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The Commodities Exchange Act and the Presumption against Extraterritoriality: An Examination of Transnational, Platform-Based Electronic Trading under Second Circuit Precedent

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THE COMMODITIES EXCHANGE ACT AND THE PRESUMPTION AGAINST EXTRATERRITORIALITY: AN EXAMINATION OF TRANSNATIONAL, PLATFORM-BASED ELECTRONIC TRADING UNDER SECOND CIRCUIT PRECEDENT

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I. INTRODUCTION

In recent years, the traditional method of trading commodities and futures contracts ("futures") in open outcry pits has given way to electronic, platform-based trading, which permits traders of commodities and futures to access not only United States markets, but also foreign markets with little more than an internet connection. This increased accessibility has yielded thorny issues concerning whether traders injured by an entity's manipulation of a commodity or future traded on a foreign exchange can bring a claim in the United States under the Commodities Exchange Act ("CEA").[1]

Generally, the primary impediment to such actions is the presumption against extraterritoriality, which embodies the "longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'"[2] In *Morrison v. Nat'l Austl. Bank LTD.*, the Supreme Court established a framework to determine whether a claim is permissibly territorial in the context of the Securities Exchange Act ("SEA").[3] That framework has come to be known as *Morrison*'s "transactional test."[4] The Second Circuit subsequently refined *Morrison*'s transactional test in a series of SEA cases,[5] also determined that the test was equally applicable to the CEA.[6] Recently, in *Choi v. Tower Research LLC*, the Second Circuit applied *Morrison's* transactional test to CEA claims involving futures transactions that were settled on a foreign exchange, but matched on a domestic electronic trading platform.[7]

Against this backdrop, this article examines: (i) the evolution of commodities/futures markets with the emergence of electronic, platform-based trading; (ii)

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[1] *See* 7 U.S.C. § 6 (2012); North Sea Brent Crude Oil, No. 17-2233 (2d Cir.) [hereinafter "*Brent II*"].

[2] *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (quoting Foley Bros. v. Filardo, 336 U.S. 281, 285 (1949)).

[3] *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 266-85 (2010).

[4] *Id.* at 269-70.

[5] Edward Kirk & Adeyemi Ojudun, *United States: Recent Decisions Clarify The Extraterritorial Reach Of U.S. Securities Laws Under The Second Prong Of Morrison*, CLYDE & CO. (Sep. 14, 2017), http://www.mondaq.com/unitedstates/x/628742/Shareholders/Recent Decisions Clarify The Extraterritorial Reach Of US Securities Laws Under The Second Prong Of Morrison.

[6] Myun-Uk Choi v. Tower Research Capital L.L.C., 890 F.3d 60, 66 (2d Cir. 2018).

[7] *See id.* at 65-68.

the Supreme Court's reinvigoration of the presumption against extraterritoriality and its "transactional test"; (iii) the Second Circuit's refinement and application of that test to CEA cases, including those involving electronic platform-based trading; and (iv) the factors that will determine whether a specific platform-based futures trade is sufficiently domestic under *Morrison* in future cases.

With respect to the last point, while recent technological advances may appear to muddle the application of the presumption against extraterritoriality, the answer surprisingly turns on old-fashioned principles of contract formation.[8] Specifically, where CEA claims are based on transactions involving a foreign commodities exchange, those claims nonetheless are sufficiently domestic if the plaintiff incurred "irrevocable liability" for the trades at issue in the United States.[9] Under recent Second Circuit precedent, that inquiry will rely, in large part, on an analysis of the rules of the foreign exchange at issue and the location of the technological infrastructure that connects buyers and sellers.[10]

