Foreign Corruption as Market Manipulation

by Gina-Gail S. Fletcher

Introduction

On March 6, 2019, the Commodity Futures Trading Commission (CFTC) announced that it would be taking an active role in prosecuting violations of the Commodities Exchange Act (CEA) that involve foreign corruption.[1] On the same date, the CFTC published an enforcement advisory further signaling its intention to investigate and prosecute violations of the laws and regulations of the CEA linked to foreign corrupt practices, such as violations of the Foreign Corrupt Practices Act (FCPA). The FCPA prohibits US-based businesses from engaging in corrupt practices, such as bribery, in foreign countries in which they do business. Currently, both the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) vigorously and vigilantly enforce the FCPA. How and to what extent, therefore, would the involvement of the CFTC impact the prosecution of FCPA violations?

This Essay explores this question by focusing on two specific inquiries. First, this Essay examines what kinds of foreign corrupt practices could overlap with the CFTC's jurisdiction. The CFTC is the exclusive regulator of the derivatives and commodities market, and one of its primary concerns is to deter and detect market manipulation. In turning its focus to foreign corrupt practices that violate the CEA, one implication is that there is a connection between foreign corruption and manipulation of the US derivatives and commodities markets. Exploring how foreign corruption can manifest into market manipulation, therefore, is important to understanding the potential types of conduct that may warrant CFTC attention. Second, this Essay assesses the implications of the CFTC's foray into the prosecution of foreign corruption. For example, with the addition of another regulator to the FCPA's enforcement roster, derivatives and commodities market participants likely face FCPA-related compliance requirements that they did not previously have.

Part I of this Essay begins with an overview of the FCPA. It describes the purpose of the FCPA and the enforcement approach of the DOJ and SEC in relation to the Act. Part I also summarizes the CFTC's role in the financial markets and its traditional jurisdictional scope. Part II examines three potential scenarios in which foreign corruption could result in manipulation of the US derivatives and commodities markets. Part III considers the implications of the CFTC's involvement in the enforcement of the FCPA and, lastly, raises additional questions that may prove fruitful for future research.

I. Overview of the FCPA and the CFTC

A. The FCPA

The FCPA was enacted in the wake of bribery scandals involving major US companies abroad. Originally passed in 1977, the FCPA was the first statute to outlaw bribery of foreign officials, significantly expanding the extraterritorial reach of US laws. Specifically, the FCPA prohibits giving or offering anything of value to a foreign official for the purpose of obtaining or retaining business. Covered under the FCPA's provisions are (i) issuers registered with or required to file reports with the SEC; (ii) "domestic concerns," which includes any citizen, national, or resident of the US, any US-based business, and any director, officer, or agent of such an entity; and (iii) any person or entity that engages in acts in furtherance of bribery while in the US

While the anti-bribery provisions are the heart of the FCPA, it also imposes accounting and internal control provisions on publicly traded companies. Companies with securities traded on national exchanges are required to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." To comply with the internal control provisions, issuers must implement and maintain an internal system of controls designed to provide reasonable assurances that there are no unauthorized transactions and improper payments.

Individuals prosecuted for violations of the FCPA may face both civil and criminal liability. On the civil side, defendants face fines of up to $10,000 per violation. Defendant corporations may receive criminal penalties of up $2 million for violations of the anti-bribery provisions and $25 million for the accounting provisions. Individual defendants can face potential criminal penalties of $100,000 and up to five years of imprisonment for paying bribes, and up to twenty years of imprisonment for running afoul of the accounting requirements. In addition to these statutorily mandated penalties, companies also face additional fines, disgorgement of profits earned through corruption, and potential debarment from contracting with the US government. Furthermore, although the FCPA does not create a private right of action, companies may face shareholder derivative suits and federal securities claims related to FCPA violations.

