

## VI. *Future Delivery, Enforcement Now: Charting the CFTC's Expanded Authority to Regulate Fraud*

### A. Introduction

The Commodity Futures Trading Commission (CFTC or Commission) was created by Congress in 1974 with the passage of the Commodity Futures Trading Commission Act,<sup>1</sup> which amended the Commodity Exchange Act of 1936 (CEA)<sup>2</sup> and created a new commission to exercise authority that had formerly been lodged within the Department of Agriculture's Commodity Exchange Commission.<sup>3</sup> This legislative genealogy—and the fact that the CFTC's enabling legislation finds its home in the agricultural title of the United States Code—hints at the fact that the CFTC has been concerned almost exclusively with regulating the futures markets for durable goods and agricultural products.<sup>4</sup> At first glance, it might seem that an agency tasked with overseeing contracts for the delivery of dry goods and produce at specified times and prices would be of little relevance in today's digitized, globalized economy, dependent on technology and service sectors rather than traditional agriculture and manufacturing.<sup>5</sup> But recent reforms have broadened the CFTC's mandate, and the Commission now regulates a wide range of economic activity that has

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<sup>1</sup> Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93–463, 88 Stat. 1389 (codified as amended at 7 U.S.C. §§ 1–27f (2018)) (amending the Commodity Exchange Act to create the Commodity Futures Trading Commission).

<sup>2</sup> Commodity Exchange Act of 1936, Pub L. No. 74–675, 49 Stat. 1491 (codified as amended at 7 U.S.C. § 1 (2018)) (originally creating the Commodity Exchange Commission, now delineating the CFTC's role and authority).

<sup>3</sup> See Pub. L. No. 74–675 § 3(b) (giving the CEA authority to regulate the exchange of futures contracts).

<sup>4</sup> See Leida Slater, Note, *The Commodities Game Has a New Referee*, 52 CHI.-KENT L. REV. 438, 440 (1975) (discussing the history of commodities and futures markets, which developed as a way for farmers to sell their products to consumers; futures contracts helped farmers minimize risks stemming from over- or under-estimating demand for a particular product).

<sup>5</sup> See Kym Anderson, *Globalization's Effects on World Agricultural Trade, 1960–2050*, 365 PHIL. TRANSACTIONS ROYAL SOC'Y B 3007, 3009 (2010) (“Global agricultural trade has grown much slower than trade in other products. Prior to the 1960s, farm products accounted for more than 30 per cent of all merchandise trade globally, but since the beginning of this century their share has averaged less than 9 per cent.” (citation omitted)).

little to do with the exchange of traditional futures contracts for durable goods and agricultural products.<sup>6</sup>

In the wake of the 2008 Financial Crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).<sup>7</sup> Among other reforms, this legislation extended the CFTC's regulatory authority to cover commodity transactions offered "on a leveraged or margined basis, or financed by the offeror."<sup>8</sup> Such transactions would be regulated by the CFTC "as if" they were traditional futures contracts.<sup>9</sup> The Dodd-Frank Act also amended the Commodity Exchange Act to prohibit the use of "any manipulative or deceptive device or contrivance" in transactions that were regulated by the CFTC.<sup>10</sup> These two amendments granted the CFTC strong regulatory authority over a broad swath of economic activity, but they have gone little-noticed by commentators and fairly untested by the CFTC until recently.<sup>11</sup>

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<sup>6</sup> See generally M. Holland West & Matthew K. Kerfoot, *The Impact of Dodd-Frank on Derivatives*, 18 FORDHAM J. CORP. & FIN. L. 269, 272–75 (2013) (discussing the expanded authority granted to the Securities and Exchange Commission and the CFTC by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to regulate derivatives and swaps).

<sup>7</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111–203, 124 Stat. 1376 (codified as amended in 15 U.S.C. and other titles).

<sup>8</sup> 7 U.S.C. § 2(c)(2)(D)(iii) (2018).

<sup>9</sup> *Id.* Traditionally, the CFTC's authority did not extend to retail commodity transactions, because such transactions were not futures contracts. See *CFTC v. Zelener*, 373 F.3d 861, 866–67 (7th Cir. 2004). A "futures contract," broadly defined, "is a fungible promise to buy or sell a particular commodity at a fixed date in the future. Futures contracts are fungible because they have standard terms and each side's obligations are guaranteed by a clearing house. . . . Trading occurs in 'the contract', not in the commodity." *Chicago Board of Trade v. SEC*, 187 F.3d 713, 715 (7th Cir. 1999) (quoting *Chicago Mercantile Exchange v. SEC*, 883 F.2d 537, 542 (7th Cir. 1989)).

<sup>10</sup> 7 U.S.C. § 9(1) (2018). This language mirrors the anti-fraud provision in the Securities Exchange Act of 1934, Pub. L. No. 73–291, § 10(b), 48 Stat. 881, §10(b) (codified as amended at 15 U.S.C. § 78j(b) (2018)).

<sup>11</sup> See Tyce Walters, *Regulatory Lies and Section 6(c)(2): The Promise and Pitfalls of the CFTC's New False Statement Authority*, 32 YALE L. & POL'Y REV. 335, 335–36 (2013) (suggesting that the CFTC's expanded anti-fraud power has been "little-noticed," that the provision was "tucked with little fanfare into a small corner of the Dodd-Frank Act," and that "the provision has gone unnoticed by academic commentators").