II. THE EVOLUTION OF COMMODITIES AND FUTURE TRADES

Historically, commodities trading has been a localized phenomenon, and commodities exchanges arose in cities where the trading of certain types of commodities was prevalent.[11] This was often due to the city's proximity to, or its status as a major distribution point for, the commodity (*e.g.*, the trading of cattle in Chicago, Illinois).[12] This trading activity also led to the development of standardized futures contracts.[13] In both instances, trades were executed at the exchange's open-outcry pit, where "floor traders" matched buyers and sellers.[14] However, recent advances in technology, specifically electronic trading platforms which provide investors with access to exchange-based products *via* the internet and that utilize "matching engines" to pair buyers and sellers, have rendered open-outcry pits and "floor traders" essentially obsolete.[15] These matching engines, which are high-tech computer servers, often have a physical presence or infrastructure located near the original physical exchanges they have come to replace.[16]

Such platforms arose in the commodities markets for the same reasons that they arose in the equities markets: to disseminate price information and execute trades faster.[17] The electronic trading of commodities started in the late 1980s when the Chicago Mercantile Exchange ("CME") and the Chicago Board of Trade ("CBOT") realized that there existed a global demand for foreign currencies and U.S. Treasuries that persisted when the physical

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[8] *See infra* p. 20 and note 105.

[9] Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 68 (2d Cir. 2012).

[10] *See* Edward Kirk & Adeyemi Ojudun, *supra* note 5.

[11] *See* Everette B. Harris, *History of the Chicago Mercantile Exchange Futures*, *in* TRADING IN LIVESTOCK: ORIGINS AND CONCEPTS 49, 52 (Henry H. Bakken ed., 1970).

[12] *See id.*:

[13] *See* Carley Garner, *A Trader's First Book on Commodities* 24-25 (2d ed. 2013).

[14] *See* H. Kent Baker, Greg Filbeck & Jeffrey H. Harris, *Commodities: Markets, Performance, and Strategies* 447 (2018) [hereinafter *"Commodities*]."

[15] *See* Absolute Activist Value Master Fund Ltd., 677 F.3d at 447.

[16] *See* Graham Bowley, *The New Speed of Money, Reshaping Markets* THE NEW YORK TIMES (Jan. 1 2011), https://www.nytimes.com/2011/01/02/business/02speed.html?pagewanted=all.

[17] *Id.*

exchanges were not open for business in the United States.[18] With the success of such after-hours trading, the number of electronic platforms associated with other exchanges grew rapidly from 8 in 1990 to 40 in 1997.[19]

More recently, the CME and CBOT have greatly expanded the role of electronic platforms by instituting side-by-trading and making their platforms available during the exchanges' normal business hours.[20] This marked the beginning of the end for open-outcry trading, as no human floor-trader, no matter how motivated or boisterous, could match the speed at which an electronic platform can (i) convey and update price information (*e.g.,* bids, asks, and trades) and (ii) match opposite positions.[21] Indeed, between 1994 and 2014, the total volume of CME contracts traded on the Globex, CME's electronic trading platform, increased from approximately 1% to roughly 90% of all trades.[22] By 2015, the CME Group, the result of a merger between CME and CBOT, announced that it was closing almost all of its trading pits.[23]

This change sparked what has been called the "arms race" for speed,[24] which was waged between competing exchanges and fostered by high-frequency traders ("HFTs").[25] HFTs are trading firms that utilize computer algorithms and other technology to execute trades faster than other market participants.[26] This strategy enables firms to make pennies per-trade on "millions of trades executed in milliseconds."[27] Because time is literally money for HFTs, every millisecond, or even microsecond; reduction in transaction speed is a competitive advantage.[28] This has led to a phenomenon in which HFTs and exchanges, to decrease overall transaction time, place their electronic trading infrastructure in close proximity to one another in order to reduce the distance an electronic buy or sell instruction has to physically travel.[29] For example, in 2008, Intercontinental Exchange Inc. ("ICE") moved its electronic matching engines and associated infrastructure from Atlanta, Georgia, to Chicago, Illinois, which purportedly decreased the executable speed of trades initiated by HFTs in Chicago by approximately 20-milliseconds.[30]

This clustering of electronic platform infrastructure is not limited to transactions involving commodities/futures traded on exchanges located within the United States. That same infrastructure is often used to match trades on foreign exchanges as well. For example, the Korean Exchange ("KRX") permits after hours trades on the Globex platform, which is

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[18] *See* Commodities, *supra* note 14 at 448.