Both the DOJ and the SEC are responsible for enforcing the FCPA, but only the DOJ may bring criminal charges against defendants. Prior to the 2000s, the FCPA was enforced sporadically and fines rarely exceeded $1,000,000 when imposed. However, the trend has decidedly changed, with both the DOJ and SEC declaring enforcement of the FCPA to be a high priority. Since the early 2000s, the number of FCPA enforcement actions has increased significantly in size, moving from an average of three enforcement actions per year pre-2000 to an average of approximately twenty-eight actions per year between 2008 and 2017. Likewise, monetary penalties associated with FCPA violations have increased greatly, going from a yearly average of $4.3 million between 1977 and 1997 to a $37 million annual average between 2008 and 2017.

Although there is no consensus as to why the DOJ and SEC have focused their attentions on FCPA violations, the increased enforcement has a significant impact on how multinational firms conduct their businesses. As one scholar has noted, in light of the extremely large penalties and collateral consequences that may flow from an FCPA enforcement action, companies possess a "rational level of fear" of running afoul of the statute. To proactively minimize potential violations of the FCPA, multinational corporations have spent considerable resources designing and implementing compliance programs intended to identify and root out potential sources of FCPA liability. Further, institution of an enforcement action can result in significant, ongoing financial liability for firms, including costs related to undertaking internal investigations; employing independent consultants to oversee and report on the company's remediation efforts; and addressing civil liability stemming from their violations, among other costs. Thus, the FCPA imposes substantial costs on firms that fall within the statute's ambit, even in the absence of an actual violation.

B. The CFTC—Purview & Purpose

The CFTC is one of the two primary regulators of the financial markets in the US. Established in 1974, the CFTC has exclusive jurisdiction over commodities and derivatives, such as futures, swaps, and options. Originally tasked with regulating futures on agricultural products, the jurisdictional scope of the CFTC has expanded significantly since its inception to include energy, foreign exchange, interest rates, credit default swaps, and, most recently, digital currencies. Anyone that trades commodity derivatives must register with the National Futures Association—the self-regulatory organization responsible for regulating the futures market—and must trade on a futures exchange. The CFTC has regulatory authority over the NFA and futures exchanges, which grants the agency indirect regulatory authority over futures traders.

A primary regulatory focus of the CFTC is to identify and punish instances of fraud and manipulation involving derivatives and commodities, thereby ensuring the efficiency and integrity of the markets. The Commodities Exchange Act (CEA) grants the CFTC broad authority to bring civil enforcement actions for price manipulation, fraud-based manipulation, and insider trading, for example. In recent years, the CFTC has increased its anti-manipulation efforts, formed a task force aimed at spoofing, brought a greater number of manipulation-related enforcement actions, and levied significantly higher fines for market abuse. With these efforts, the CFTC has signaled its intention to increase its profile as a significant regulator and enforcer in the financial markets. The agency's focus on the FCPA, therefore, can be viewed as part of its larger push to be a more active regulator within the financial markets, alongside the DOJ and SEC.

In March 2019, the CFTC issued an enforcement advisory () to encourage companies and individuals to self-report violations of the CEA that implicate foreign corruption. According to the Advisory, market actors that self-report may be entitled to significant reductions in civil penalties. For actors not registered with the CFTC, there will be a presumption of no civil penalty. Registered actors, however, already have an obligation to report to the CFTC and, as such, will not be entitled to this presumption. But, as the Advisory states, registrants that self-report, cooperate with the CFTC, and remediate their violations may receive a substantial reduction in their penalties. Notably, the CFTC's Advisory closely mirrors the DOJ's FCPA guidance regarding voluntary self-reporting, cooperation, and timely remediation.

The CFTC, therefore, intends to work closely with the DOJ (and SEC) but will focus exclusively on prosecuting violations of the CEA and CFTC's rules and regulations that involve foreign corruption in the markets the CFTC regulates. Given the CFTC's broad jurisdictional authority to prevent and prosecute market abuse in the derivatives and commodities markets, the CFTC's entry into the overlapping space between the CEA and the FCPA is, arguably, within the agency's regulatory scope. Yet, this has not traditionally been an area of focus for the CFTC and, as such, it is necessary to consider when and how foreign corruption may result in manipulation of the US commodities and derivatives markets or otherwise violate the CEA. In Part II of this Essay, I analyze three potential theories of when and how the CEA and FCPA may intersect.

