



UNIVERSITY OF MARYLAND

SCHOOL OF LAW

January 3, 2011

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

**Re:** Prohibition of Market Manipulation, RIN Number AD27

Dear Mr. Stawick:

These comments are submitted in response to the Commodity Futures Trading Commission's ("CFTC" or "Commission") Notice of Proposed Rulemaking on Prohibition of Market Manipulation<sup>1</sup> under Title VII of the Dodd- Frank Wall Street Reform and Consumer Protection Act<sup>2</sup> (the "Dodd-Frank Act").

## I. General Comments

Enhanced anti-manipulation authority was given to the Commission under Section 753 of Dodd-Frank, which amends section 6(c) of the Commodity Exchange Act<sup>3</sup> ("CEA"), to provide enhanced authority to the CFTC to preclude market manipulation. The amended section does not allow "the use or employment of any manipulative or deceptive device or contrivance,"<sup>4</sup> and further mandates that the CFTC create regulations for this section's implementation no later than one year from the bill's enactment. This anti-manipulation authority is borrowed from the Securities Exchange Act of 1934<sup>5</sup> ("Exchange Act"), which has been used to combat, *inter alia*, market manipulation.

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<sup>1</sup> Prohibition of Market Manipulation, 75 F.R. 67657 (Nov. 3, 2010), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-27541a.pdf> [hereinafter "Proposed Rules"].

<sup>2</sup> Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>3</sup> 7 U.S.C. 1 *et seq.*

<sup>4</sup> See Proposed Rules, *supra* note 1.

<sup>5</sup> 15 U.S.C. 78j(b).

Additionally, the CFTC may implement rules pursuant to section 6(c)(3) of the CEA as authorized by Section 8(a)(5) of the CEA.<sup>6</sup> In light of this, the Commission proposed a set of rules, a new Part 180, for market manipulation that would advance the goal to “deter and prevent price manipulation or any other disruptions to market integrity.”<sup>7</sup>

## II. Enhanced Anti-Manipulation Authority is Comparable to Other Regulatory Agencies’ Anti-Manipulation Authority

Prior to the passage of the Dodd-Frank Act, the burden of proving specific intent to manipulate was in effect, but, as evidenced by recent history, that standard proved to be insufficient to protect the markets under the CFTC’s jurisdiction. In light of this, Section 753 of Dodd-Frank, found its origins in the Derivatives Market Manipulation Prevention Act introduced by Senator Cantwell in 2009. It was added to “prohibit the use of manipulative or deceptive devices or fraudulent information in swap and commodity markets.”<sup>8</sup> Most importantly, this new anti-manipulation power lowers the standard from “knowingly” to “reckless.” It was designed to empower the Commission with “the *same anti-manipulation standard* employed by the [Securities and Exchange Commission (“SEC”)] for more than 75 years, which has been upheld and defined in many court cases, including the Supreme Court.”<sup>9</sup> Furthermore, the same authority and legal standard was already granted to the Federal Energy Regulatory Commission (“FERC”) and the Federal Trade Commission (“FTC”) in 2005 and 2007, respectively.<sup>1011</sup>

The proposed rule, Section 180.1, is modeled on SEC Rule 10b-5, which has been interpreted as a “catch-all” prohibition on fraud and manipulation under Section 10(b) of the Securities Exchange Act of 1934. As Rule 10b-5 is time tested and proven to be an effective anti-manipulation rule, Section 180.1 reflects an effective anti-manipulation rule mandated by Section 753.

The Commission correctly proposes that Proposed Section 180.1 be given a broad, remedial reading as to be in accordance with the scope of SEC Rule 10b-5. As previously stated, Section 180.1 would incorporate a reckless standard. The Commission correctly proposes that judicial precedent interpreting and applying Exchange Act Section 10(b) and SEC Rule 10b-5 in the context of the securities markets should *guide* application of the scienter standard. This is important because the time tested Rule 10b-5 will provide regulatory certainty and will not disrupt the market function.

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<sup>6</sup> 7 U.S.C. 12a(5).

<sup>7</sup> 7 U.S.C. 5(b).

