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Insider Trading Enforcement Intensifies Across Markets and Regulators

BY EUGENE INGOGLIA, ANTHONY MANSFIELD AND CHELSEA PIZZOLA

On Sept. 28, 2018, the U.S. Commodity Futures Trading Commission (CFTC) announced the formation of an "Insider Trading and Information Protection Task Force" (CFTC Task Force) within the agency's Enforcement Division. "CFTC Charges Block Trade Broker with Insider Trading," CFTC (Sept. 28, 2018). Twelve days later, former U.S. Attorney for the Southern District of New York Preet Bharara and U.S. Securities & Exchange Commission Commissioner Robert Jackson announced the formation of a separate task force (Bharara Task Force) aimed at insider trading in the securities markets. Preet Bharara & Robert J. Jackson Jr., "Insider Trading Laws Haven't Kept Up With the Crooks," N.Y. Times (Oct. 9, 2018).

EUGENE INGOGLIA *and* ANTHONY MANSFIELD *are partners and* CHELSEA PIZZOLA *is an associate at Allen & Overy. Mr. Ingoglia is a former Assistant U.S. Attorney for the S.D.N.Y. and was a member of the trial team for one of the hedge fund defendants in 'Blaszczak', discussed herein. Mr. Mansfield previously served as a Chief Trial Attorney and counsel to the director in the CFTC's Enforcement Division. Ms. Pizzola previously served as a law clerk in the Office of Chairman J. Christopher Giancarlo at the CFTC.*

The development of both derivatives- and securities-centric task forces to address insider trading signals intensified regulatory focus on this area of law across financial markets. Indeed, in announcing the CFTC Task Force, CFTC Enforcement Division Director James McDonald—who previously served as a prosecutor in the U.S. Attorney's Office for the Southern District of New York, which has brought many of the most significant insider trading prosecutions—stressed that the CFTC "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." The Bharara Task Force was formed with the stated objective of tightening up perceived laxities and gaps in current insider trading law by proposing regulatory and legislative reforms.

CFTC Task Force and Related Enforcement Actions

The CFTC announced its task force in conjunction with the filing of a

complaint in the U.S. District Court for the Southern District of New York against introducing broker EOX Holdings (EOX) and one of its associated persons, Andrew Gizienski, alleging violations of CFTC Rule 180.1's prohibition on misappropriation of confidential information. 17 C.F.R. §180.1. Misappropriation in violation of Rule 180.1 occurs when a party trades on the basis of material, nonpublic information, or discloses such information to a third party (conduct known as "tipping"), in violation of a duty of confidentiality to the source of the information. (Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,403 (July 14, 2011) ("Depending on the facts and circumstances, a person who engages in deceptive or manipulative conduct in connection with 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, for example by trading on the basis of material non-public information in breach of a pre-existing duty (established by another law or rule, or agreement, understanding, or some other source), or by trading on the basis of material non-public information that was obtained through fraud or deception, may be in violation of final Rule 180.1.").)

In the EOX case, the CFTC brought charges under both "tipper-tippee" and direct insider trading theories of liability, alleging that Gizienski breached a duty of trust and confidence to EOX customers by (1) disclosing to a friend—whose account Gizienski traded on a discretionary basis—certain confidential information about other customers, such as their identities, trading activity, and positions, and (2) trading the friend's discretionary account on the basis of such confidential information, all in breach of pre-existing duties of trust and confidence to EOX customers imposed by law or rule and by contract. (EOX and Gizienski have moved to dismiss, arguing that a broker acting for both sides of a block trade does not have a duty of trust and confidentiality—and thus cannot be charged with misappropriation—because both parties expect that the broker will share their information with the other side of the trade. Complaint, *CFTC v. EOX Holdings*, Civil Action No. 1:18-cv-8890-GBD (S.D.N.Y. filed Dec. 3, 2018).) The CFTC also brought charges against EOX itself, alleging that EOX failed to supervise its associated persons as required under CFTC Rule 166.3 in that it failed to establish, implement, and enforce policies or procedures to prevent and detect misuse of confidential customer information.

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The CFTC previously had brought only two insider trading cases since it promulgated Rule 180.1 in 2011. *In re Ruggles*, CFTC Docket No. 16-34 (Sept. 29, 2016); *In re Motazedi*, CFTC Docket No. 16-02 (Dec. 2, 2015). In each of the two previous cases, the CFTC alleged that a trader at a proprietary trading firm breached a duty of confidentiality to his or her employer by engaging in front-running of his or her employer's proprietary accounts using the employee's knowledge of the times, volumes, and prices at which the employer intended to trade certain commodity futures.