II. Foreign Corruption as Manipulation—Examining the Possibilities

The CFTC's interest in and focus on preventing market manipulation has increased significantly in the past decade. Since 2010, the number of market manipulation cases filed by the CFTC has increased from a single case in 2010 to over twenty-six such cases in 2018. Prior to 2018, the single-year high for manipulation cases brought by the CFTC was 2017, when the agency filed twelve cases. Indeed, fraud and market manipulation accounted for fifty-six of the CFTC's total eighty-three enforcement actions for 2018. Thus, the CFTC's decision to focus its attention on foreign corrupt practices that implicate market manipulation and fraud in US commodities markets is in line with its ongoing and increasing emphasis on minimizing and eliminating conduct that undermines the integrity of the commodities and derivatives markets.

As stated above, the CFTC's foray into enforcement of foreign corruption is new and, as a result, there are no *actual* examples of the intersection of the CEA and

FCPA. Nonetheless, this Part explores three instances in which FCPA violations may arise within the CFTC's jurisdictional scope: if bribes or corrupt conduct are used (i) to secure commodities- or derivatives-related business; (ii) to corner or squeeze a commodity; or (iii) to manipulate benchmarks used to price derivatives.

A. Securing Business

An obvious intersection of the CEA and FCPA would involve the use of bribes or other corrupt conduct to secure derivatives- or commodities-related business. For example, if a hedge fund bribes a foreign official with authority over a sovereign wealth fund to secure it as an investor in a derivative transaction, such conduct could potentially constitute a violation of the CEA involving foreign corrupt practices. The CEA violation, however, would not be related to market manipulation. Rather, the CEA violation would likely arise from reporting failures or fraudulent reporting of these payments. The hedge fund's bribe could violate the CEA in two ways. First, the use of investor funds to pay bribes, rather than to invest in commodity transactions, would constitute fraud under the CEA. Indeed, if the true nature of the illegal payments is not disclosed or the payments are misrepresented to the investors of the hedge fund, such conduct would plainly violate the CEA. Second, and relatedly, registered market participants such as commodity pool operators—which includes many hedge funds—are required to keep detailed and accurate accounting records of their expenditures. If the bribes are mischaracterized as ordinary business expenses, the CFTC could charge the commodity pool operator with recordkeeping violations.

Precedent exists for this possibility. In 2016, the DOJ and SEC brought charges against Och-Ziff, one of the world's largest hedge funds, for FCPA violations relating to payments to Libyan officials. Och-Ziff allegedly paid bribes to Libyan officials, using investor funds, to help win mining rights for a joint venture in which it was involved. Additionally, Och-Ziff paid bribes to induce investment from the Libya's sovereign wealth fund into Och-Ziff's managed funds. The SEC charged Och-Ziff with fraud for misleading investors on the use of their funds and with recordkeeping violations for recording these illegal payments as business expenses. In settling the case, Och-Ziff (i) agreed to pay the DOJ and SEC $412 million for criminal and civil violations, (ii) entered into a three-year deferred prosecution agreement, and (iii) was required to retain a compliance monitor for three years.

It is not difficult to see that, with slight changes, similar facts could implicate the CEA. For example, if Och-Ziff transacted in derivatives, rather than equities, the very same conduct could bring it under the regulatory purview of a CFTC enforcement action based on its foreign misconduct. Notably, however, the conduct described would be subject to an enforcement action by the DOJ, nonetheless. Thus, while this is an area in which the CEA and FCPA intersect, it is questionable whether the CFTC's involvement meaningfully enhances enforcement of the FCPA.

