

INSIGHTS

Long-Awaited CFTC v. Kraft Settlement Resolves Manipulation Allegations

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By: [Michael W. Brooks](#) and [Joshua Robichaud](#)

UPDATE: *The statements referenced and linked in this post have been removed from the CFTC's public website in connection with [an ongoing dispute](#).*

Today the legal battle between the Commodity Futures Trading Commission (CFTC) and Kraft Foods Group, Inc. (Kraft) over whether Kraft manipulated the wheat market in 2011 officially ended with the entering of a [Consent Order](#) in the U.S. District Court for the Northern District of Illinois. It was disclosed on March 25, 2019 that the parties reached a binding agreement, but the details have remained non-public until today. The settlement includes a civil penalty of \$16 million dollars to be paid by Mondelez Global, LLC (an affiliate of and co-defendant with Kraft Foods Group, Inc.). While the settlement resolves the dispute between the parties, it leaves open issues of first impression and removes an opportunity to clarify the scope of the CFTC's anti-manipulation rule. One thing this should not signal to market participants is a surrender by the CFTC.

As we have [discussed previously](#), Kraft allegedly changed from behaving as a captive customer in the wheat cash market (and using futures only to hedge) to acquiring large quantities of wheat futures contracts and signaling to the market that it intended to take the contracts to delivery with the expectation that this would encourage convergence of futures prices and cash prices (which were at a premium to futures), allowing Kraft to liquidate its futures position at a profit and purchase in the cash market at a savings. These factual allegations were neither proven nor stipulated by the parties, but the CFTC's characterization of the activity as manipulation presented the question whether exercising market power short of cornering or squeezing a market constitutes market manipulation.

Practical Takeaways: What is Market Manipulation?

Many market observers previously had hoped to get more clarity through a decision on the merits in this case. The Consent Order certainly will not satisfy that desire. Instead, we are left with a Commission declaring victory and a respondent paying a substantial penalty. What does this mean for market participants? They must behave as though the Commission won or risk being a defendant in the next attempt to better define the scope of the Commission's anti-manipulation authority.

As such, rather than considering what the law is, might be, or should be, market participants should consider what the CFTC alleged violated the law. In this regard, the following highlights can be taken as words of caution for future conduct:

- Kraft, a physical end-user, allegedly carried a futures position substantially larger than its expected physical needs.
- It allegedly carried that large position into the delivery period with a plan to take delivery and redeliver some portion of the delivered product back into the futures market.
- This practice allegedly was a departure from its historic practice.
- Its goal allegedly was to influence market prices (in the futures and cash markets).
- It did not matter to the CFTC that the anticipated effect would be to encourage convergence of the futures and cash markets consistent with the fundamental purpose of futures contracts.

While any one of these factors alone might not have resulted in allegations of market manipulation, and all combined might not have led to a finding on the merits in favor of the CFTC, any one factor is sufficient to warrant vetting by legal and compliance.

Message from the CFTC: (1) We Won and (2) Don't Expect Similar Concessions in the Future

In a brief statement issued by the CFTC, the Commission expressed pleasure in bringing the matter to “a successful resolution” and touted the settlement amount as equaling “nearly three times the unlawful profit the Commission alleged the Defendants obtained” (which is one way of calculating the maximum penalty allowed). The CFTC had alleged that Kraft yielded “more than \$5.4 million in futures trading profits and savings from its strategy” and was seeking the maximum penalty allowable, which would equal the greater of \$1 million for each violation of the anti-manipulation provisions of the statute and “\$140,000 for each additional violation” or “triple the monetary gain to Kraft for each violation.”^[1]

This sentiment was echoed in a statement issued by the two Democratic commissioners, Commissioners Berkovitz and Behnam: “In this case, it is not only Kraft’s \$16 million payment that is doing the talking. The Commission is speaking loudly and clearly as well: those who manipulate or attempt to manipulate our commodity markets will be prosecuted and punished.”

Both the Commission as a whole, and the Democratic commissioners, highlighted a portion of the Consent Order that restricts the parties’ ability to speak publicly about the case. The Commission specifically noted that it “considered carefully Paragraph 8 of Section I of the Consent Order, which *was included at the Court’s request*” (*emphasis added*), which provides: “Neither party shall make any public statement about this case other than to refer to the terms of this settlement agreement or public documents filed in this case, except any party may take any lawful position in any legal proceedings, testimony or by court order.” This language is similar to boilerplate language typically included in CFTC settlements that unilaterally limits the respondent’s ability to make public statements but here applies to the Commission’s statements as well.

The Commission cautioned that such mutually binding language should not be expected in future settlements “except in limited situations where our statutory enforcement mission of preventing market manipulation is substantially advanced by the settlement terms and the

public's right to know about Commission actions is not impaired." As highlighted by the Democratic commissioners, the Commission interprets the provision to only govern official statements by the Commission as a whole or by agency staff when acting on the Commission's behalf or speaking for the CFTC and not to cover statements by individual commissioners speaking in their personal capacities. In fact, the limitation only applies to the parties and not to individuals, which also likely means employees and agents of Kraft are not prevented by the Consent Order from speaking freely about the case in their own personal capacities. It will be interesting to see whether any exercise this freedom.

Finally, query whether the Commission's statement today about Paragraph 8 of Section I itself violates Paragraph 8 of Section I. It would seem to be a "public statement [by the Commission, a party,] about [the] case other than to refer to the terms of [the] settlement agreement or public documents filed in [the] case," and it is not taking any position in a legal proceeding, testimony, or by court order.

With this settlement, the CFTC's litigation record for fiscal year 2018 with respect to market manipulation comes to 1-1-1, including its recent win in [*CFTC v. Monex*](#), its loss in [*CFTC v. Wilson*](#), and the tie in this case. One thing clear from the Commission's and commissioners' statements is that it doesn't intend to quit while even.

[1] See [Complaint](#), *CFTC v. Kraft Foods Group, Inc., et al.*, No. 15-2881 (N.D.Ill. Apr. 1, 2015). As for the potential penalties for additional violations, the CFTC had alleged violations related to *non-bona fide* exchange-for-physical (EFP) transactions at least five times per year from 2009 to 2014 (\$4,200,000 in potential penalties, assuming within statute of limitations) and position limit violations on five days (\$700,000 in potential penalties).