

CLIENT ALERT

The CFTC Continues Pursuit of Insider Trading – Creates Special Task Force

October 9, 2018

AUTHORS

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On September 28, 2018, the Commodity Futures Trading Commission (“**CFTC**”) filed a complaint in the U.S. District Court for the Southern District of New York alleging that an introducing broker (“**IB**”) and one of its associated persons (“**AP**”) engaged in insider trading to the benefit of one customer account over the accounts of other customers.¹ The CFTC filed this complaint on the same day that it announced that it was creating an Insider Trading & Information Protection Task Force (“**Task Force**”). The 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.”² James McDonald, Director of the CFTC’s Division of Enforcement, emphasized that the “[i]llegal use of inside or otherwise confidential information significantly undermines market integrity and harms customers in [CFTC] markets. [The Complaint] shows that the [CFTC] will vigorously pursue this type of misconduct.”³

Trading based on proprietary information is generally permitted in the commodity and derivatives markets. Unlike securities markets, traders are not required to disclose material nonpublic information before trading on the basis of their own information. However, as discussed in the Complaint, trading on (1) material, (2) nonpublic information, and (3) in breach of a pre-existing duty may constitute a violation of the CFTC’s anti-manipulation rule.

¹ *CFTC v. EOX Holdings LLC*, No. 1:18-cv-08890 (S.D.N.Y. filed Sept. 28, 2018) (“Complaint”), available here <https://www.cftc.gov/sites/default/files/2018-09/enfeoxholdingsllccomplaint092818.pdf>.

² See CFTC Press Release, *CFTC Charges Block Trade Broker with Insider Trading* (Sept. 28, 2018) at <https://www.cftc.gov/PressRoom/PressReleases/7811-18>.

³ *Id.*

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Such activity may be referred to as “misappropriation” because it involves trading on the basis of material, nonpublic information that was obtained lawfully, but used in a manner that violates a relationship of trust and confidence between the source of the information and the trader. A relationship of trust and confidence can arise out of a regulatory obligation, an express agreement, or an implicit understanding established through a course of conduct.

Companies should review their internal insider trading compliance policies and procedures as they relate to the commodities markets, including what may constitute confidential information, what is permissible for traders who have access to confidential information, and information barriers, where appropriate. Companies should also be familiar with the scope of their non-disclosure obligations contained in non-disclosure agreements or non-disclosure obligations embedded within larger agreements.

Alleged Facts

EOX Holdings LLC (“**EOX**”) is registered with the CFTC as an IB.⁴ EOX’s agreements with its customers required EOX not to disclose confidential information about its customers, including their trading activity, unless such information was necessary to broker the customers’ trades with third parties.⁵ Andrew Gizienski, a registered AP with EOX, was prohibited from disclosing confidential customer information to anyone outside of EOX by regulation as well as under the terms of his employment agreement with EOX.⁶

Sometime in the spring and summer of 2013, Gizienski obtained discretionary authority over one customer account (referred to in the Complaint as Customer A).⁷ From August 2013 through May 2014 (the “**relevant period**”), Gizienski used nonpublic information of other EOX customers, such as their trading positions and the prices at which they bought and sold contracts, to trade for Customer A’s accounts.⁸ He also disclosed the same nonpublic information to Customer A. According to the Complaint, Gizienski did so with the intent to “curry favor with Customer A and prove his worth as a trader.”⁹ The Complaint cites various instant message (“**IM**”) conversations between Gizienski and Customer A as evidence of Gizienski’s prohibited conduct. In one IM conversation between Gizienski and Customer A, Gizienski discusses the trading activity of another customer (referred to in the Complaint as Customer B).¹⁰ The Complaint states that “Gizienski did not disclose this information for the purpose of executing a trade for Customer B, nor did he do so with Customer B’s consent. Gizienski tipped Customer A to this information so they could use it for their own trading

⁴ Complaint at 4.

⁵ Complaint at 6.

⁶ Complaint at 6.

⁷ Complaint at 8.

⁸ Complaint at 8.

⁹ Complaint at 9.

¹⁰ Complaint at 9.

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purposes.” In addition, the Complaint alleges that Gizienski “[o]n more than 100 occasions . . . executed block trades against other EOX customers, without their prior consent and without disclosing that he was taking the opposite side of [the customers’] order for the benefit of Customer A.”¹¹

The Complaint alleges that Gizienski violated the CFTC’s prohibition on market manipulation by:

(i) intentionally or recklessly trading on the basis of material, nonpublic information in breach of a pre-existing duty owed to EOX customers; (ii) intentionally or recklessly tipping material, nonpublic information about EOX customers to Customer A; and/or (iii) intentionally or recklessly engaging, or attempting to engage, in acts, practices, or a course of business which operated or would operate as a fraud or deceit upon other persons.¹²

As for EOX, the Complaint alleges that the IB failed to have policies and procedures in place “to monitor Gizienski’s trading on behalf of Customer A or to ensure the readily apparent conflicts of interest that his trading while still acting as a broker for other EOX customers created was not to the detriment of EOX customers.”¹³ The Complaint also alleges a host of recordkeeping violations that prevented the CFTC from being able to fully investigate the matter.¹⁴ The alleged violations include failing to:

- Retain all of its brokers’ “pre-trade communications with customers,” including “pre-trade communications on brokers’ mobile devices”;
- Maintain policies and procedures “relating to the use of or access to its brokers’ mobile devices”;
- Prepare and retain adequate records of customer orders; and
- Maintain policies and procedures related to brokers’ written records of customer orders.¹⁵

The Complaint seeks an order enjoining Gizienski and EOX from further violating the relevant provisions of the Commodity Exchange Act and the CFTC’s regulations, permanent trading bans, disgorgement of fees and trading revenues, and civil penalties.¹⁶

¹¹ Complaint at 14.

¹² Complaint at 17. The Complaint also alleges that Gizienski violated CFTC Rule 155.4(b), which prohibits IBs and affiliated persons from: (1) disclosing an order held unless necessary for execution; or (2) taking the opposite position of a customer’s order without the customer’s consent.

¹³ Complaint at 15.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Complaint at 22 – 23.

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