B. Corners & Squeezes

Another possible overlap between the CEA and FCPA would arise if market actors employ foreign corrupt practices to "corner" or "squeeze" the market for a commodity. A corner is a distortive practice in commodities markets whereby a trader establishes a dominant position in a commodity and is able to force all others in the market to transact with her at monopolistic prices. Whereas a corner is complete domination of the market, a squeeze is less absolute and less extreme in its effect. These types of transactions are deemed manipulative because they result in artificial prices for the affected commodity. The "unnatural" shortage of the commodity causes the price to be artificially inflated, thereby allowing the bad actor to profit from cornering or squeezing the market.

A corner or squeeze could implicate the FCPA if a market actor bribed a foreign government official to restrict its country's supply of a commodity for which it was a primary producer. If such a bribe was paid in order to impact the price of the commodity, the bribe could constitute a violation of both the FCPA and CEA. For example, let us suppose Prime Copper Refinery ("Refinery") processes copper mined in the country of "Mineralia," one of the top global producers of copper. Mineralia recently discovered a new ore deposit of copper and is considering whether to expand its mining operations. Refinery's profitability would decrease if Mineralia begins mining copper from this new deposit and, therefore, it would benefit if Mineralia delayed any new mining plans. To influence Mineralia's decision, Refinery makes payments to officials in Mineralia's government who have influence and decision-making authority over the country's decision to mine. Let us suppose further that, as a result of Mineralia's decision to forgo mining, the world's supply of copper is significantly reduced, making Refinery one of the few suppliers of copper globally. As described above, Refinery, in collusion with Mineralia's government officials, has squeezed the copper market, artificially inflating the price of copper and derivatives related to copper. Under this scenario, the CFTC would likely have grounds to prosecute Refinery for price manipulation, attempted price manipulation, and use of a manipulative device or scheme.

Other variations on these facts are possible, but in essence, this example is premised on a company paying a bribe to gain monopolistic or near-monopolistic control over a given commodity market. Although no such example is currently available, recent FCPA enforcement actions involving commodities production have included a Chilean metals mining company, gold Mining in Ghana, and a Brazilian state-owned oil company. To the extent any of these FCPA violations had an effect on US commodities prices, the CFTC could hold these market actors liable for market manipulation for their intentionally manipulative conduct. In these cases, it is arguable that the CFTC's involvement may add something to the DOJ's and SEC's enforcement if it is prosecuting conduct that negatively affects US commodities prices. However, given the long-standing difficulty the CFTC has faced in successfully proving market manipulation domestically, one must ask whether the agency's expansion into international market manipulation will fare better.

C. Benchmark Manipulation

A third possibility lies in foreign corrupt practices being employed to influence or taint a benchmark used to price or value derivative instruments. A benchmark is the aggregation of multiple sources of market information into a single metric—such as a price, rate, or index—that is used as the basis for valuing derivatives. For example, an interest rate option may be valued by reference to an interest rate benchmark that aggregates and synthesizes interest rates from other financial institutions into a single, market-representative number. Benchmarks are ubiquitous in the derivatives markets because they facilitate ease of pricing, provide a wealth of information on market conditions, and improve market liquidity by standardizing pricing across derivatives. Typically, independent third parties aggregate market inputs and produce benchmarks based on proprietary methodologies. Thus, the utility of the benchmark is directly connected to the reliability and breadth of the inputs that form the end result.

Benchmarks could implicate both the FCPA and CEA if a foreign official responsible for contributing data used in compiling a benchmark was bribed to falsify her country's contributed data to the benchmark. For example, suppose the price per barrel that "Oilzealand" charges for its oil is a key input for a crude oil benchmark and reflects the median price of major state-based oil production globally (the "Oil Benchmark"). Suppose further that a hedge fund has large options contracts expiring in a few days, all of which reference the Oil Benchmark, and, if the Oil Benchmark trends higher, the hedge fund will lose substantial sums. To prevent these losses, the hedge fund bribes government officials in Oilzealand to lower the price inputs submitted to the Oil Benchmark. Oilzealand's false inputs sufficiently lower the Oil Benchmark, thereby allowing the hedge fund to profit on its options contracts.

