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FIRST “INSIDER TRADING” CASE GOES FROM BAD TO WORSE FOR CFTC

AGENCY CHALKS UP ANOTHER DEFEAT IN THE FIFTH CIRCUIT

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On January 8, 2024, the U.S. Court of Appeals for the Fifth Circuit reversed a jury verdict for the Commodity Futures Trading Commission (“CFTC”) in an enforcement action against EOX Holdings, L.L.C. (“EOX”) and its employee, Andrew Gizienski.[1] The jury had found that Gizienski “took the other side of orders” in violation of a CFTC regulation and imposed a $6.5 million civil monetary penalty. Originally brought in the Southern District of New York,[2] the CFTC announced the case with much fanfare in the waning hours of the federal government’s 2018 fiscal year as a new “insider trading” case under authority recently given to the agency by the Dodd Frank Act.[3] Its press release publicizing the case heralded the formation of an Insider Trading and Information Protection Task Force within the CFTC’s Division of Enforcement tasked with overseeing this new authority.[4]

EOX is a registered introducing broker and Gizienski was one of its associated persons working out of the firm’s Houston office. The defendants specialized in working orders for block trades in energy futures contracts traded on ICE Futures U.S. With the approval of ICE Futures, EOX’s clearing firms, and EOX’s compliance department, Gizienski was allowed to have discretionary authority to trade a friend’s account. Gizienski exercised that discretion to have his friend’s account take the other side of orders that EOX received from other institutional customers. In addition, Gizienski told his friend about orders that other institutional customers were placing.

In Count One of its complaint, the CFTC alleged that this conduct constituted “insider trading” in violation of Section 6(c)(1)[5] of the Commodity Exchange Act (“CEA”) and CFTC Regulation 180.1,[6] which prohibit the use of “any manipulative or deceptive device or contrivance” “in connection with” the sale of a futures contract. In Count Two, the CFTC alleged that Gizienski’s conduct violated CFTC Regulation 155.4(b)(2)(i).[7] Regulation 155.4(b)(2)(i) provides:

> No introducing broker or any of its affiliated persons shall . . . Knowingly take, directly or indirectly, the other side of any order of another person revealed to the introducing broker or any of its affiliated persons by reason of their relationship to such other person, except with

such other persons's [sic] prior consent and in conformity with contract market rules approved by or certified to the Commission.

The complaint also charged EOX with recordkeeping and failure to supervise violations. The complaint sought injunctive relief, civil monetary penalties and disgorgement of profits derived from the alleged violations of the CEA and CFTC Regulations.

In 2019, the case was transferred to the Southern District of Texas, and three years later, it went to a jury for a seven-day trial. Traders who testified conceded that they had not suffered any damages as a result of Gizienski's conduct, prompting the CFTC to drop its claim for restitution and disgorgement.[8]

On Count One, the jury found for the defendants on the CFTC's highly vaunted insider trading claim, . rejecting the CFTC's theory that Gizienski's conduct violated CEA Section 6(c)(1) and Regulation 180.1. On Count Two, however, the jury found for the CFTC, saving the CFTC's only other substantive charge. The jury determined that Gizienski had "taken the other side" of customer orders by exercising discretion over his friend's account to be the counterparty to the EOX's other institutional customers without their consent some 122 times in violation of Regulation 155.4(b)(2)(i). For "taking the other side" of customers' orders, the jury imposed a civil monetary penalty of $6.5 million.

The defendants appealed the jury's verdict finding them liable for "tak[ing] the other side" of customers' orders. They argued that the CFTC had not given them fair notice that their conduct – having an account, over which they had discretion but no financial interest, trade against another customer - constituted "tak[ing] the other side" as prohibited by Regulation 155.4(b)(2)(i). The CFTC argued the plain language of Regulation 155.4(b)(2)(i) made clear that both having an account owned by the introducing broker, or an account which the introducing broker merely controlled, trade against a customer's order without that customer's consent was prohibited.

The Fifth Circuit noted that it is true "that the text of Rule 155.4(b)(2)(i) does not limit its application to principals. But nothing extends its application beyond principals either."[9] As a result, the court concluded that "[o]n its face, then, the text of Rule 155.4(b)(2)(i) is at best ambiguous. It did not give fair notice to the Defendants absent further guidance from the CFTC, and for nearly four decades, no such guidance came."[10]

The court cited the Second Circuit's decision in *Upton v. SEC*,[11] where the Second Circuit found the SEC had not put the defendant there on reasonable notice that its practice violated an SEC regulation when the SEC was aware of such practices and had not taken any steps "to advise the public that it believed the practice was questionable."[12] The court also cited the CFTC's own *Futures Glossary: A Guide to the Language of the Futures Industry* which defines "bucketing" to mean "[d]irectly or indirectly taking the opposite side of a customer's order into *a broker's own account or into an account in which a broker has an interest*, without open and competitive

execution of the order on an exchange."[13] The Fifth Circuit's decision leaves intact only the recordkeeping and supervisory claims against EOX.

With this loss, it seems that the Fifth Circuit is becoming an ever more hospitable forum for those seeking to challenge the SEC and CFTC. Over the past two years, the Fifth Circuit has ruled that the SEC's administrative adjudication system was constitutionally flawed,[14] the SEC's adoption of a share repurchase rule was arbitrary and capricious,[15] and that the CFTC's withdrawal of a no action letter permitting a political event contract market to operate was likely arbitrary and capricious.[16] The Fifth Circuit's most recent decision shows that fundamental notions of reasonable notice can arise even in the context of a forty-year-old regulation. And, if you are willing to litigate to a Circuit Court of Appeals, an agency's regulations may not mean what the agency staff say they mean; the regulations may mean what they say.

FOOTNOTES

[1] *CFTC v. EOX Holdings, L.L.C. and Andrew Gizienski*, Slip. Op., Case No. 22-20622 (5th Cir. Jan. 8, 2024) ("Slip Op.").

[2] *CFTC v. EOX Holdings, L.L.C. and Andrew Gizienski*, Case No. 18-cv-8890 (S.D.N.Y. Sept. 28, 2018).

[3] Press Release No. 7811-18, *CFTC Charges Block Trade Broker with Insider Trading* (CFTC Sept. 28, 2018).

[4] Press Release No. 7811-18.

[5] 7 U.S.C. § 9(1).

[6] 17 C.F.R. § 180.1.

[7] 17 C.F.R. § 155.4(b)(2)(i).

[8] Slip Op. at 4.

[9] *Id.* at 8.

[10] *Id.*

[11] 73 F.3d 92 (2d Cir. 1996).

[12] *Id.* at 10 *quoting Upton*, 73 F.3d at 97.

[13] *Id.* at 13 *quoting* the CFTC's *Futures Glossary: A Guide to the Language of the Futures Industry* (emphasis added).

[14] *Jarkesy v. SEC*, 34 F.4th 446 (5th Cir. 2022), *rehearing en banc denied*, 51 F.4th 644 (5th Cir. 2022), *cert. denied*, 143 S.Ct. 2688 (2023).

[15] *Chamber of Commerce of United States v. SEC*, 85 F.4th 760 (5th Cir. 2023).

[16] *Clarke v. CFTC*, 74 F.4th 627 (5th Cir. 2023).

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MEET THE TEAM

Katherine Cooper

New York

katherine.cooper@bclplaw.com
+1 212 541 1141

Renato Mariotti

Chicago

renato.mariotti@bclplaw.com
+1 312 602 5037

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