No. 09-669

# In the Supreme Court of the United States

ANTHONY DIPLACIDO, PETITIONER

*v.*

COMMODITY FUTURES TRADING COMMISSION

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION


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## QUESTION PRESENTED

Whether the Commodity Futures Trading Commission reasonably concluded that petitioner had manipulated the settlement prices of electricity futures contracts, in violation of the Commodity Exchange Act, 7 U.S.C. 13(a)(2), by buying contracts at higher prices than necessary and selling contracts at lower prices than necessary with the specific intent to cause artificial prices and with that result.

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## OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-11a) is unreported. The opinion and order of the Commodity Futures Trading Commission (Pet. App. 12a-123a) is unreported.

## JURISDICTION

The judgment of the court of appeals was entered on October 16, 2009. The petition for a writ of certiorari was filed on December 7, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATEMENT

1. The Commodity Exchange Act (CEA or Act), 7 U.S.C. 1 *et seq.*, establishes a comprehensive scheme to regulate trading in futures contracts. See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456

U.S. 353, 355-356 (1982). *Inter alia*, 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" organized commodity exchange or trading facility. 7 U.S.C. 13(a)(2). The Act authorizes the Commodity Futures Trading Commission (CFTC or Commission) to impose various penalties—including cease and desist orders, trading bans, registration revocations, and civil money penalties—on any person who the CFTC finds has engaged in prohibited manipulation. 7 U.S.C. 9, 13b.

2. Petitioner was a registered floor broker on the New York Mercantile Exchange (NYMEX). In August 2001, the CFTC filed an administrative complaint alleging, *inter alia*, that petitioner had violated the CEA on five occasions in 1998 by manipulating the settlement prices of futures contracts on the NYMEX. Pet. App. 12a & n.1.

In September 2001, after a four-day hearing, an administrative law judge (ALJ) issued an initial decision finding petitioner liable as charged. The ALJ imposed a cease and desist order, a 20-year trading ban, a registration revocation, and a $500,000 civil money penalty. Pet. App. 14a-15a, 20a.

On November 5, 2008, the CFTC issued an opinion and order sustaining the ALJ's determination in principal part. Pet. App. 12a-123a. The Commission found that, on four occasions between April and July 1998, petitioner had colluded with two energy traders who worked for Avista, Inc. (Avista), to inflate or to depress the settlement prices of electricity futures contracts traded on the NYMEX. *Id*. at 16a-17a, 18a-20a, 67a-93a. The purpose of the manipulation was to increase Avista's profits on certain over-the-counter derivatives contracts, the prices of which were tied to the settlement prices of the electricity futures contracts. *Id.* at 20a.

At the time that petitioner carried out the scheme, settlement prices for the electricity futures contracts on the NYMEX were determined based on the prices paid for contracts during the market close—the last two minutes of trading each day. Pet. App. 19a. Because the market for electricity futures was small and illiquid, petitioner was able to manipulate the settlement prices by executing large orders during the close. *Id.* at 72a-73a. When petitioner and Avista wanted to drive the settlement price down, petitioner would offer to sell large numbers of contracts at prices lower than the prevailing bids from prospective buyers—a practice known as "violating the bids." *Id.* at 22a-26a. When petitioner wanted to drive the settlement price up, petitioner would bid to buy large numbers of contracts at prices higher than the prevailing offers from prospective sellers, a practice known as "violating the offers." *Id.* at 26a-30a.

The record before the Commission contained recordings of petitioner and the Avista traders plotting how to implement their scheme and communicating during the scheme's execution. Pet. App. 22a-30a, 75a. The record also contained testimony by other traders about petitioner's violation of bids and offers. *Ibid.* And the record included testimony from petitioner's assistant that he had observed petitioner violating bids and offers, that petitioner had instructed him to use code words to conceal his misconduct, that other traders had complained about petitioner's practices, and that petitioner had attempted to conceal evidence from NYMEX investigators. *Ibid.*; *id.* at 107a.