[19] *See id.* at 449.

[20] *See id.* at 448-49.

[21] *See id.*

[22] *See* Commodities, *supra* note 14 at 449.

[23] *See id.* at 450-51.

[24] *Id.* at 449.

[25] *See* Bennett Voyles, *ICE Heads North*, Tech. Talk, at 43 (March/April 2008) [hereinafter *"ICE Heads North*]."

[26] *See Choi*, 890 F.3d at 64.

[27] *Id.*

[28] *See* Commodities, *supra* note 14, at 454. *See also ICE Heads North, supra* note 25, at 43.

[29] *See* ICE Heads North at 43.

[30] *Id.*

physically located in Aurora, Illinois.[33] Similarly, the Intercontinental Exchange Futures Europe ("ICE Futures Europe"), a London-based Exchange that focuses on energy futures,[34] uses the matching engines of its corporate parent, "ICE", which are located in Chicago, Illinois.[35]

Thus, the question arises whether a person who traded commodities/futures on a *foreign* exchange *via* an electronic platform located in the United States has redress under the CEA against an individual/entity that manipulated the price of that commodity/future. One of the obstacles the aggrieved party must overcome in this increasingly common scenario is showing that his/her claim does not run afoul of the presumption against extraterritoriality.[36]

III. THE PRESUMPTION AGAINST EXTRATERRITORIALITY, THE SUPREME COURT'S DECISION IN MORRISON AND ITS PROGENY IN THE SECOND CIRCUIT

A. The Presumption Against Extraterritoriality

The presumption against extraterritoriality is a canon of statutory construction applicable to federal statutes.[37] The presumption embodies the "longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'"[38] The presumption rests on the "commonsense notion that Congress generally legislates with domestic concerns in mind,"[39] and advances the salutary goal of avoiding "unintended clashes between our laws and those of other nations which could result in international discord."[40] So, unless Congress affirmatively and clearly expressed its intention to give a statute extraterritorial effect, courts must presume that it is "primarily concerned with domestic conditions."[41] In other words, "[w]hen a statute gives no clear indication of an extraterritorial application, it has none."[42]

B. The Supreme Court Reinvigorates the Presumption Against Extraterritoriality in *Morrison*

Prior to *Morrison*, the presumption against extraterritoriality had fallen into desuetude among the Circuit Courts of Appeals, particularly in the context of actions arising under § 10(b) of the SEA.[43] For example, the Second Circuit applied what was known as the "conducts and effects" test to determine whether a securities fraud claim involving

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[33] *See Choi*, 890 F.3d at 63.

[34] Press Release, ICE Clear Eur. Launches European CDS Clearing, Intercontinental Exch. (July 20, 2009), https://ir.theice.com/press/press-releases/all-categories/2009/07-20-2009 (stating that among other futures, ICE Futures Europe "hosts trade in half of the world's crude and refined oil futures."). "'"

[35] *See* ICE Heads North, *supra* note 25 at 43.

[36] *See, e.g.*, Brent I; Choi, 890 F.3d at 66-68

[37] *See* Morrison, 561 U.S. at 255.

[38] Arabian Am. Oil Co., 499 U.S. at 248 (quoting Foley Bros. v. Filardo, 336 U.S. 281, 285 (1949)).

[39] Smith v. United States, 507 U.S. 197, 217 n.5 (1993).

[40] Arabian Am. Oil Co., 499 U.S. at 248.

[41] Morrison, 561 U.S. at 255.