In an opinion handed down in July 2019, the Court of Appeals for the Ninth Circuit approved the CFTC's broad interpretation of its anti-fraud powers under the amended CEA and upheld the application of these powers to transactions in which a consumer purchases an actual commodity on margin, i.e., not a traditional futures contract.<sup>12</sup> The Ninth Circuit's decision concerned the procedural question of whether the CFTC had stated a valid claim, and the substantive legal question remains unclear.<sup>13</sup> This Article will examine the implications of the CFTC's expanded power to regulate deceptive practices in commodity markets. Part B examines the factual background of an enforcement action brought by the CFTC against Monex Credit Company (Monex), alleging various deceptive conduct that violated the CEA's anti-fraud provision and harmed Monex customers. Part C discusses the implications of this decision for participants in commodities markets, with particular emphasis on cryptocurrency platforms. The *Monex* decision has potentially far-reaching effects; if other courts follow the Ninth Circuit's reasoning in interpreting the CEA's anti-fraud provision, the CFTC could potentially prohibit and fine deceptive conduct in any contract of sale for any physical commodity in interstate commerce, extending its authority well beyond its traditional role of regulating futures contracts.<sup>14</sup>

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<sup>12</sup> CFTC v. Monex Credit Co., 931 F.3d 966 (9th Cir. 2019).

<sup>13</sup> See Theodore M. Kneller, Jonathan Marcus, Daniel O'Connell, & Mark D. Young, Skadden, Arps, Slate, Meagher & Flom LLP, *Ninth Circuit Holds CFTC Dodd-Frank Enforcement Authority Allows Fraud-Only Claims*, JD SUPRA (July 31, 2019), <https://www.jdsupra.com/legalnews/ninth-circuit-holds-cftc-dodd-frank-30420/> [<https://perma.cc/25CL-9GLM>] [hereinafter Kneller et al., *Fraud-Only Claims*] (stating that the CFTC may view *Monex* as a "test case," but that "significant questions remain about the scope of the CFTC's authority over fraudulent practices in the cash and physical markets").

<sup>14</sup> Michael W. Brooks, Robert E. Pease, Ryan M. Eletto, *Ninth Circuit Sides with CFTC on Scope of Anti-Manipulation Authority*, NAT. L. REV. (Aug. 3, 2019) <https://www.natlawreview.com/article/ninth-circuit-sides-cftc-scope-anti-manipulation-authority> [<https://perma.cc/CL6P-JCWA>] (concluding that the *Monex* decision "may encourage the CFTC to look for pure fraud in physical commodity markets separate and apart from manipulation" and that "market participants will be wise to treat [the CEA's anti-fraud provision] as an expansive prohibition both in futures and swaps markets but also in connection with commodities in interstate commerce").

**B. Facts and Proceedings in *CFTC v. Monex Credit Co.***

*I. Underlying Facts*

In September 2017, the CFTC filed a complaint in the U.S. District Court for the Northern District of Illinois, alleging that between 2011 and 2017, Monex and its principals and affiliates had “defrauded thousands of retail customers throughout the United States out of hundreds of millions of dollars while executing tens of thousands of illegal, off-exchange retail commodity transactions.”<sup>15</sup> Monex operates several programs to sell precious metals to retail customers.<sup>16</sup> At issue in the CFTC’s enforcement action was Monex’s “Atlas” program, which allowed individual investors to trade positions in various precious metals “on a leveraged, margined or financed basis in which a retail customer purportedly purchases physical metal and pays only a portion of the purchase price.”<sup>17</sup>

Monex required customers to deposit funds into their Atlas account to serve as margin for the leveraged positions they would purchase in various precious metals.<sup>18</sup> Margin requirements were generally 22–25% of a customer’s open positions, i.e., a margin of \$25,000 would allow a customer to take positions valued at up to \$100,000.<sup>19</sup> Monex could make a margin call or force the liquidation of a customer’s trading account at any time.<sup>20</sup> The prices for each trade

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<sup>15</sup> Complaint for Injunctive and Equitable Relief and Penalties Under the Commodity Exchange Act at 1, *CFTC v. Monex Credit Co.*, 311 F. Supp. 3d 1173 (C.D. Cal. 2018) (No. 1:17-cv-06416 in N.D. Ill., removed to C.D. Cal. and renumbered No. 1:17-cv-06416) [hereinafter CFTC District Court Complaint]. Because it was issuing a ruling at the pleading stage, the Ninth Circuit in its opinion accepted all the facts alleged in the CFTC’s complaint as true. *Monex Credit Co.*, 931 F.3d at 969.

<sup>16</sup> CFTC District Court Complaint, *supra* note 15, at 5.

<sup>17</sup> *Id.* at 9.

<sup>18</sup> *Id.* at 10 (“Monex requires that Atlas customers deposit funds to serve as margin for open trading positions in their Atlas accounts.”).

<sup>19</sup> *Id.* (“During the relevant period Monex’s initial margin requirement was generally 22–25% of the value of a trading account’s open positions. With an initial margin requirement of 25%, for example, a trader could deposit \$25,000 in an Atlas account and open a position valued at \$100,000.”).