Based on that evidence, the Commission concluded that petitioner had engaged in unlawful manipulation in violation of the CEA. Pet. App. 67a-93a. In reaching that conclusion, the Commission applied the four-factor test that it has traditionally applied in resolving manipulation cases. *Id.* at 69a-70a. Specifically, the Commission found that the evidence established that petitioner had possessed the ability to influence the prices for electricity futures contracts; that he had specifically intended to influence those prices; that the prices were artificial; and that petitioner had caused the artificial prices. *Id.* at 71a-93a.

The Commission upheld the cease and desist order, trading ban, and registration revocation imposed by the ALJ. Pet. App. 108a-110a. "In light of the extreme gravity" of petitioner's manipulation violations, however, the Commission determined that the civil money penalty imposed by the ALJ was insufficient, and the Commission increased the penalty to $1 million. *Id.* at 120a-121a.

3. In a non-precedential, summary order, the court of appeals affirmed the CFTC's decision in principal part but reduced the civil penalty to $680,000. Pet. App. 1a-11a. As relevant here, the court of appeals rejected petitioner's contention that the Commission had departed from its usual test for manipulation by abandoning a purported requirement of proof that the defendant controlled the relevant market. *Id.* at 4a. The court explained that, under the Commission's well-established precedents, "market control may be a feature of some forms of manipulation, *e.g.*, a 'corner' or a 'squeeze,' but is *not* a requirement of manipulation in all its forms." *Ibid.* (citing *In re Hohenberg Bros. Co.*, [1975-1977

Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271, at 21,477 (CFTC Feb. 18, 1977)).[1]

The court of appeals also observed that the CFTC's predecessor agency (the Commodity Exchange Authority) had found manipulation under a substantively equivalent statute based on "closely analogous facts" and the same legal "theory applied in this case." Pet. App. 3a (citing *In re Henner*, 30 Agric. Dec. 1151 (1971)). The court explained that, in *In re Henner*, as here, the agency had found manipulation where a trader had "intentionally paid more than he would have had to pay . . . for the purpose of causing the closing quotation [to increase.]." *Ibid.* (quoting *In re Henner*, 30 Agric. Dec. at 1174).

The court of appeals noted that, "[i]n the absence of a statutory definition of 'manipulation,'" the CFTC has adopted a four-part test under which it finds manipulation when the evidence shows "(1) that the accused had the ability to influence market prices; (2) that [he] specifically intended to do so; (3) that artificial prices existed; and (4) that the accused caused the artificial prices." Pet. App. 6a (quoting *In re Cox*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786,

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[1] In a "corner," the party engaging in manipulation has "a monopoly of a cash commodity, coupled with ownership of long futures contracts in excess of the amount of that commodity, so that shorts—who because of the monopoly cannot obtain the cash commodity to deliver on their contracts—are forced to offset their contract[s] with the long at a price which he dictates." *Cargill, Inc.* v. *Hardin*, 452 F.2d 1154, 1162 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972). In a "squeeze," no one has "an actual monopoly of the cash commodity itself, but for one reason or another deliverable supplies of the commodity in the delivery month are low." *Ibid.* As a result, "the futures price can be manipulated by" a long with futures "contracts substantially in excess of the deliverable supply." *Ibid.*

at 34,060 (CFTC July 15, 1987)). The court concluded that "the Commission carefully applied all four elements of the traditional test" in this case. *Id.* at 7a.

The court of appeals also rejected petitioner's contention that, in applying the traditional test to his manipulative trading practices, the Commission had relied on his violation of bids and offers alone to establish all four elements of the test, so that, under the Commission's approach, even lawful activity, such as hedging, would be illegal. Pet. App. 6a-7a. The court noted that the Commission's "finding of intent * * * depended not merely on [petitioner's] having violated bids and offers, but also on taped conversations signaling manipulative intent and the ALJ's finding that [petitioner's] denial of intent lacked credibility." *Id.* at 7a. Similarly, the court explained, the Commission's finding that petitioner had caused artificial prices was based not only on his violation of bids and offers but also on "evidence (including expert testimony) that artificial prices were a 'reasonably probable consequence' of [petitioner's] large trades made during the Close in an illiquid market." *Ibid.* (citation omitted).

