CLIENT ALERT

CFTC Imposes $4 Million Penalty on Statoil for Attempted Propane Price Manipulation Despite Acknowledging that Statoil Did Not Purchase More Cargoes than Needed to Meet its Delivery Obligations

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On November 14, 2017, the Commodity Futures Trading Commission issued an order (the "**Order**") accepting the settlement offer of, and imposing sanctions against, Statoil ASA ("**Statoil**") for attempted manipulation in the propane markets.[1] The Commission found that Statoil traded propane during the pricing window of the Argus Far East Index (the "**Argus FEI**") in order to benefit Statoil's financial and physical positions that settled against the Argus FEI. The Order imposed a $4 million civil monetary penalty against Statoil and ordered Statoil to cease and desist from violating Section 9a(2) of the Commodity Exchange Act, as amended (the "**CEA**"), but did not impose additional undertakings.[2] The Order is troubling because it appears that Statoil had an argument that it had a legitimate business need to enter into the physical propane transactions to meet its preexisting physical sale obligations. The CFTC apparently believed that problematic communications cited in the Order trumped Statoil's apparent business need to purchase propane.

The Legal Standard for Attempted Manipulation

Section 9a(2) of the CEA makes it unlawful for "[a]ny person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or of any

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1 *In re: Statoil ASA*, Dkt. No. 18-04 (Nov. 14, 2017).

2 To date, there have been no announced settlement orders with individuals or published non-prosecution agreements.

swap."[3] The CFTC stated that the two elements of an attempted manipulation claim are: (1) an intent to *affect a market price*; and (2) some overt act in furtherance of that intent.[4] The Commission's description of the first element of an attempted manipulation claim could be read as inconsistent with a 2016 ruling of the U.S. District Court of the Southern District of New York that attempted manipulation under CEA Section 9a(2) requires an intent to cause *artificial* prices, not simply an intent to *affect* price.[5] Discussing the intent element of attempted manipulation, the court in *CFTC v. Wilson & DRW Investments* held that "there is no manipulation without intent to cause artificial prices."[6] Although the CFTC's Order stated that the intent element for attempted manipulation is satisfied if a person intends to cause a price that does not "reflect the legitimate forces of supply and demand," the Order is unclear about whether intent to cause an artificial price is necessary or merely sufficient to state a claim for attempted manipulation.[7] The CFTC's articulation of the attempted manipulation standard suggests that it may continue to pursue attempted manipulation claims based solely on an intent to affect a market price as opposed to an intent to cause an artificial price.

The Commission's Finding of a Scheme to Manipulate Based Upon Conflicting Evidence of Intent

The Commission found that from as early as October 2011 through November 2011, Statoil attempted to manipulate the Argus FEI in order to benefit Statoil's financial and physical propane positions in the Far East, including Statoil's NYMEX-cleared swaps, which settled based upon that index. The Commission identified "major" losses in Statoil's gas liquids unit throughout 2011 as a primary motivation to engage in the unlawful conduct. According to the Commission, after incurring these losses, Statoil sought in October and November of 2011 to improve profitability by building physical and financial positions in the Far East that would benefit from rising Argus FEI prices. The Commission observed that in an "effort to avoid these losses *and meet December customer obligations*," Statoil moved to "prop up" the Argus FEI by purchasing propane cargoes during the November Argus FEI propane price-setting window.[8]

The intent evidence that the Commission relied upon is not very persuasive. The Commission pointed to two communications in which Statoil traders wrote:

- "We are delivering 13.5 cargoes in December, giving us a strong position and good insight in to [sic] the direction of the November quote in Argus" and

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3 7 U.S.C. § 13(a)(2) (2012). Even though the alleged violations occurred approximately two months after the August 15, 2011 effective date of the CFTC's new fraud-based anti-manipulation rule, the CFTC did not rely on the new rule in making its finding of a violation. *Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation*, 76 Fed. Reg. 41,398, 41,401 (July 14, 2011) (codified at 17 C.F.R. pt. 180).

4 Order at 4.

5 *CFTC v. Wilson & DRW Investments*, No. 13-cv-7884, 2016 WL 7229056, at *12 (S.D.N.Y. Sept. 30, 2016).