[42] *Id.*

[43] *Id.* at 253-54.

transnational conduct was actionable under § 10(b).[44] That test turned on a case-by-case assessment of whether Congress, had it thought about the specific scenario at issue, would have wanted "'the precious resources of the United States courts and law enforcement agencies to be devoted to [a predominately foreign transaction] rather than leave the problem to foreign countries.'"[45] This question was answered in the affirmative if: (i) "'the wrongful conduct had a substantial effect in the United States or upon United States citizens,'" or (ii) "'the wrongful conduct occurred in the United States.'"[46] In practice, the test proved difficult to administer, highly subjective, and context driven, resulting, at times, in the same factor being determinative in one case but not in another.[47] This, in turn, led to criticism that the test was "unpredictable and inconsistent."[48]

In *Morrison*, the Supreme Court repudiated the "conduct and effects" test as well as the approaches employed by the other Courts of Appeal and restored the presumption against extraterritoriality as the touchstone for assessing a federal statute's territorial reach.[49]

The plaintiffs in *Morrison* were Australian nationals that purchased common shares of a foreign bank that were "not traded on any exchange in this country."[50] They asserted that the defendants misled investors about the bank's acquisition of a mortgage lending company headquartered in Florida.[51] Applying the "conduct and effects" test, the district court dismissed the plaintiffs' § 10(b) claims, on the ground that the "domestic acts [alleged] were, at most, a link in a securities fraud that concluded abroad."[52] The Second Circuit affirmed on appeal.[53]

Although the Supreme Court held that the lower courts correctly concluded that the plaintiffs failed to articulate a cognizable §10(b) claim, it rejected the "conduct and effects" test and applied the presumption against extraterritoriality.[54] The Supreme Court' succinctly explained its rationale: the presumption against extraterritoriality has been "long and often recited in [its] opinions"[55] and the "conduct and effects" test lacked any "textual or even extratextual basis" justifying its application.[56]

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[44] *See id.* at 255-56.

[45] *Id.* at 257 (quoting Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 985 (2d Cir. 1975)). *See also* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1334 (2d Cir. 1972).

[46] *Id.* (quoting SEC v. Berger, 1337 F.3d 187, 192-93 (2d Cir. 2003)).

[47] *See id.*

[48] *Id.* at 260.

[49] *See id.* at 265.

[50] *Id.* at 247.

[51] *See id.* at 247

[52] *Id. See also* Nat'l Aust. Bank Sec. Litig., No. 03 Civ. 6537, 2006 WL 3844465, at *4-5 (S.D.N.Y. Oct. 25, 2006).

[53] *See* Morrison, 561 U.S. at 247. *See also* Morrison v. Nat'l Austl. Bank Ltd., 547 F.3d 167, 177 (2d Cir. 2008).

[54] *See* Morrison, 561 U.S. at 265.

[55] *Id.* at 255.

[56] *Id.* at 258.

The Supreme Court then established a two-step framework for applying the presumption to a given federal statute.[57] The first step requires a court to determine whether Congress "clearly expressed" its intent for the statute to extend to foreign conduct.[58] If Congress has, then the inquiry is at an end and the statute will apply regardless of where the conduct occurred.[59] If Congress has not "'clearly expressed'" its intent to give a statute extraterritorial effect, the law is presumed to be "['] primarily concerned with domestic conditions.'"'.'"[60] At that point, a court must then proceed to the second step of the analysis which asks whether the case involves a permissible domestic application of the statute.[61] This determination requires a court to identify "the 'focus' of congressional concern" underlying the statute,[62] and then assess whether the conduct alleged to be relevant to that focus occurred in the United States.[63] If it has, then the statute is not being applied in an impermissibly extraterritorial manner, even if other aspects of the case occurred abroad.[64]

