggressive than the CFTC in recent years in prosecuting alleged fraud and manipulation in its jurisdictional energy markets, having assessed large fines based on sometimes novel theories of market manipulation. While FERC and the CFTC coordinate on certain enforcement activities in the energy markets, FERC to date has not brought any insider trading cases, announced any insider trading investigations, or done anything suggesting they view insider trading as a valid theory of liability under their anti-fraud rule (which is substantially similar to the CFTC's).⁴

⁴ See 18 C.F.R. §§ 1c.1, 1c.2.