<sup>20</sup> *Id.* at 11 (“If equity in a customer’s trading account declines to Monex’s “call” level, Monex can issue a margin call and require its customer to immediately deposit additional funds to raise the equity level above Monex’s

were set by Monex; the trades happened on Monex's own off-exchange platform; Monex served as the counterparty for every trade; and the metals traded stayed at all times in Monex's control.<sup>21</sup>

## 2. *Arguments in the District Court*

The kernel of the fraud alleged by the CFTC was that Monex sales representatives told customers that buying leveraged positions through the Atlas program was “low risk, safe, and secure, when in fact investing in precious metals on leverage in the Atlas Program [was] highly likely to result in the loss of customer funds.”<sup>22</sup> Monex sales personnel also told prospective Atlas customers that Monex's representatives were fiduciaries and would make investment decisions in the prospective customer's best interest.<sup>23</sup> The CFTC alleged in its complaint that “[t]hese claims [were] false, as Monex does not act as a fiduciary for its customers.”<sup>24</sup> However, the district court dismissed these charges of fraud because it concluded that under Section 6(c)(1) of the CEA (Anti-Fraud Provision),<sup>25</sup> the CFTC only had authority to prosecute fraud-based market manipulation, but could not independently enjoin conduct that was merely deceptive, but not manipulative.<sup>26</sup>

Monex argued that because Atlas customers' precious metals were placed in depositories controlled by Monex and customers could pay for their positions in full and request shipment of their precious metals to themselves or an agent, Monex fell under the “actual delivery” exception to the CFTC's jurisdiction to regulate margin-

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initial margin requirement. Monex can change its margin requirements at any time in its sole discretion.”).

<sup>21</sup> *Id.* at 1–3, 12 (stating that “Monex offers off-exchange, leveraged precious metals trading to retail investors through its ‘Atlas’ program,” “Monex serves as the counterparty for each Atlas transaction,” and “Monex controls all aspects of its trading platform, including the price for every trade”).

<sup>22</sup> *Id.* at 18.

<sup>23</sup> *Id.* (alleging that Monex sales representatives portrayed themselves as fiduciaries to customers, when in fact they were not).

<sup>24</sup> *Id.*

<sup>25</sup> 7 U.S.C. § 9(1) (2018).

<sup>26</sup> *CFTC v. Monex Credit Co.*, 311 F. Supp. 3d 1173, 1188–89 (C.D. Cal. 2018) (concluding that the CFTC's anti-fraud enforcement power only reached conduct that is both deceptive *and* manipulative).

based retail commodity transactions.<sup>27</sup> The district court accepted this argument and dismissed the alleged violations that fell within the ambit of the “actual delivery” exception.<sup>28</sup>

While the district court found that the “actual delivery” exception did not defeat the CFTC’s jurisdiction as to fraud alleged under the anti-fraud provision, the district court concluded that this section prohibited only “fraud-based manipulation,” and not merely “deceptive” statements that did not have a manipulative effect on commodity prices.<sup>29</sup>

### 3. *The Ninth Circuit’s Decision*

On appeal, the Ninth Circuit reversed, thus allowing the CFTC’s enforcement action against Monex to go forward.<sup>30</sup> The Ninth Circuit began with a careful reading of the Anti-Fraud Provision, as expanded by Dodd-Frank.<sup>31</sup>

The statutory text prohibits the use of “any manipulative or deceptive device or contrivance” in connection with “any swap, or a contract of sale of any commodity in interstate commerce, or for future

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<sup>27</sup> Defendants’ Reply Memorandum in Support of Motion to Dismiss at 4–7, CFTC v. Monex Credit Co., 311 F. Supp. 3d 1173 (C.D. Cal. 2018) (No. 1:17-cv-06416 in N.D. Ill., removed to C.D. Cal. and renumbered No. 1:17-cv-06416) [hereinafter Monex District Court Reply] (“Monex, by contrast, admittedly delivers all financed customer metals to independent depositories and transfers title, but the CFTC now illogically insists contrary to its own Final Guidance that direct physical possession by the customer, even prior to loan repayment, is required.”).

<sup>28</sup> *Monex Credit Co.*, 311 F. Supp. 3d at 1183 (concluding that “Monex’s alleged practices of delivering precious metals to independent depositories within 28-days of their purchase by retail customers on margin falls within the Actual Delivery Exception to the CFTC’s authority”). The “actual delivery” exception to the CFTC’s enforcement authority provides that a contract for the sale of a commodity that results in “actual delivery” of the commodity within twenty-eight days of the date of the contract shall not be subject to CFTC’s regulations for futures contracts. 7 U.S.C. § 2(c)(2)(D)(ii)(II)(aa) (2018).

<sup>29</sup> *Monex Credit Co.*, 311 F. Supp. 3d at 1183–1885 (concluding that, while the CFTC did not need a separate jurisdictional provision to pursue claims that fell outside of the “actual delivery” exception, the CFTC nonetheless could only bring enforcement actions to enjoin conduct that was deceptive *and* manipulative).

<sup>30</sup> CFTC v. Monex Credit Co., 931 F.3d 966, 969 (9th Cir. 2019).

<sup>31</sup> *Id.* at 975–76.

delivery on or subject to the rules of any registered entity.”<sup>32</sup> The district court, as discussed above, concluded that the phrase “manipulative or deceptive” meant conduct that was “both manipulative *and* deceptive,” not “one or the other.”<sup>33</sup> The court noted that the statute employs the disjunctive “or,” and is a “mirror image of § 10(b) of the Securities Exchange Act, which the Supreme Court has interpreted as a ‘catch-all clause to prevent fraudulent practices.’”<sup>34</sup> The court therefore presumed that “by copying § 10(b)’s language and pasting it in the CEA, Congress adopted § 10(b)’s judicial interpretations as well.”<sup>35</sup>