Turning to Section 10(b), the Supreme Court first determined that Congress had not clearly expressed its intent for that provision to apply extraterritorially.[65] Proceeding to the second step of the analysis, the Supreme Court dete[rmined] that 'the [object of the statute's solicitude' was not the 'place where the deception originated, but on] purchases and sales of securities in the United States."[66] Thus, if a 10(b) claim involved (i) a security listed on a domestic exchange, or (ii) the sale or purchase of any other security in the United States, it was not impermissibly extraterritorial, even if other aspects of the claim were foreign.[67] This framework is commonly referred to as *Morrison*'s "transactional test," and the two independently sufficient means of satisfying that test have been referred to as the "domestic exchange prong" and the "domestic transaction prong."[68]

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[57] *See id.* at 255-56. *See also* WesternGeco L.L.C. v. ION Geophysical Corp., 138 S. Ct. 2129, 2136 (2018) ("This Court has established a two-step framework for deciding questions of extraterritoriality.").

[58] Morrison, 561 U.S. at 255.

[59] *See id.* at 255

[60] Morrison, 561 U.S. at 255 (quoting EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991)).

[61] *See id.* at 255-56.; *See also* WesternGeco L.L.C., 138 S. Ct. at 2136; RJR Nabisco, Inc. v. Eur. Cmty., 136 S. Ct. 2090, 2101 (2016).

[62] Morrison, 561 U.S. at 249. The Supreme Court has explained that the focus of a statute can include the "conduct it "seeks to 'regulate,'" as well as the parties and interests it "seeks to 'protec[t]'" or vindicate." WesternGeco L.L.C., 138 S. Ct. at 2137.

[63] Morrison, 561 U.S. at 255-57.

[64] *See id.* at 257.; *See also* WesternGeco L.L.C., 138 S. Ct. at 2136 ("Courts make this determination by identifying "the statute's 'focus'" and asking whether the conduct relevant to that focus occurred in United States territory.") (internal quotation marks omitted).

[65] *See* Morrison, 561 U.S. at 257.

[66] *Id.* at 266-67.

[67] *See id.* According to the Supreme Court, this approach provided a "stable background against which Congress can legislate with predictable effects," unlike the conduct and effects test which required a court to "guess [Congress's intent] anew in each case," and it also minimized the possibility of interference with foreign laws, *id.* at 261.

[68] *See, e.g.*, Choi,80 F.3d 60. The Second Circuit has observed that Morrison's language, taken in isolation, could be read to support the argument that the purchase of a security on a foreign exchange satisfied the "domestic exchange prong" of the transactional test if the security was also cross-listed on a domestic exchange. *See* City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 179-80 (2d Cir. 2014). The court ultimately rejected this "listing theory" as "irreconcilable with Morrison read as a whole," since the focus of the Supreme Court's analysis was the location of the transaction, *id.* at 180.

C. The Second Circuit's Refinement of the Transactional Test to SEA Claims

Although the first prong of *Morrison*'s transactional test is straightforward to apply – a securities exchange is domestic if it is registered with the SEC – the Supreme Court "did not provide guidance as to what constitutes 'domestic transactions in other securities'" under the second prong.[69] The Second Circuit addressed this open question in *Absolute Activist Value Master Fund Ltd. v. Ficeto*.[70]

There, the plaintiffs were foreign hedge funds that purchased shares of companies not traded on a domestic exchange.[71] The defendants included, *inter alia*, officers of an investment management company that provided investment advisory services to the plaintiff funds.[72] Defendants allegedly violated § 10(b) by: : (i) causing plaintiffs to purchase shares from companies in which the defendants already had invested (or had warrants); and (ii) engaging in a "pump and dump" scheme whereby the defendants sold their shares at inflated prices to the plaintiff's detriment.[73]

The Second Circuit began its analysis by turning to the SEA's definitions of the terms "buy," "purchase," "sale" and "sell."[74] According to the court, "these definitions suggest that the 'purchase' and 'sale' [of a security] take place when the parties become bound to effectuate the transaction."[75] The court further reasoned that, "[g]iven that the point at which the parties become irrevocably bound is used to determine the timing of a purchase and sale, we similarly hold that the point of irrevocable liability can be used to determine the locus of a securities purchase or sale."[76] Additionally, because a sale ordinarily involves the passage of title, the court stated that "a sale of securities can [also] be understood to take place at the location in which title is transferred."[77] Thus, *Absolute Activist* concluded that "transactions involving securities that are not traded on a domestic exchange are domestic if irrevocable liability is incurred or title passes within the United States."[78]