The EOX case differs from these prior enforcement actions in that it is the CFTC's first misappropriation action against a derivatives market intermediary or an associated person thereof. Here, the CFTC alleged a breach of duty to *customers* of the intermediary rather than to the respondent's employer, as in previous cases. Moreover, this is the first insider trading case in which the CFTC has charged the intermediary entity itself for failure to implement and enforce adequate controls to guard against violations of Rule 180.1. In announcing the filing of the EOX complaint (and the formation of the CFTC Task Force), James McDonald cautioned that the CFTC will vigorously enforce its requirement that CFTC registrants "develop and enforce policies prohibiting the misuse of confidential information, as they are required to do under the law."

Rule 180.1 is relatively new, having been enacted under statutory authority granted by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, and the text of Rule 180.1 is nearly identical to SEC Rule 10b-5, under which the SEC and federal prosecutors have traditionally brought securities insider trading charges. In its interpretation of Rule 180.1, the CFTC has chosen to be guided—but not bound—by judicial and regulatory interpretations of the securities laws with respect to insider trading. 76 Fed. Reg. 41,398, 41,399 (July 14, 2011). These interpretations are in the midst of considerable evolution, however. (The EOX case raises an additional question regarding

the elements of a misappropriation claim in the context of a commodities market intermediary under CFTC Rule 180.1. Under the securities law misappropriation construct, from which the CFTC has borrowed heavily to inform the contours of a misappropriation claim under CFTC Rule 180.1, the claim is predicated on the misuse of material non-public information to achieve a *personal benefit*. However, in the context of other commodities market intermediaries, e.g., swap dealers, the CFTC appears to have focused on the potential harm to the owner of the information, not the potential gain to the user of the information. See infra *United States v. Newman*, 773 F.3d 438, 448 (2d Cir. 2014) and accompanying text. In light of the EOX case, it is not clear whether the CFTC intends to apply multiple, and potentially different, standards for a misappropriation claim under the CEA and CFTC rules, and if so, the legal rationale for such differing standards.)

Ongoing Evolution Of Insider Trading Law

In recent years the U.S. Attorney's Office for the Southern District of New York has broken with tradition in that, when charging insider trading defendants under Title 15 and Title 18 of the U.S. Code, it has sought and received jury instructions that Title 18 securities fraud and wire fraud are different—and easier to prove—than securities fraud, under Title 15, for the same conduct. See *United States v. Blaszczak*, No. S1 17 Cr. 357 (LAK) (S.D.N.Y. March 12, 2018); Indictment, *United States v. Chow*, No. 17 Cr. 667 (GHW) (S.D.N.Y. Oct. 30, 2017), ECF No. 2; Verdict Form, *United States v. Walters*, No. 16 Cr. 338 (PKC) (S.D.N.Y. May 19, 2016), ECF No. 129; Superseding Indictment, *United States v. Stewart*, No. 15 Cr. 287 (LTS) (S.D.N.Y. July 15, 2015), ECF No. 25 (*Stewart* Superseding Indictment.). In the past, the elements of the claims were treated the same for insider trading defendants, where the different counts addressed the identical facts. In contrast, in recent cases tried this year, the instructions were different, including under Title 18 the absence of a requirement of proof that a remote tippee knew that the original tipper received a personal benefit in exchange for the initial tip or even that the original tipper received a benefit at all, whereas Title 15 does require proof of such benefit and knowledge. *United States v. Newman*, 773 F.3d 438, 448 (2d Cir. 2014). As a result, for the first time, defendants were acquitted under Title 15 but convicted under Title 18, for the same actions.

Of note, this approach is not available to the SEC, which does not have recourse to an alternative, easier-to-prove statute under which to bring insider trading charges.

Like the SEC, the CFTC lacks authority under Title 18 and therefore also could not use the charging tactics employed by the U.S. Attorney's Office for the Southern District of New York. The CFTC has not yet made clear whether it will adopt the "personal benefit" requirement from securities law at all, however. Rather than assessing whether a disclosure provided a *benefit to the tipper*, the CFTC may instead choose to focus on whether the disclosure resulted in a *detriment to the source* of the information, which is the standard used in the CFTC rule governing a swap dealer's use of material confidential information of a counterparty. See CFTC Rule 23.410(c) (precluding a swap dealer's use of counterparty information for its own purposes "in any way that would tend to be materially adverse to the interests of a counterparty …"). The three misappropriation cases brought under Rule 180.1 to date have not resolved this question.

Conclusion

Businesses once again need to adapt to circumstances in which the same activity gives rise to risk under multiple regulatory regimes, each with different and evolving standards. Those trading in financial markets may face difficulty in determining the types of information on which they may base their trades. To mitigate the risk of liability, market participants should take a thoughtful approach, implementing policies to prevent the disclosure or misuse of information in ways that are likely to violate either SEC or CFTC insider trading prohibitions, or the broad view taken by federal criminal authorities, and monitoring communications and trading to detect any possible perceived violations.