

CLIENT ALERT

The CFTC Channels Yogi Berra: “It’s Déjà Vu All Over Again”

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In a settlement order released on June 14, 2021, the Commodity Futures Trading Commission (“CFTC”) for the second time imposed remedial sanctions against Classic Energy, LLC (“Classic Energy”), a registered Introducing Broker (“IB”) during the relevant period, and Matthew Webb (“Webb”), the founder and an affiliated/associated person of Classic Energy, for misappropriating material, nonpublic information in violation of a preexisting duty (“Settlement Order”).¹ The manipulative and fraudulent activities showcased in this settlement appear to be an extension of issues addressed by the CFTC when it found last year that Webb had unlawfully executed customer orders for block trades against an account that he owned and controlled without disclosing that he was the principal on the other side of the trades.²

According to the Settlement Order, Classic Energy and Webb misappropriated the block trade information of certain institutional energy company customers (“Energy Companies”) through a multi-pronged scheme. The misappropriated material, nonpublic information included details about the price and quantity at which the Energy Companies sought to execute block trades in natural gas futures contracts on the Intercontinental Commodities Exchange (“ICE”) and the New York Mercantile Exchange (“NYMEX”) (“misappropriated information”).

Respondents’ scheme included: (i) Webb disclosing the Energy Companies’ block trade details to another trader, knowing that the trader would profit by using the misappropriated information to execute offsetting trades on ICE and NYMEX; (ii) “kicking back” some of the profits earned by that trader to Webb and others that assisted in misappropriating

¹ *In re Webb*, Order Instituting Proceedings Pursuant to Section 6(c) and (d) of the Commodity Exchange Act, Making Findings, and Imposing Remedial Sanctions, CFTC Docket No. 21-09 (Jun. 14, 2021) available [here](#).

² Please see our discussion of those issues in our prior client alert, available [here](#).

The CFTC Channels Yogi Berra: “It’s Déjà Vu All Over Again”

the information; and (iii) misleading the Energy Companies to believe that their resulting block trades were arm’s-length transactions when they were self-interested transactions designed to allow Webb and other traders to profit from the misappropriated information.

Under the Settlement Order, the CFTC permanently banned Respondents from engaging in trading on, or subject to the rules of, any entity registered with the CFTC, having any commodity interests traded on their behalf, and acting as commodity interest intermediaries, among other things.³ Additionally, the Settlement Order required Respondents to jointly and severally disgorge profits in the amount of \$585,000.⁴

Below please find our deeper dive summary of the identified misconduct.

Chain of Duties to Protect Customer Information Confidentiality

The Settlement Order explained that based on the CFTC’s regulations governing the conduct of introducing brokers under their brokerage agreements, and the agency relationship between Classic Energy and its Energy Company customers, Classic Energy and Webb had a duty to keep their customers’ material, nonpublic information confidential. Webb acquired the misappropriated information from certain of the Energy Companies’ employees tasked with trading energy contracts on behalf of the Energy Companies (“Energy Company Traders”), sometimes via personal device communications. According to the CFTC: “Webb owed duties to the Energy Companies to keep this Inside Information⁵ confidential under his brokerage agreements, as an agent of the Energy Companies for the purposes of facilitating block trades, and as a registered introducing broker under Commission Regulation.”⁶ Also, the Energy Company Traders were described as each having a “duty to keep Inside Information confidential and not disclose it to unauthorized persons or use it for their own benefit” due to their respective employment agreements, and the policies and procedures of each Energy Company which governed their employment.⁷

Breach of Duty and Misappropriation of Inside Information

From at least September 4, 2015 through January 27, 2019, the CFTC found that Respondents breached their duties (either directly or vicariously) to not misappropriate their customers’ material, nonpublic information by disclosing the Energy Companies’ Inside Information to another, unidentified trader that was not authorized to receive that information

³ Settlement Order at 15.

⁴ *Id.*

⁵ The CFTC defined the “Inside Information” specific to this case as the “nonpublic block trade order information of Classic [Energy]’s institutional energy company customers . . . , including information about the price and quantity at which the Energy Companies sought to execute block trades in certain natural gas futures contracts on both ICE and NYMEX.” Settlement Order at 2.

⁶ *Id.* at 7.

⁷ *Id.* at 4.