This scenario represents another intersection of the FCPA and CEA that has related precedent in the market. In 2012, it was uncovered that the London Interbank Offered Rate (LIBOR)—the leading interest rate benchmark—was being systematically manipulated by banks responsible for submitting the inputs on which it was based. At the time of its manipulation, LIBOR was calculated from the submissions of leading banks. After elimination of the highest and lowest submissions, the rate was calculated as an average of the remaining submissions. Traders at the banks, however, would falsify their submissions to LIBOR based on whether they needed the rate to increase or decrease to ensure the profitability of their outstanding derivatives. For their role in the LIBOR manipulation schemes, the CFTC fined participating banks billions of dollars for violations of the CEA. Such a scenario could also violate the FCPA if the benchmark's inputs were manipulated owing to bribery of a foreign official. Numerous benchmarks for physical commodities rely on inputs from state-owned commodities producers. Bribes paid to manipulate benchmarks referenced by derivative contracts within the CFTC's regulatory ambit, therefore, could implicate both the CEA and FCPA.

III. Implications and Additional Questions

The potential scenarios discussed above are neither far-fetched nor complete. Rather, they are possible intersections between the CEA and foreign corruption that would fall within the CFTC's regulatory purview. Indeed, such scenarios are not purely hypothetical. It was recently revealed that Glencore Plc, one of the largest commodity traders in the world, was under investigation by the CFTC for possible corrupt practices that violated the CEA. The CFTC's expected active engagement in the area raises certain questions for the future of FCPA enforcement and interagency cooperation and coordination in this space.

First, what does the CFTC's involvement add to the global fight against foreign corrupt practices? An immediate critique of the CFTC's focus on foreign corruption is that it adds yet another regulator to an area in which there are already two overseers domestically, not to mention numerous others globally. Arguably, to the extent foreign corruption affects the US commodities markets, such misconduct ought to be captured under the FCPA's broad grant of authority to the DOJ and the SEC. Additionally, the CFTC has indicated its intent not to "pile on" and initiate investigations or enforcement actions that duplicate the efforts of the DOJ and SEC. Indeed, the CFTC's Advisory aligns with the policies and practices of the DOJ, further supporting the CFTC's stated intentions not to conflict with or duplicate the efforts of other enforcement agencies. At a minimum, the CFTC's foray into anti-corruption enforcement does not appear to be inefficient; rather, the agencies seem intent on engaging in collaborative enforcement. Yet this does not quite answer the question of what this new agency *adds* to global anti-corruption efforts that is not already covered by the DOJ's and SEC's jurisdictional authority under the FCPA.

Most obviously, the CFTC adds expertise on the workings of the commodities and derivatives markets, in addition to a deeper understanding of how market manipulation works in these markets. As the focus of foreign corruption enforcement actions hones in on commodities traders, the CFTC is able to lend expertise to the other enforcement agencies in untangling undoubtedly complex schemes that may distort commodities markets. Additionally, although the CFTC lacks the authority to bring actions under the FCPA, it can complement the DOJ's and SEC's actions by pursuing foreign corrupt practices that violate the CEA but may not have been fully addressed under other enforcement actions. For example, the CFTC is not limited to bringing enforcement proceedings against public issuers or registrants. Rather, the CFTC's authority to prosecute foreign corrupt practices that violate the CEA extends to non-issuers, which is beyond the SEC's jurisdiction. Notably, the CFTC is also able to bring enforcement actions against individuals and entities not required to register under the CEA. Thus, jurisdictionally, the CFTC fills a gap where there is DOJ authority to bring criminal proceedings but there may not be a civil regulator with authority.