<sup>8</sup> Official Website of Senator Maria Cantwell, U.S. Senator, *Senate Passes Cantwell Anti-Manipulation Amendment*, (May 6, 2010), available at <http://cantwell.senate.gov/news/record.cfm?id=324761> (last visited on Jan. 3, 2011).

<sup>9</sup> *Id.*

<sup>10</sup> Energy Policy Act of 2005, Public Law 109-58, §§315, 2183, 119 Stat. 594 (2005) (amending 15 U.S.C. 717c-1; 16 U.S.C. 824v).

<sup>11</sup> Energy Independence and Security Act of 2007, Public Law 110-140, §§811, 812, 121 Stat. 1492 (2007) (amending 42 U.S.C. 17301, 17302).

At the same time, adding “but not control” language would preserve the necessary flexibilities in the interpretation in order to be in consistent with the Commission’s regulatory mission<sup>12</sup> and the purpose of the CEA<sup>13</sup>.

Some market participants argue that the Commission should not incorporate the standards and case law under Rule 10b-5 as they are inapplicable to the futures and derivatives markets.<sup>14</sup> They argue that the securities standards are inapplicable because of fundamental differences in the structures of the two market frameworks. In fact, they state that “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*... In contrast, participants in the futures and derivatives markets do not rely on analogous issuer-specific information when deciding whether to transact.”<sup>15</sup> However, the anti-manipulation rules and regulations are not bound by the legal frameworks of the two markets. Rather the focal point of these anti-manipulation rules is to maintain market integrity, which is the common goal shared by both the securities and futures markets. Also, the influx of capital from retail investors to the commodity markets through vehicles called ETFs has changed the dynamics of the futures markets. Now, more than ever, the Commission should exercise its anti-manipulation authority and protect investors, as it is effectively being done in the securities market. The Commission should note that FERC and FTC’s anti-manipulation authority granted by the Energy Policy Act of 2005 and Energy Independence and Security Act of 2007 is designed to deter and prevent manipulation in “commodities” that modeled the SEC’s anti-manipulation power pursuant to the Exchange Act of 1934. Of course, it requires the “reckless standard” to prove intent. The CFTC must be able to exercise the same degree of anti-manipulation authority to deter and prevent manipulation in “commodities” under the Dodd-Frank Act. In order to do so, it is imperative that the CFTC incorporate the “reckless” legal standard.

Proposed Section 180.2 mirrors the statute: “Unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate

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<sup>12</sup> “The CFTC's mission is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options, and to foster open, competitive, and financially sound futures and option markets.” Official Website of the CFTC, *Mission & Responsibilities, About the CFTC*, <http://www.cftc.gov/About/MissionResponsibilities/index.htm> (last visited on Jan. 3, 2011).

<sup>13</sup> “It is the purpose of this chapter to serve the public interests ... through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission. To foster these public interests, it is further the purpose of this chapter to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this chapter and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.” *See* 7 U.S.C. §5.

<sup>14</sup> *See* Comment Letter by the Futures Industry Association, the Securities Industry and Financial Markets Association, and the International Swaps and Derivatives Associations to David Stawick, Secretary, Commodity Futures Trading Commission, (Dec. 28, 2010), *available at* <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26803&SearchText=>.

<sup>15</sup> *Id.*

commerce, or for future delivery on or subject to the rules of any registered entity.”<sup>16</sup> Although the Commission has already interpreted the “prohibition on price manipulation and attempted price manipulation to encompass every effort to influence the price of a swap, commodity, or commodity futures contract *that is intended to interfere with the legitimate forces of supply and demand* in the marketplace,”<sup>17</sup> it is important to reaffirm the relevance of that legal interpretation. Particularly, the Commission has correctly ruled that although the traditional framework for price manipulation has required demonstrating the existence of ‘artificial price,’ an “illegal effect on price can often be conclusively presumed from the nature of the conduct in question other factual circumstances not requiring expert economic analysis.”<sup>18</sup>

### **III. Anti-Manipulation Authority Has Many Benefits Without Imposing Additional Costs**

The cost-benefit analysis contained within the proposed rule underscores the benefits of adopting the rule as proposed.<sup>19</sup> Regarding the benefit portion of the cost-benefit analysis, this rule would bolster the Commission’s power and ability “to ensure fair and equitable markets.”<sup>20</sup> Experts in the field, and the CFTC itself, conclude that it will significantly benefit the general public, as well as those participating in the market, to allow the Commission to discourage and obstruct harmful manipulation, as “[m]arkets that are free of market manipulation will function better as venues for price discovery and hedging.”<sup>21</sup> Regarding the cost analysis, the Commission correctly states that market participants should already have constructed and implemented procedures to guard against their employees’ and agents’ attempts at market manipulation.<sup>22</sup> As such, there should not be any additional cost to the existing market participants.

