

The CFTC's Expanded Reach

Traditionally the jurisdiction of the CFTC has been tied to the futures markets. Contracts for future delivery were within the reach of the agency and its regulatory regime. Forward contracts were not. Dodd-Frank sought to expand the reach of the agency by extending its reach in two important ways: First, the agency was given authority over leveraged commodity transactions. Second, a broad new antifraud statute modeled on Exchange Act Section 10(b) was added. Now the question is the actual scope of these provisions. The Ninth Circuit Court of Appeals recently addressed this point in *CFTC v. Monex Credit Company*, No. 18-55815 (9th Cir. Decided July 25, 2019).

Monex has been a large precious metals dealer for years. Since at least 2011 the firm has operated what it calls the Atlas Program. Under this program a customer opens an account and can take a position in one or more precious metals. Monex controls the platform and acts as the counterparty to every transaction. The firm sets the process for every trade.

Typically, the trades require the posting of margin which ranges from 22% to 25%. The customer can take either a "short" or "long" position. Under the terms of the account agreement Monex always has possession of the metal, stored in a depository with which the firm has a contractual relation. The customer can actually take physical position of the metal but only after paying full price and requesting specific delivery. While the metal still remains in the depository, a "book entry" is made regarding the delivery.

The CFTC filed an enforcement action based on its new authority, claiming that the Monex program violated the Dodd-Frank amendments to the Act in two fundamental ways. First, under the amendments Congress extended the CEA to commodity transactions offered on a leveraged or margined basis under Section 2(c)(2)(D) unless "actual delivery" is taken within 28 days. The agency claimed that the Atlas Program was in fact an unregistered commodity platform and that the so-called delivery option was a sham. Second, the CFTC claimed that the program was deceptive within the meaning of new Section 6(c)(1) of the Act. Essentially, the house always wins. The

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District Court dismissed the complaint, concluding that the Commission was incorrect as to delivery and the new antifraud section required deception *and* manipulation, the latter of which is not present here. (The district court decision is discussed at length [here](#)).

The Ninth Circuit reversed. First, the actual delivery exception is an affirmative defense according to a recent ruling by the Eleventh Circuit. While typically an affirmative defense is not considered on a motion to dismiss where, as here, the complaint establishes the defense it can be considered.

Under the plain language of the statute, the exception to the registration requirement applies only where there is “actual” delivery. Congress chose not to define the meaning of “actual delivery.” The Eleventh Circuit in *CFTC v. Hunter Wise Commodities, LLC*, 749 F. 3d 967 (11th Cir. 2014) has considered the question. There the court concluded that actual delivery contemplated a delivery which is “*actual*,” although the court did not define the limits of the concept.

Monex rejected the *Hunter Wise* limitation of the delivery concept. Yet the language selected by Congress implies that there be some meaningful degree of possession or control by the customer. While it is possible for the requirement to be satisfied if the metal is held by a third party, that is not the situation here where the “metals are in the broker’s chosen depository, never exchange hands, and are subject to the broker’s exclusive control and customers have no substantial, non-contingent interests.” And, in any event, the court found the CFTC’s “interpretative guidance persuasive,” citing in part *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

Second, the Court rejected the conclusion that new Section 6(c)(1) requires proof of manipulation and deception to establish a violation. The section was modeled by Congress on Exchange Act Section 10(b). That section does not require proof of both elements to establish a violation. To the contrary, Section 10(b) has been held to be a “catch-all clause to prevent fraudulent practices,” quoting *Chiarella v. United States*, 445 U.S. 222, 226 (1980). It authorizes fraud-only claims. Since Section 6(c)(1) is the “mirror image” of the Exchange Act provision, it is clear that the District Court’s ruling is incorrect.