Second, how will courts and the markets respond to the CFTC's extraterritorial extension of the CEA's anti-fraud and anti-manipulation provisions? The expanded the CFTC's extraterritorial jurisdiction to include activities that have a "direct and significant . . . effect on commerce of the United States." The CFTC has relied on this authority to implement cross-border regulation over aspects of the derivatives markets that it considers to be systemically important, such as the regulation of margin, clearing, and dealer capital. To date, the CEA's manipulation and fraud provisions have not been extended extraterritorially and, therefore, it remains to be seen how courts will respond. Indeed, if the CFTC's basis for extraterritorial jurisdiction is systemic risk, then it raises the question of whether foreign corrupt practices that manipulate the markets rise to the level of systemic risk. And, if not, then does the CFTC have a statutorily sound basis on which to extend the application of the CEA's manipulation and fraud provisions to reach foreign corrupt practices?

Relatedly, how will the CFTC fare in holding firms and traders accountable for manipulation for foreign conduct given their historical difficulties in holding actors liable domestically? Proving market manipulation has been somewhat hard for the CFTC in the past, with the agency winning its first manipulation case in court in 2009. The Dodd-Frank Act expanded the agency's manipulation authority, granting it powers similar to those of the SEC and allowing the agency to address fraud-based manipulation in the commodities and derivatives markets. In the decade since its powers have been broadened, the CFTC has become more active in its anti-manipulation enforcement actions and more aggressive in its interpretation of its statutory authority. Thus, as the agency expands to include foreign conduct among its manipulation enforcement actions, it will be worthwhile to note how the CFTC charges foreign corruption under the CEA; how courts respond to these actions; and whether or to what extent foreign-based actions have an impact on the CFTC's future strategies in domestic manipulation cases.

Lastly, what are the practical implications for firms' compliance programs now that the CFTC is part of the FCPA regulatory landscape? With the addition of the CFTC to the regulatory roster, firms that operate at the intersection of the CEA and FCPA ought to reevaluate their compliance programs and internal controls to assess and identify potential sources of exposure. Companies should expect that the CFTC will be closely examining their conduct in the commodities and derivatives markets, including that of their traders and agents irrespective of their registration status with the CFTC. Yet, given the newness of the CFTC's interest in foreign bribery, firms may struggle with identifying the aspects of their operations that may draw scrutiny from the CFTC but are commonplace in the industry. For example, the use of middlemen to negotiate deals in resource-rich countries is a common practice in the world of commodities trading but may expose firms to unwanted scrutiny from the CFTC.

Firms must now include the CFTC in their calculus when deciding to self-report and assessing the extent of their potential liability for foreign corrupt practices. A key feature of the CFTC's enforcement policy encourages market participants to voluntarily self-report violations of the CEA to receive a substantial reduction in civil penalties. For conduct that violates the CEA and FCPA, firms must now consider the potential scope of their liability under two statutes, whether their FCPA violations give rise to potential liability under the CEA, and the timing of when to disclose to the DOJ, SEC, and CFTC. Further, firms must also consider the extent to which the CFTC may affect their remediation efforts in the event they have violated both the FCPA and the CEA. The costs of FCPA investigation and remediation efforts are likely to increase with the addition of a third regulator, which should factor into firms' cost calculus when addressing foreign bribery allegations.

Conclusion

The CFTC's focus on foreign corrupt practices and their impact on US commodities and derivatives markets is a new and interesting frontier that will undoubtedly have meaningful repercussions within the legal and financial markets. Despite there being a wealth of possibilities for how foreign corrupt practices may run afoul of the CEA, it is largely unknown how and when the CFTC will apply its authority to police foreign corruption. As the CFTC brings these cases in the future, it will be interesting to see how the CFTC extends the extraterritorial reach of its primary statute and how this affects compliance and internal controls at firms. The markets ought to pay close attention to the CFTC's actions in this space, given the potential effects on how business is conducted and sources of liability for firms and individuals, regardless of whether they are registered with the CFTC. It is also important, I believe, for scholars to pay attention to this space as well. This is true not only because of the potential impact on FCPA prosecutions and enforcement actions, but also because of the slow yet steady confluence of the three primary actors of financial regulation—the DOJ, SEC, and CFTC—and the continued extraterritorial expansion of their authority over the markets.

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