The certainty and ease of application provided by the *Morrison/Absolute Activist* framework was short lived. In *Parkcentral Global Hub Ltd. v. Porsche Auto Holdings SE*, the Second Circuit held that even where a plaintiff demonstrates that irrevocable liability arose in the United States, a § 10(b) claim is nonetheless impermissibly extraterritorial if the claims

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[69] Giunta v. Dingman, 893 F.3d 73, 79 (2d Cir. 2018).; *See also* Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012) ("While Morrison holds that § 10(b) can be applied to domestic purchases or sales, it provides little guidance as to what constitutes a domestic purchase or sale.").

[70] Absolute Activist Value Master Fund Ltd., 677 F.3d at 66-67.

[71] *See id.* at 62-63.

[72] *See id.*

[73] *See id.* at 63-64.

[74] *See id.* at 67.

[75] *Id.*

[76] *Id.* at 67.

[77] *Id.*

[78] *Id.* at 68. In so ruling, the Second Circuit rejected the argument that the location of the broker dealer and the securities issuers in the United States was relevant to the extraterritoriality analysis. *See id.* Similarly, the court held that the parties' nationalities were irrelevant to the analysis, *see id.* at 69.

are "predominately foreign."[79] Although the Second Circuit expressly declined to provide a test or guidance for determining when a given transaction is "so predominately foreign as to be impermissibly extraterritorial,"[80] its decision provides some insight.

Specifically, the *Parkcentral* plaintiffs invested in "securities-based swap agreements," which referenced the common stock of Volkswagen AG ("VW"), a German corporation whose shares trade on a foreign exchange.[81] Essentially, the value of the swap agreements depended on the price of VW's shares, even though the plaintiffs did not actually have an ownership interest in VW shares.[82] Plaintiffs alleged that they entered into these agreements in the United States.[83] The defendant, also a German corporation, was not a party to the swap agreements.[84] However, the plaintiffs accused the defendant of making fraudulent statements in Germany in connection with its bid to acquire VW.[85] According to the plaintiffs, defendant's misconduct impacted the value of VW's shares, which, in turn, affected the value of their swap agreements.[86]

The Second Circuit concluded that the plaintiff's claims were predominately foreign, regardless of the fact that she had entered into the swap agreements in the United States, because: (i) German authorities had already instituted proceedings against the defendant, thereby exacerbating comity concerns; (ii) the wrongful statements were made in Germany; and, (iii) it would be unfair to expose the defendant to liability under the SEA where the sole connection to the forum was a private agreement "independent from the reference[d] securities" of which the defendant was "completely unaware."[89]

IV. THE SECOND CIRCUIT'S EXTENSION OF THE *MORRISON/ABSOLUTE ACTIVIST* TEST TO CEA CLAIMS

Shortly after deciding *Parkcentral*, the Second Circuit held in *Loginovskaya v. Batratchenko* that the *Morrison/Absolute Activist* framework was equally applicable to the CEA, based on the structural similarities between the CEA and SEA.[90]

The court began its analysis by noting that "[t]he CEA as a whole," including CEA § 22, the statute's private right of action provision, "is silent as to extraterritorial reach," and therefore is presumed to be concerned primarily with domestic conditions.[91] Proceeding to

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[79] Parkcentral Glob. HUB Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 216 (2d Cir. 2014). According to the Second Circuit, Morrison held that, in the absence of a trade on a domestic exchange, a "domestic transaction" was a necessary, but not necessarily a sufficient basis, for concluding that the claims at issue called for a permissibly territorial application of the SEA.