The court also supported its interpretation of the anti-fraud provision by drawing on other canons of statutory interpretation. The district court in its opinion concluded that “deceptive or manipulative” in the Anti-Fraud Provision must be read conjunctively because Section 4b(a)(2)(A) of the CEA<sup>36</sup> makes it unlawful for “any person, in or in connection with an order to make, or the making of, any contract of sale of any commodity for future delivery or swap . . . to cheat or defraud or attempt to cheat or defraud” the other party in the transaction.<sup>37</sup> Since this provision appears to reach conduct that is deceptive, but not manipulative, the “rule against surplusage” would seem to require that the Anti-Fraud Provision covers “both manipulative and deceptive conduct,” according to the district court.<sup>38</sup> The Ninth Circuit disagreed, finding that the Anti-Fraud Provision’s “overlap with other provisions is minimal, and partial redundancy hardly justifies displacing otherwise clear text.”<sup>39</sup>

Finally, the Ninth Circuit concluded that the CFTC did not require a specific jurisdictional grant to exercise its authority to prohibit deceptive or manipulative conduct under the Anti-Fraud Provision because the statute on its face applies to “any . . . contract of

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<sup>32</sup> 7 U.S.C. § 9(1) (2018).

<sup>33</sup> *Monex Credit Co.*, 931 F.3d at 976 (“The district court determined that the statute unambiguously requires ‘both manipulative *and* deceptive conduct, not one or the other.’ Or, another way to say it, the district court held that ‘or’ really meant ‘and.’”).

<sup>34</sup> *Id.* (quoting *Chiarella v. United States*, 445 U.S. 222, 226 (1980)).

<sup>35</sup> *Id.* (citing *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 85–86 (2006)).

<sup>36</sup> 7 U.S.C. § 6b(a)(2)(A) (2018).

<sup>37</sup> *Monex Credit Co.*, 311 F. Supp. 3d at 1187 (quoting 7 U.S.C. § 6b(a)(2)(A) (2018)).

<sup>38</sup> *Id.* at 1186.

<sup>39</sup> *Monex Credit Co.*, 931 F.3d at 976.

sale of any commodity in interstate commerce.”<sup>40</sup> The CEA gives the CFTC the authority to bring an enforcement action in federal district court “[w]henver it shall appear to the Commission that any registered entity or other person has” violated “any provision of this chapter.”<sup>41</sup>

Thus, the Ninth Circuit allowed the CFTC’s action against Monex to go forward because, in the court’s view, the CFTC has the authority to prohibit purely deceptive conduct in the leveraged sale of commodities and its stated claims against Monex that were at least “plausible.”<sup>42</sup>

### **C. The Import of the Ninth Circuit’s Decision in *CFTC v. Monex Credit Co.***

Since the Ninth Circuit issued its decision at the pleading stage, whether the CFTC will succeed on the merits against Monex is unclear, though some commentators have suggested that the CFTC will “surely view the result as a green light to press ahead” with bringing enforcement actions based solely upon deceptive conduct.<sup>43</sup> In deferring to the CFTC’s broad interpretation of its anti-fraud enforcement powers and rejecting Monex’s argument that it fell under the CEA’s “actual delivery” exception, the Ninth Circuit raised important signposts that all participants in commodity markets, particularly buyers and sellers in the cryptocurrency space, would do well to heed.<sup>44</sup>

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<sup>40</sup> *Id.* at 977 (quoting 7 U.S.C. § 9(1) (2018)).

<sup>41</sup> 7 U.S.C. § 13a-1(a) (2018).

<sup>42</sup> *Monex Credit Co.*, 931 F.3d at 977.

<sup>43</sup> Kneller et al., *Fraud-Only Claims*, *supra* note 13.

<sup>44</sup> *See, e.g.*, Peter Y. Malyshev et al., *Implications of the CFTC v. Monex Decision for Trades in Commodities and Crypto-Assets*, REED SMITH CLIENT ALERTS (Sept. 3, 2019) <https://www.reedsmith.com/en/perspectives/2019/09/implications-of-the-cftc-v-monex-decision-for-trades-in-commodities> [<https://perma.cc/3PMQ-V669>] (concluding that physical commodity traders, metal traders, foreign-exchange traders, and participants in the cryptocurrency markets will likely have to boost their compliance efforts in the wake of the Ninth Circuit’s *Monex* decision, or face the prospect of costly CFTC enforcement actions).



1. *Implications of the Ninth Circuit's Treatment of the "Actual Delivery" Exception in Monex*

Monex argued that extending the CFTC's anti-fraud enforcement authority to leveraged transactions in actual commodities, where actual delivery was made—or at least possible—would give the CFTC sweeping jurisdiction over “all commodity sales regardless of whether they involve futures, leverage or financing, including pure cash and carry sales such as sales of grains and potatoes at grocery stores or gold coins at pawn shops.”<sup>45</sup>

The Ninth Circuit concluded that Monex did not fall under the “actual delivery” exception to the CEA because the precious metals held by customers in Monex's Atlas program remained in “[Monex's] chosen depository, never exchange[d] hands, and [were] subject to [Monex's] exclusive control, and customers [had] no substantial, non-contingent interests” in the metals.<sup>46</sup> The CEA in other sections speaks of “delivery,” which the court said “cannot be satisfied by the simple device of a transfer of title.”<sup>47</sup> Therefore, because the court assumed that “‘Congress means the same words in the same statute to mean the same thing,’ *actual* delivery must require more than simple title transfer.”<sup>48</sup>

The decision helps to clarify the meaning of “actual delivery” under the CEA, and entities that facilitate retail transactions of commodities on a leveraged or financed basis—including online markets that allow consumers to buy and sell positions in cryptocurrencies—should now be aware that they may be subject to the CFTC's anti-fraud authority, even if title to the purchased commodity is nominally transferred to the customer.<sup>49</sup>

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<sup>45</sup> Defendants–Appellees' Answering Brief at 36, *CFTC v. Monex Credit Co.*, 931 F.3d 966 (9th Cir. 2019) (No. 18-55815) [hereinafter *Monex Ninth Circuit Brief*].

