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# CFTC v. Kraft Foods: What is Market Manipulation?

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The Commodity Futures Trading Commission (CFTC) is engaged in its first court battle interpreting its new anti-manipulation authority under the Commodity Exchange Act (CEA) as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank): *CFTC v. Kraft Foods Group, Inc. and Mondel?z Global LLC*.[1] The case involves allegations that Kraft Foods manipulated the wheat futures and cash markets in 2011. While the case is still in its infancy, and additional facts may come to light that clarify the CFTC's position, the Complaint can be read to suggest that conduct intended to (or maybe even just anticipated to) influence market prices is *per se* manipulation if the actor benefits from the impact on prices. As discussed below, this leaves participants in physical commodity markets with important questions to consider.

**Does Intentionally Changing Supply & Demand Fundamentals Equal Manipulation?**

According to the Complaint, Kraft historically procured its wheat supply primarily in the local (Toledo, Ohio) cash market and used wheat futures to hedge its cash purchases, rarely taking delivery of wheat via the Chicago Board of Trade (CBOT) delivery process. However, in late 2011, the cash market was trading at a premium to the futures market and, according to contemporaneous emails quoted in the Complaint, Kraft estimated that it could save more than $7 million if it sourced wheat in December 2011 through the futures market rather than through the cash market. As the Complaint explains, taking delivery through the futures market was expected to result in delivery of lower quality wheat at less convenient locations.

Kraft also appears to have recognized that its move from the cash market to the physically delivered futures market would reduce demand in the cash market and increase demand in the futures market for the same time period. All other things equal, this was expected to reduce cash prices and increase futures prices. When this in fact happened, Kraft reversed course, liquidating its futures position and purchasing supply in the now relatively cheaper cash market.

Put another way, Kraft historically behaved as a captive customer to the Toledo cash market and sought in 2011 to diversify its supply options and inject price competition by forcing suppliers in the cash market to compete with the futures market. Kraft's behavior seems akin to a captive cable television customer reluctantly buying a satellite dish with the hope that the threat of leaving its local cable company will encourage the cable company to offer a more reasonable price. While the customer may hope to never in fact switch to satellite service, incurring the cost of installing a satellite dish gives the customer options and bargaining power.

The *Kraft* Complaint can be read to assert that such a threat, and/or taking actions to backup such a threat, can constitute fraud or manipulation.

**Hedger as Speculator: A Cardinal Sin?**

It is not clear from the Complaint whether anything more than the threat to source from the futures market would be needed to give rise to manipulation allegations, but the CFTC certainly takes issue with Kraft's decision to engage in speculative trading informed by its non-public knowledge of its procurement plans. The Complaint first points to the anticipated impact of the move to the futures market on the cash market, then it highlights Kraft's activity in the futures market designed to benefit from price changes Kraft expected to occur as a result of its shift from the cash market to the futures market.

According to the Complaint, Kraft anticipated that the increased demand in the December 2011 futures contract after Kraft's shift to futures would narrow the spread between the December futures contract and the March futures contract, and Kraft sought to take advantage of this expected change by establishing a December/March futures spread position. The CFTC appears particularly troubled by the fact that Kraft's futures position exceeded its physical needs. In practical terms, this view might impose a new prohibition on commercial market participants establishing speculative positions based on the anticipated market impact of their own conduct.

**The Challenge**

If *Kraft* stands for the proposition that competitive behavior designed to obtain the lowest price available is manipulative when the trading strategy impacts market prices to the trader's benefit, then end-users and other physical market participants will find themselves in a challenging position. On the one hand they will need to assess the likely impact of their trading activity on market prices to avoid the appearance of trading to benefit a related position. Then, on the other hand, they will need to intentionally refrain from making otherwise economically rational trading decisions based on their expectations. Ultimately, this might leave commercial market participants unable or unwilling to speculate in any market in which they participate.

Notably, the CFTC has not accused Kraft of attempting to corner the wheat market. Nor has the CFTC alleged Kraft attempted to create an artificially high price in the December futures contract with the intent to force the futures market toward backwardation and cause producers and merchants to abandon cash-and-carry strategies and to deliver wheat in the prompt month. However, the CFTC might be inferring an intent to manipulate the market from Kraft's trading activity in the futures market (*e.g.*, timing and volume of trades). If Kraft's trading was uneconomic or otherwise inconsistent with the legitimate business rationales described above, such facts would help market participants better distinguish between competitive, economically rational behavior and an unlawful manipulative scheme. In other words, the question remains whether Kraft's strategy (as described in the Complaint) is itself manipulative, or if Kraft's execution of the strategy may have been manipulative (i.e., designed to create an artificial price).

[1] Complaint for Injunctive Relief, Civil Monetary Penalties, and Other Equitable Relief, cv-15-2881 (N.D. Ill., filed Apr. 1, 2015) (Complaint). The defendants filed a motion to dismiss the manipulation charges on June 1, 2015. That motion is pending before the Court.