6 *Id.*

7 Order at 4.

8 Order at 2 (emphasis added).

- "If we are buying 17 cargoes there are only a few days when we will not be able to have a good impact on the Argus quote. . . . We are actually likely to move it quite a bit up as we keep buying. . . ."[9]

While these communications violate a cardinal rule of written communications in trading shops—never write that your physical trading will benefit a related financial position—they are not smoking gun evidence of intent. Neither communication speaks to *why* the traders bought the cargoes. The Commission's position suggests continued CFTC insistence, notwithstanding the recent decision to the contrary in *Wilson*, that a manipulation claim can be brought based on an intent to impact price without showing an intent to create an artificial price.

Furthermore, it is not clear from the Order how the Commission distinguished between the traders' alleged dual motivations, and it is questionable whether such dual motivations actually establish the scienter required to prove an attempted manipulation claim. The case law that addresses dual intent situations is limited, but the U.S. District Court for the Southern District of New York resolved an analogous Securities and Exchange Commission case brought under Rule 10b-5.[10] In *SEC v. Masri*, as in Statoil, there was evidence supporting both the proposition that a trader entered into transactions for a legitimate purpose (here, to meet December customer obligations) and the proposition that he entered into them with manipulative intent (here, the communications discussed above referencing the impact to the Argus FEI). In those circumstances, the court held that "in order to impose liability for an open market transaction, the SEC must prove that **but for** the manipulative intent, the defendant would not have conducted the transaction."[11]

Although CFTC speaking orders do not include all of the facts, some of the facts cited by the Commission undercut its findings. The Commission acknowledged that Statoil "did not purchase more cargoes than needed to meet its physical delivery obligations," although some traders apparently contemplated doing so.[12] The Commission also acknowledged, as reflected in finding only attempted manipulation, that Statoil's scheme, if there was one, to "create an artificial settlement price . . . did not materialize."[13] Importantly, the Commission did not find that Statoil lost money on the cargoes for which it had a physical delivery obligation, nor did it find that the market lacked additional cargoes that Statoil could have purchased. If additional cargoes were available, and Statoil intended to push the Argus FEI up, one would expect Statoil to buy them, even at a loss. Instead, the Commission acknowledged that "there was [] a large volume of propane available to purchase" that Statoil *did not* buy.[14]

The intent inferences drawn by the Commission in the Order also appear to be inconsistent with other Commission precedent holding that manipulative intent should <u>not</u> be inferred from trading predicated on a legitimate business need.

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[9] Order at 3.

[10] *SEC v. Masri*, 523 F. Supp. 2d 361 (S.D.N.Y. 2007).

[11] *Masri*, 523 F. Supp. 2d at 362-63 (emphasis added).

[12] Order at 3.

[13] *Id.*

[14] *Id.*

In *Indiana Farm Bureau Cooperative*, for example, the Commission held that "[i]n the absence of evidence that respondents were responsible for the market congestion [the alleged squeeze], it cannot be inferred that respondents' trading activity, *consistent with their hedging program and commercial commitments*, was intended to produce an artificial price."[15] The Commission emphasized that "[s]tanding for delivery as they did was respondents' contractual right and was *motivated by pre-existing commercial needs* and the uncertainty of prices in the inactive cash market."[16] Although *Indiana Farm* involved standing for delivery on a futures contract, it stands for the proposition that an intent to manipulate cannot be inferred from purchasing a commodity to meet a contractual obligation. As in *Indiana Farm*, in the Statoil Order, the Commission did not find that Statoil created the market conditions that existed when the trading occurred and acknowledged that Statoil's physical propane purchases were consistent with its delivery obligations.

Conclusion

CFTC speaking orders do not present all of the relevant facts so it is hard to draw broad-based conclusions from them. This Order is troubling because Statoil appears to have had a legitimate business need to purchase propane to meet its contractual obligations, did not engage in uneconomic transactions and there was, at best from the CFTC's perspective, evidence of dual intent. Nevertheless, the settlement serves as yet another reminder that traders must exercise extreme caution in their written communications when discussing physical positions that may be related to financial positions.

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[15] *In re Indiana Farm Bureau Cooperative*, CFTC No. 75-14, 1982 WL 30249, at *11 (Dec. 17, 1982) (emphasis added).
[16] *Id.* (emphasis added).

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