<sup>46</sup> *Monex Credit Co.*, 931 F.3d at 974.

<sup>47</sup> *Id.* (quoting *CFTC v. Noble Metals Int'l, Inc.*, 67 F.3d 766, 773 (9th Cir. 1995)).

<sup>48</sup> *Id.* (quoting *Texas Dep't of Housing & Cmty. Affairs v. Inclusive Cmty. Project, Inc.*, 135 S. Ct. 2507, 2535 (2015)).

<sup>49</sup> See *Malyshev et al.*, *supra* note 44 (suggesting that cryptocurrency wallet providers may have to comply with the CEA's anti-fraud requirements because “[t]he cryptocurrency wallet provider business model does not typically include physical delivery of cryptocurrency to wallet owners within 28 days and includes custody of wallet owners' cryptocurrency at the wallet provider”).

2. *What the Ninth Circuit's Monex Decision Means for the Scope of the CFTC's Anti-Fraud Authority Under 7 U.S.C. § 9(1)*

Ultimately, the Ninth Circuit's decision that the CFTC had stated a valid claim—at least regarding the violations of the Anti-Fraud Provision alleged in Count III of its complaint—was not based on the applicability of the “actual delivery” exception.<sup>50</sup> This is because the Anti-Fraud Provision prohibits the use of “any manipulative or deceptive device” in any “contract of sale of any commodity in interstate commerce.”<sup>51</sup>

The Ninth Circuit did not deal squarely with this statutory language when it denied Monex's Motion to Dismiss. The court said that it was not at all clear that the Anti-Fraud Provision was “an elephant in a mousehole,” as Monex argued, but that “[b]y its terms, [the statute] applies broadly to interstate commerce.”<sup>52</sup> But the court declined to address whether the broad authority under the Anti-Fraud Provision would apply (as Monex argued) to all sorts of pure cash-and-carry sales.<sup>53</sup>

The appellate court's decision to decide only the issue before it, instead of trying to define the outer limits of the CFTC's power to prohibit deceptive conduct in all sorts of commodity markets, leaves several important compliance questions unanswered for a wide swath of actors trading all sorts of commodities.<sup>54</sup>

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<sup>50</sup> *Monex Credit Co.*, 931 F.3d at 975, 976–77 (concluding that Counts I, II, and IV of the CFTC's complaint were not barred by the “actual delivery” exception, and that the “actual delivery” exception did not apply to Count III of the CFTC's complaint).

<sup>51</sup> 7 U.S.C. § 9(1) (2018). Counts I, II, and IV of the CFTC's complaint alleged violations by Monex of 7 U.S.C. § 6(a), 7 U.S.C. § 6b, and 7 U.S.C. § 6d(1), respectively, all of which relate to the CFTC's authority to regulate “retail commodity transactions,” an authority which is subject to the “actual delivery” exception in 7 U.S.C. § 2(c)(2)(D)(i)(II). See *CFTC v. Monex Credit Co.*, 311 F. Supp. 3d 1173, 1179 (C.D. Cal. 2018); CFTC District Court Complaint, *supra* note 15, at 23–26, 28–29.

<sup>52</sup> *Monex Credit Co.*, 931 F.3d at 977.

<sup>53</sup> *Id.* (“The question we address is only whether [the anti-fraud provision] applies to stand-alone fraud claims in the sale of leveraged commodities. Whether the statute extends to non-leveraged sales is not before us.”).

<sup>54</sup> See Malyshev, *supra* note 44 (“The *Monex* decision has raised questions about whether the CFTC's jurisdiction has been dramatically expanded and if any securitization transaction will be subject to the CFTC's jurisdiction as a

The Dodd-Frank Act amended the anti-fraud provision to give the CFTC authority to promulgate rules and regulations prior to July 21, 2011 in order to delineate the types of prohibited deceptive and manipulative conduct under the statute.<sup>55</sup> The CFTC promulgated its final rule articulating its anti-fraud and anti-manipulation authority on July 14, 2011.<sup>56</sup> In its Supplementary Information to the rule, the CFTC explained that Rule 180.1, like the statutory language in the Anti-Fraud Provision that underlays it, extended to “any swap, or a contract of sale of any commodity in interstate commerce.”<sup>57</sup> Moreover, the CFTC specifically declined to adopt the request of “certain commentators” on the agency’s proposed rule to limit the scope of the Anti-Fraud Provision to “merely extending the Commission’s existing anti-fraud and anti-manipulation authority to cover swaps,” because such a narrow interpretation would conflict with the statutory language and the intent of the Dodd-Frank Act.<sup>58</sup>

The CFTC suggested, however, that concerns “that the Commission’s use of the word ‘commodity’ in proposed Rule 180.1 ‘indicates that the rule will apply to virtually every commercial transaction in the economy’ are misplaced,” because the CFTC “expects to exercise its authority under [the Anti-Fraud Provision] to cover transactions related to the futures or swaps markets, or prices of commodities in interstate commerce, or where the fraud or manipulation has the potential to affect cash commodity, futures, or swaps markets or participants in these markets.”<sup>59</sup> This language on its face is rather broad and covers an expansive list of transactions, which suggests that some of the fears outlined by Monex could someday be realized, perhaps under an administration with a firmer regulatory hand than the current one.<sup>60</sup>

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leveraged commodity trade (assuming that the counterparty is a retail participant).”).