**ARGUMENT**

The non-precedential, summary order of the court of appeals is correct, and it does not conflict with any decision of this Court or another court of appeals. This Court's review is therefore not warranted.

1. The court of appeals correctly upheld as reasonable the conclusion of the CFTC that petitioner had manipulated the settlement prices of electricity futures contracts, in violation of the CEA, 7 U.S.C. 13(a)(2), by buying contracts at higher prices than necessary and selling contracts at lower prices than necessary with the

specific intent to cause artificial prices and with that result. Pet. App. 5a-9a.

The CEA does not define the term "manipulation." Pet. App. 6a. Nonetheless, as petitioner concedes, the courts and the CFTC have reached a consensus that the term refers to "the intentional extraction of artificial prices." Pet. 2; see, *e.g.*, *Frey* v. *CFTC*, 931 F.2d 1171, 1175 (7th Cir. 1991) (defining manipulation as "an intentional exaction of a price determined by forces other than supply and demand"); *Cargill, Inc.* v. *Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971) (defining manipulation as intentional conduct that has "resulted in a price which does not reflect basic forces of supply and demand"), cert. denied, 406 U.S. 932 (1972). Petitioner's conduct falls squarely within that definition.

As the court of appeals observed (Pet. App. 6a), the CFTC has traditionally applied a four-part test to determine whether a defendant has engaged in manipulation. Under that test, a defendant is guilty of manipulation if he "had the ability to influence market prices; (2) * * * [he] specifically intended to do so; (3) * * * artificial prices existed; and (4) * * * the [defendant] caused the artificial prices." *Ibid.* (quoting *In re Cox*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,060 (CFTC July 15, 1987)); see, *e.g.*, *In re Soybean Futures Litig.*, 892 F. Supp. 1025, 1045 (N.D. Ill. 1995). As petitioner concedes (Pet. 7), the CFTC applied that traditional four-part test in concluding that petitioner had engaged in manipulation here. See Pet. App. 69a-70a.

Contrary to petitioner's claim that the Commission somehow applied the test in a way that "render[ed] the traditional four-part standard inoperable" (Pet. 13), "the Commission carefully applied all four elements of the traditional test." Pet. App. 7a. In particular, as the court of appeals concluded, a variety of evidence, in addition to petitioner's violation of bids and offers, established each of the traditional elements. *Id.* at 7a-9a; see *id.* at 22a-30a (describing evidence) *id.* at 71a-93a (explaining how evidence established that petitioner's conduct satisfied each element of the test). The CFTC's application of its settled standard for determining manipulation to the particular context of this case does not warrant this Court's review.

2. Contrary to petitioner's contention (Pet. 13, 14), the decision below does not conflict with the decision of any other court of appeals. Petitioner's claim of a conflict is based on the erroneous assertion that other courts of appeals have held that "defendants must control either the futures market or the deliverable cash supply in order to have the ability to influence commodities prices." Pet. 14 (citing *Cargill,* 452 F.2d at 1164, and *Volkart Bros., Inc.* v. *Freeman*, 311 F.2d 52, 59 (5th Cir. 1962)). Neither decision cited by petitioner so holds. Instead, those cases hold only that market control is generally a necessary component of certain types of manipulation, specifically "corners" or "squeezes." See *Cargill,* 452 at 1164 (stating that "a squeeze cannot be successfully executed unless a long has sufficient control of enough futures contracts to force the shorts to come to him to settle their contracts"); *Volkart Bros.*, 311 F.2d at 59 (observing that most cases of manipulation have involved situations where a trader "effectively controlled the spot commodity to the extent necessary to enable it to convert its dominant long futures position into an illegal corner or squeeze"); see note 1, *supra*. Neither decision addresses whether market control is necessary where, as here, manipulation is effected

through uneconomic trading practices. In fact, as petitioner himself acknowledges (Pet. 6), no court of appeals other than the court below has addressed that question.[2]