### **IV. Market Manipulation Cases**

To see proof of the need for such regulations as the CFTC has proposed here, one need look no further than the current state of metals trading. It has been reported that from November 2009

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<sup>16</sup> Proposed Rules at 67662, *supra* note 1.

<sup>17</sup> Proposed Rules at 67660, *supra* note 1 (quoting *Cargill, Inc. v. Hardin, Secretary of Agriculture*, 452 F.2d 1154, 1163 (8th Cir. 1971) (emphasis added)).

<sup>18</sup> Proposed Rules at 67661, *supra* note 1.

<sup>19</sup> “[S]ection 15(a) [of the CEA] does not require the Commission to quantify the costs and benefits of a rule or to determine whether the benefits of the regulation outweigh its costs; rather, it requires that the Commission ‘consider’ the costs and benefits of its actions... costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the CEA.” Proposed Rules at 67661, *supra* note 1.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

through March of 2010, Andrew Maguire, a whistle-blowing metals trader, was able to predict the progressive developments of manipulation of the silver market.<sup>23</sup> He was reportedly able to do this in advance because JPMorgan Chase (“JPM”) sends “signals to the market [of] its intention to take down the precious metals. Traders recognize these signals and make money shorting the metals alongside JPM. Maguire explained how there are routine market manipulations at the time of option expiry, non-farm payroll data releases, and COMEX contract rollover, as well as ad-hoc events.”<sup>24</sup> In early February 2010 correspondence, the trader stated that “[i]t is common knowledge here in London among the metals traders that it is JPM's intent to flush out and cover as many shorts as possible prior to any discussion in March about position limits. I feel sorry for all those not in this loop. A serious amount of money was made and lost today and in my opinion as a result of the CFTC's allowing by your own definition an illegal concentrated and manipulative position to continue.”<sup>25</sup>

Moreover, manipulation of copper prices is far from a thing of the past; in fact, as recently as December 21, 2010, it was reported that “a single trader has reported it owns 80%-90% of the copper sitting in London Metal Exchange warehouses, equal to about half of the world's exchange-registered copper stockpile and worth about \$3 billion. The report coincided with copper prices reaching record highs Tuesday.”<sup>26</sup> Such concentrated ownership in metals is not limited to silver and copper; rather, similar situations are represented in large holdings of aluminum, nickel, zinc, and tin.<sup>27</sup> This only confirms the need for regulations as currently proposed: “[w]hile commodities exchanges scrutinize all holdings to ensure a single player isn't trying to corner the market, and many of the positions are owned by big firms on behalf of clients, the large holdings do result in a concentration of ownership that could skew prices.”<sup>28</sup>

Sincerely,



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<sup>23</sup> Chris Powell, *A London trader walks the CFTC through a silver manipulation in advance*, THE GOLD ANTI-TRUST ACTION COMMITTEE, March 25, 2010, <http://www.gata.org/node/8466> (last visited on Jan. 3, 2011).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> Tatyana Shumsky and Carolyn Cui, *Trader Holds \$3 Billion of Copper in London*, WALL ST. J. (December 21, 2010), available at [http://online.wsj.com/article/SB10001424052748704118504576034083436931412.html?mod=rss\\_whats\\_news\\_us&utm\\_source=feedburner&utm\\_medium=feed&utm\\_campaign=Feed:+wsj/xml/rss/3\\_7011+\(WSJ.com:+What's+News+US\)](http://online.wsj.com/article/SB10001424052748704118504576034083436931412.html?mod=rss_whats_news_us&utm_source=feedburner&utm_medium=feed&utm_campaign=Feed:+wsj/xml/rss/3_7011+(WSJ.com:+What's+News+US)) (last visited on Jan. 3, 2011).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*