<sup>55</sup> 7 U.S.C. § 9(1) (2018).

<sup>56</sup> Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41398 (July 14, 2011) (codified at 17 C.F.R. pt. 180).

<sup>57</sup> *Id.*

<sup>58</sup> *Id.* at 41401 (Supplementary Information to Final Rule 180.1).

<sup>59</sup> *Id.*

<sup>60</sup> See Brooks, Pease & Eletto, *supra* note 14 (“Under the CFTC’s interpretation of its anti-fraud authority and the definition of commodity, it appears that the only obstacle to the CFTC bringing fraud claims against the grocery store fraudster is self-restraint.”).

3. *The Impact of the CFTC's Broad Anti-Fraud Enforcement Authority on Cryptocurrency Markets*

One area in which the broad anti-fraud authority claimed by the CFTC and ratified by the Ninth Circuit in the *Monex* decision could unleash a fusillade of new enforcement actions is the nascent and still largely untamed cryptocurrency industry.<sup>61</sup> The CFTC in 2015 declared that virtual currencies were “commodities,” subject to its jurisdiction and the provisions of the Commodity Exchange Act.<sup>62</sup> So far, at least two federal district courts have accepted this declaration.<sup>63</sup> Both *CFTC v. McDonnell*<sup>64</sup> and *CFTC v. My Big Coin Pay*<sup>65</sup> involved alleged violations of the Anti-Fraud Provision by people and companies that offered virtual currency trading services.<sup>66</sup> In both cases, the courts denied the defendants’ motions to dismiss and held that the

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<sup>61</sup> See generally Allen Kogan, Comment, *Not All Virtual Currencies Are Created Equal: Regulatory Guidance in the Aftermath of CFTC v. McDonnell*, 8 AM. U. BUS. L. REV. 199, 211–15 (2019) (discussing ways in which the CFTC has worked to develop a regulatory framework for virtual currencies by classifying them as a “commodity” subject to the provisions of the Commodity Exchange Act).

<sup>62</sup> *In re Coinflip, Inc.*, CFTC No. 15–29, 2015 WL 5535736 (Sept. 17, 2015), at 3 (bringing an enforcement action against a cryptocurrency provider for alleged violations of the CEA).

<sup>63</sup> See *CFTC v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492 (D. Mass. 2018) (accepting the view that cryptocurrencies are commodities, subject to the CFTC’s oversight); *CFTC v. McDonnell*, 287 F. Supp. 3d 213 (E.D.N.Y. 2018) (accepting that cryptocurrencies are commodities subject to the CFTC’s oversight).

<sup>64</sup> 287 F. Supp. 3d 213 (E.D.N.Y. 2018).

<sup>65</sup> 334 F. Supp. 3d 492 (D. Mass. 2018).

<sup>66</sup> See *My Big Coin Pay*, 334 F. Supp. 3d at 494 (“The amended complaint alleges a fraudulent ‘virtual currency scheme’ in violation of the Commodity Exchange Act . . . and a CFTC implementing regulation banning fraud and/or manipulation in connection with the sale of a commodity.”); *McDonnell*, 287 F. Supp. 3d at 217 (“After hearing testimony from an Investigator in the Division of Enforcement for the CFTC, the court finds the plaintiff has made a preliminary prima facie showing that the defendants committed fraud by misappropriation of investors’ funds and misrepresentation through false trading advice and promised future profits.”).

CFTC had stated a valid claim for relief and penalties under the CEA.<sup>67</sup>

It seems that the Ninth Circuit's decision in *Monex* will make it less likely that either *My Big Coin Pay* or *McDonnell* might eventually be overturned on appeal.<sup>68</sup> As more federal courts accept the proposition that virtual currencies are "commodities" subject to regulation by the CFTC and the provisions of the CEA, people and companies that sell virtual currencies to people in interstate commerce will be exposed to potentially broad liability for any "deceptive" statements made or conduct engaged in, in the sale of the virtual currencies, in violation of the Anti-Fraud Provision and Rule 180.1.<sup>69</sup>

As multiple commentators have pointed out, the *Monex* court's broad interpretation of the CFTC's anti-fraud enforcement power is not confined to cases involving the trading of precious metals on margin.<sup>70</sup> The kind of deceptive conduct that formed the plausible basis for an enforcement action under the Anti-Fraud Provision in *Monex* was held to be a sufficient basis for an enforcement action in

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<sup>67</sup> See *My Big Coin Pay*, 334 F. Supp. 3d at 498–99; *McDonnell*, 287 F. Supp. 3d at 229–30.

<sup>68</sup> See Stephen Palley, *The CFTC, Actual Delivery, and Fraud: A Federal Court Gives New Guidance*, THE BLOCK (Aug. 1, 2019 6:45 PM) <https://www.theblockcrypto.com/post/34428/the-cftc-actual-delivery-and-fraud-a-federal-court-gives-new-guidance> (discussing the similarities between the precious metals trading platform at issue in *Monex* and the cryptocurrency providers that fall under the CFTC's jurisdiction, and concluding that the broad view of the CFTC's regulatory powers in *Monex* "squarely applies to the CFTC's jurisdiction over crypto margin trading made available to U.S. customers").