The CFTC Channels Yogi Berra: “It’s Déjà Vu All Over Again”

(the Settlement Order refers to that unidentified trader as “Individual Trader 1”). Because Webb was an agent of the Energy Companies and Classic Energy was a registered introducing broker, Respondents breached their preexisting duties to the Energy Companies when they knowingly engaged in non-arm’s-length block trades with Energy Company Traders at prices unmoored from market fundamentals, allowing a separate, unauthorized person to profit on offsetting trades. Then, Respondents and certain of the Energy Company Traders from whom they received the misappropriated information personally benefitted from that misappropriation through kickbacks and increased commissions. Respondents were also found to have concealed the scheme, creating a “false impression” that the transactions were executed in the “ordinary course of Classic[] [Energy’s] business”⁸ by (i) communicating with an Energy Company Trader using a personal device; (ii) creating a misleading audit trail; and (iii) Webb’s receiving his share of the profits in cash.

Because of this misconduct, the CFTC determined that Respondents violated the anti-fraud and anti-manipulation rules of the Commodity Exchange Act and the CFTC’s regulations when it “engaged in a scheme to defraud” the Energy Companies’ customers by “intentionally misappropriating” the Energy Companies’ material, nonpublic block trade information.⁹ Additionally, the CFTC determined that Respondents’ failure to disclose that Webb paid commission kickbacks to an employee of one of the Energy Companies also violated the CFTC’s anti-fraud and anti-manipulation rules.

Fictitious Sales

Section 4c(a)(1) and (2) of the CEA, in part, makes it “unlawful for any person to offer to enter into, enter into, or confirm the execution of a transaction” that is a fictitious sale or is “used to cause any price to be reported, registered, or recorded that is not a true and bona fide price.”¹⁰ According to the Settlement Order, Webb facilitated and confirmed the execution of trades between the Energy Company Traders and Individual Trader 1, which he knew (i) were not arm’s-length transactions executed at bona fide prices and (ii) would be used by Individual Trader 1 to negate normal market risks using the Inside Information and profit from offsetting trades. The CFTC explained that “[f]ictitious sales include both the unlawful practices specifically enumerated in Section 4c(a) as well as trading techniques that give the appearance of submitting trades to the open market while negating the risk or price competition incident to such a market.”¹¹

⁸ *Id.* at 7.

⁹ See section 6(c)(1) of the Commodity Exchange Act, 7 U.S.C. § 9(1), and section 180.1 of the CFTC’s regulations. 17 C.F.R. § 180.1. See also Settlement Order at 7.

¹⁰ 7 U.S.C. § 6c(a)(1), (2).

¹¹ Settlement Order at 7.

The CFTC Channels Yogi Berra: “It’s Déjà Vu All Over Again”

Failure to Supervise

Respondents also failed to appropriately supervise their brokerage traders in violation of CFTC Regulation 166.3, which required Respondents to diligently supervise the handling of all commodity interest accounts introduced by Classic Energy and all other activities of its partners, officers, employees, and agents.¹²

Misleading ICE During Its Investigation

Webb violated Section 9(a)(4) of the CEA when he knowingly made false statements to ICE during its investigation of related wrongdoing concerning Respondents’ misappropriation of its customers’ material, nonpublic information. For example, in that investigation, Webb falsely told ICE investigators that he “never” took the other side of a customer’s block trade “unless he could make a better market than other market makers.”¹³ The CFTC deemed these statements false, and also explained that the statements were material “because they went to the heart of ICE’s investigation into whether Webb used his proprietary trading account [] to improperly take the other side of Classic [Energy] block trade customer orders.”¹⁴

Remedial Sanctions

Because of these violations, the CFTC permanently imposed a broad trading and registration ban on Respondents related to trading in commodity interest transactions (futures, swaps, and commodity options), or having commodity interests traded on their behalf. Additionally, the Settlement Order required Respondents to jointly and severally disgorge profits in the amount of \$585,000 to the U.S. Treasury Department. As we noted in our prior client alert involving similar matters, the disgorgement sanction imposed by the CFTC appears inequitable because the payment is not provided to Respondents’ injured customers. Even though the losses were incurred by Respondents’ defrauded customers, the CFTC effectively transferred the customers’ lost funds to the U.S. Treasury rather than returning them to the injured parties.

¹² 17 C.F.R. § 166.3.

¹³ Settlement Order at 10.

¹⁴ *Id.*

The CFTC Channels Yogi Berra: “It’s Déjà Vu All Over Again”

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