The decision below accords with administrative and district court decisions that have addressed the same or similar questions. As the court of appeals noted, in *In re Henner*, 30 Agric. Dec. 1151 (1971), the Commodity Exchange Authority, the CFTC's predecessor agency, found manipulation under a substantively equivalent statute based on "closely analogous facts" and the same legal "theory applied in this case." Pet. App. 3a. In *In re Henner*, as here, a trader "intentionally paid more than he would have had to pay . . . for the purpose of causing the closing quotation [to increase.]" *Ibid.* (quoting *In re Henner*, 30 Agric. Dec. at 1174). In concluding that the trader had engaged in illegal manipulation, the Commodity Exchange Authority expressly rejected the proposition that "control of the market" was a prerequisite to finding a violation. *In re Henner*, 30 Agric. Dec. at 1234.[3]

CFTC and district court decisions likewise have expressly rejected petitioner's contention that market control is a necessary element of price manipulation under

[2] The decision below could not create a conflict with another court of appeals in any event, because it was a summary order, which has no precedential effect. See 2d Cir. R. 32.1(b).

[3] Petitioner's contention that the ruling in *In re Henner* turned on Henner's ability to "force other traders to deal with him" (Pet. 18) makes no sense. Henner was attempting to buy at the highest price possible, so he had no need to "force" sellers to accept that price; they were eager to do so. Pet. 19. In any event, the Commodity Exchange Authority explained that the manipulation at issue "merely involve[d] paying more than necessary for the commodity or for futures contracts or selling cheaper than necessary." *In re Henner*, 30 Agric. Dec. at 1234-1235.

the CEA. See *In re Hohenberg Bros. Co.*, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271, at 21,477 (CFTC Feb. 18. 1977); *In re Soybean Futures*, 892 F. Supp. at 1046-1047.[4] Indeed, even petitioner concedes (Pet. 16) that market control is not required to establish manipulation carried out by spreading false rumors. Petitioner fails to recognize, however, that uneconomic trading for the purpose of manipulating prices is analogous to spreading misinformation. See *In re Henner*, 30 Agric. Dec. at 1234; 2 Timothy J. Snider, *Regulation of the Commodities Futures and Options Markets* § 12.17 (2d ed. 1995). Transactions subject to the CEA are "affected with a national public interest" because they provide a means for discovering futures prices. 7 U.S.C. 5(a). By trading uneconomically, petitioner intentionally interfered with this critical price-discovery function. *In re Henner*, 30 Agric. Dec. at 1234.[5]

3. Petitioner further contends (Pet. 19-24) that the test for illegal manipulation applied here by the CFTC would sweep in legitimate economic activity such as hedging. As the court of appeals correctly concluded (Pet. App. 7a), the CFTC's approach would not have that

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[4] *In re Cox*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,060 (CFTC July 15, 1987), the CFTC decision cited by petitioner (Pet. 14), involved an alleged squeeze. It does not indicate that market power is required for other types of manipulation.

[5] The decision below also does not conflict with the NYMEX proceedings that were brought against petitioner. See Pet. 8. The charges in those proceedings were based on NYMEX rules, not the CEA. C.A. App. 197-201. And the results of such proceedings are not binding on the CFTC. See *Flaxman* v. *CFTC*, 697 F.2d 782, 786 (7th Cir. 1983); *In re Murphy*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,798, at 31,345 (CFTC Sept. 25, 1985).

effect. The CFTC applied the traditional test for manipulation, *ibid.*; see *id.* at 69a-70a, which requires proof that the defendant specifically intended to manipulate prices. Market participants who engage in lawful hedging do not have that intent. Accordingly, the CFTC's approach does not threaten to "interfere[] with the legitimate economic functions of futures markets." Pet. 24. On the contrary, it is the intentional distortion of market prices in which petitioner engaged that poses a threat to legitimate market functions.

**CONCLUSION**

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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