<sup>69</sup> See, e.g., Malyshev et al., *supra* note 44 ("The CFTC will likely pursue manipulation or fraud claims under [the anti-fraud provision] not only with respect to derivatives (futures, swaps, and options) but also with respect to commodities."); Palley, *supra* note 63 ("Enforcement activity involving fraud in connection with margin trading seems likely to be another continued angle of attack [against cryptocurrency platforms], particularly when one considers the description of the allegedly fraudulent activity CFTC alleges and the similarity to behavior by some who serve or have served U.S. customers.").

<sup>70</sup> See, e.g., Malyshev et al., *supra* note 44 ("The *Monex* decision has significant implications not only for metal traders, but also for physical commodity traders as well as those in the cryptocurrency and retail forex markets."); Palley, *supra* note 63 ("While the defendant [in *Monex*] deals in precious metals, given the fact that Bitcoin is a commodity, the case squarely applies to the CFTC's jurisdiction over crypto margin trading made available to U.S. customers.").

*My Big Coin Pay*, a case involving a cryptocurrency provider.<sup>71</sup> Also remarkable, and potentially highly important for market participants looking to reduce their possible liability for fraud, is how similar the sorts of “deceptive” statements that formed the basis for a well-pleaded complaint under the Anti-Fraud Provision were in both cases. In *Monex*, the CFTC alleged that, *inter alia*, Monex sales literature told prospective customers that precious metals were low-risk and intrinsically valuable, while also providing “outstanding profit potential.”<sup>72</sup> Monex sales representatives were trained to tell prospective customers that the Atlas program was “an opportunity to invest with defined risk, while enjoying the possibility of unlimited upside potential.”<sup>73</sup> Similarly, in *My Big Coin Pay*, the CFTC alleged that the defendants had told customers that their proprietary virtual currency, My Big Coin, was “backed by gold,” that it was being “actively traded” on various currency exchanges, and that it could be used for payment wherever Mastercard was accepted.<sup>74</sup> In both cases, the CFTC alleged that the defendants knew these statements to be false, or recklessly disregarded the possibility of their falsity, and the courts held that the allegations were stated with sufficient particularity to make out valid claims for relief under the Anti-Fraud Provision.<sup>75</sup>

The leveraged trading of virtual currencies, like the leveraged trading of precious metals, is a somewhat esoteric area of the economy, little understood by most retail investors.<sup>76</sup> As more people

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<sup>71</sup> *My Big Coin Pay*, 334 F. Supp. 3d at 498 (holding that the cryptocurrency at issue was a commodity subject to CFTC regulation, and that the sellers of positions in the currency had engaged in deceptive conduct in violation of 7 U.S.C. § 9(1) that harmed customers).

<sup>72</sup> CFTC District Court Complaint, *supra* note 15, at 14–15.

<sup>73</sup> *Id.* at 17.

<sup>74</sup> *My Big Coin Pay*, 334 F. Supp. 3d at 494.

<sup>75</sup> Compare CFTC v. Monex Credit Co., 931 F.3d 966, 977 (9th Cir. 2019) (concluding that the CFTC’s anti-fraud enforcement power applies to leveraged commodity sales, and the CFTC’s claims of deceptive conduct by Monex were plausible), with *My Big Coin Pay*, 334 F. Supp. 3d at 499 (concluding that the CFTC’s amended complaint “sets forth in detail” plausible allegations of deceptive conduct in the leveraged sale of a particular cryptocurrency).

<sup>76</sup> See, e.g., Rawley Heimer & Alp Simsek, *Should Retail Investors’ Leverage be Limited?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 13, 2019) <https://corpgov.law.harvard.edu/2019/06/13/should-retail-investors-leverage-be-limited/> [<https://perma.cc/HDH8-28Z2>] (suggesting that regulators should impose leverage limits on investments, because leverage is a

become interested in trading virtual currencies, however, and as more currency trading platforms advertise via the Internet, sellers and trading companies will have to exercise extreme care in crafting statements made to prospective customers.<sup>77</sup> Commentators interested in the development of virtual currencies have already noticed the potential breadth of this liability.<sup>78</sup> For instance, financial regulators in Japan, Hong Kong, and Europe have imposed strict regulations on cryptocurrency derivatives, with Hong Kong having gone so far as banning outright investment in cryptocurrency funds by retail investors.<sup>79</sup> The Financial Conduct Authority in the United Kingdom is also considering a ban on the sale of cryptocurrency derivatives to retail investors.<sup>80</sup> The CFTC could follow this trend and use its broad anti-fraud authority—with the imprimatur of the Ninth Circuit—to bring enforcement actions against cryptocurrency exchanges selling

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catalyst for speculation that can harm retail investors who may not be fully informed about the risk of their investments); *Squawk Box* (CNBC television broadcast Oct. 11, 2019), <https://www.cnbc.com/video/2019/10/11/why-fidelity-has-jumped-on-the-commission-free-trading-trend.html> [https://perma.cc/48PZ-GWKG] (featuring an interview with Fidelity Investments President of Personal Investing Kathleen Murphy, in which she states, beginning at roughly 5:30, that while Fidelity is excited to “embrace crypto,” the company is “very careful” about how it offers cryptocurrency investments to customers, and that, so far, cryptocurrency investment products are not offered broadly on Fidelity’s retail platform, because “investors that aren’t really institutional investors” might “make a mistake with cryptocurrency”).

<sup>77</sup> See, e.g., Brooks, Pease, & Eletto, *supra* note 14 (suggesting that the *Monex* decision “may have limited value for prospective compliance efforts” because “fraud of any kind is incompatible with a culture of compliance,” but that participants in cryptocurrency and commodities markets should nonetheless treat the CEA’s anti-fraud provision as a broad prohibition on statements or conduct that could be deceptive).

<sup>78</sup> Kogan, *supra* note 61, at 233, 241–42 (suggesting that the *McDonnell* court was too broad in its reasoning, because its holding, taken to its logical end, would “theoretically permit[] CFTC actions against real-estate brokers and shipping companies simply by alleging some form of fraud against their customers”; arguing that the “holding in *McDonnell* that all virtual currencies are commodities subject to CFTC jurisdiction should . . . be narrowed, if not completely overturned”).

<sup>79</sup> *Too Dicey: Betting on the Price of Bitcoin May Soon be Deemed Illegal Gambling*, *ECONOMIST*, Oct. 5, 2019, at 79 (discussing regulatory developments by financial watchdogs to limit retail investors’ ability to take positions in cryptocurrency derivatives).

<sup>80</sup> *Id.*

cryptocurrency derivatives to retail investors if it appeared to the Commission that these investment products exposed retail investors to undue financial risk and the possibility of falling victim to deceptive conduct by the exchanges.<sup>81</sup>

#### D. Conclusion

The Trump Administration has so far taken a *laissez-faire* approach to regulating U.S. financial markets.<sup>82</sup> It seems, therefore, unlikely that the CFTC will dramatically ramp up its enforcement efforts or expand its own interpretation of its authority to regulate fraudulent conduct in the near term. Nonetheless, the CFTC has continued to bring enforcement actions for violations of the Anti-Fraud Provision and Rule 180.1 that consist merely of making false or deceptive statements.<sup>83</sup> The CFTC also has not rescinded or modified

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<sup>81</sup> See Palley, *supra* note 63 (suggesting that such enforcement actions could be an “angle of attack” that the CFTC might take against cryptocurrency exchanges).

<sup>82</sup> See, e.g., Kate Berry, *Bank Regulatory Actions Under Trump Fall to Historic Lows*, AM. BANKER (Apr. 6, 2018 10:53 AM), <https://www.americanbanker.com/news/bank-regulatory-actions-under-trump-fall-to-historic-lows> [<https://perma.cc/Z6AF-KTFA>] (featuring data showing a sharp decrease in regulatory actions under the Trump Administration, and featuring comments from financial industry experts that deregulation is main priority of the Administration); Dennis Kelleher, *Trump’s Assault on Financial Reform*, AM. PROSPECT (June 12, 2019) <https://prospect.org/economy/trump-s-assault-financial-reform/> [<https://perma.cc/89EW-AEP5>] (arguing that the Trump Administration “has set about dismantling the core pillars of financial reform” by lowering bank capital requirements, removing the “systemically important” designation from certain non-bank institutions, “enabling more unregulated derivatives dealing,” and taking other deregulatory actions); Erica Warner, *Trump Signs Law Rolling Back Post-Financial Crisis Banking Rules*, WASH. POST. (May 24, 2018 1:16 PM), [https://www.washingtonpost.com/business/economy/trump-signs-law-rolling-back-post-financial-crisis-banking-rules/2018/05/24/077e3aa8-5f6c-11e8-a4a4-c070ef53f315\\_story.html](https://www.washingtonpost.com/business/economy/trump-signs-law-rolling-back-post-financial-crisis-banking-rules/2018/05/24/077e3aa8-5f6c-11e8-a4a4-c070ef53f315_story.html) [<https://perma.cc/DSG4-4U9T>] (reporting on President Trump’s signing of legislation to roll back several regulations in the Dodd-Frank Act, which Trump said were “crippling” and “crushing community banks and credit unions nationwide”).

<sup>83</sup> See, e.g., *In re BGC Financial, LP*, CFTC No. 19–48 (Sept. 30, 2019) (alleging that the operator of foreign-exchange options trading platform made false statements to clients to the effect that certain bids or offers were



its guidance, suggesting that it will exert its anti-fraud authority under the Anti-Fraud Provision and Rule 180.1 “not technically and restrictively, but flexibly to effectuate [their] remedial purposes.”<sup>84</sup>

It is reasonable to think, therefore, that the CFTC could use its anti-fraud enforcement powers—as broadly interpreted by the Ninth Circuit in *Monex*—to attack deceptive and fraudulent conduct that harms consumers and retail investors across a broad swath of markets.<sup>85</sup> The Anti-Fraud Provision could thus become a significant regulatory tool for future administrations favoring a stiffer regulatory policy. But there are reasons for policymakers and market participants to be concerned, given that the broad statutory text of the Anti-Fraud Provision does not provide guidance or safeguards to prevent possible “abuse of discretion and over-enforcement.”<sup>86</sup>

Douglas Plume<sup>87</sup>

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executable when they were not, and to the effect that certain trades had occurred when they had not).

<sup>84</sup> 76 Fed. Reg. 41401 (July 14, 2011) (Supplementary Information to Final Rule 180.1).

<sup>85</sup> See Brooks, Pease & Eletto, *supra* note 14 (“Under the CFTC’s interpretation of its anti-fraud authority and the definition of commodity, it appears that the only obstacle to the CFTC bringing fraud claims against the grocery store fraudster is self-restraint.”).

<sup>86</sup> Walters, *supra* note 11, at 349 (raising concerns about the provision of the CEA that prohibits the making of false or deceptive statements to the CFTC, which is drafted in broad language substantially similar to the language used in 7 U.S.C. § 9(1), which prohibits the use of deceptive or manipulative devices in regulated transactions).

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