[80] *Id. See also id.* at 217 (advising that "[w]e do not purport to proffer a test that will reliably determine when a particular invocation of § 10(b) will be deemed appropriately domestic or impermissibly extraterritorial").

[81] *Id.* at 201.

[82] *See id.*

[83] *See* Parkcentral Glob. HUB Ltd., 763 F.3d at 207.

[84] *Id.*

[85] *Id.* at 203-04.

[86] *Id.* at 201-07.

[89] *Id.* at 216. S*ee also id.* at 215 (expressing concern over liability based on private transactions "without the issuers' [...] control or even knowledge")".

[90] Loginovskaya v. Batratchenko, 764 F.3d 266, 274 (2d Cir. 2014).

[91] Loginovskaya, 764 F.3d at 271. Notably, the CFTC has taken the position that the Dodd-Frank Act's amendment of Section 2(i) of the CEA – which concerns certain swap transactions – is expressly extraterritorial in scope, and therefore a court need not proceed to the second step of the Morrison analysis with respect to that

the second step of the *Morrison* analysis, the court observed that "[i]n § 22, the 'focus of congressional concern' is clearly transactional," and encompassed "domestic conduct, domestic transactions, or some other phenomenon localized to the United States" involving commodities futures contracts.[92] As such, the court reasoned that "[g]iven [. . .] the parallels between the CEA and SEA-- there is no reason why *Absolute Activist*'s formulation should not apply here."[93] Thus, *Loginovskaya* concluded that "the CEA creates a private right of action for persons anywhere in the world who transact business in the United States," which includes commodities transactions where "the transfer of title or the point of irrevocable liability for such [transactions] occurred in the United States."[94]

The next and only other Second Circuit decision applying the *Morrison/Absolute Activist* framework to CEA claims is *Choi v. Tower Research Capital LLC*, which tackled an issue of first impression.[95] Specifically, it addressed whether claims based on futures contracts traded on a foreign exchange are impermissibly extraterritorial if those trades were irreversible when matched on electronic trading infrastructure located in the United States.[96]

The plaintiffs in *Choi* were five Korean citizens who traded futures contracts on "night market" of Korean Exchange ("KRX"), a derivatives exchange located in Busan, Korea.[97] Night market trades, which are entered in Korea when the KRX is closed for business, "are quickly matched with a counterparty by an electronic trading platform," *i.e.* the Globex, located in Aurora, Illinois.[98] The trades are then "cleared and settled on the KRX when it opens for business the following morning."[99] The plaintiffs traded a derivative known as the KOSPI 200 futures contract.[100] The KOSPI is an index consisting of a weighted average of two hundred Korean stocks traded on the KRX.[101] By trading KOSPI 200 futures

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particular provision's application, *see* Brief for Amicus Curiae U.S. Commodity Futures Trading Commission in Support of Neither Party at 10-11, North Sea Brent Crude Oil, No. 17-2233 (2d Cir.) (ECF No. 148) (discussing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-20). *See also* Loginovskaya, 764 F.3d at 281 n.4 ("The Court takes no view of the effect that the Dodd-Frank amendments may have on the extraterritorial reach of the CEA: no swaps or transactions involving swaps are at issue here.")""

[92] *Id.* at 272. Section 22 of the CEA permits an individual to bring a private action in connection with: (i) receiving trading advice for a fee; (ii) making a contract for sale of any commodity for future delivery; (iii) placing an order for purchase or sale of a commodity; or (iv) market manipulation in connection with a contract for sale of a commodity. *See* 7 U.S.C. § 25(a)(1).

[93] *Id.* at 272. *See also id.* at 272 (observing that "'[t]raditionally, courts have looked to the securities laws when called upon to interpret similar provisions of the CEA.'" (quoting Saxe v. E.F. Hutton & Co., 789 F.2d 105, 109 (2d Cir. 1986)).

[94] *Id.* at 273-74 (emphasis added). Because the transaction in Loginovskaya was not exchange-based, the Second Circuit did not, at that time, address how the "domestic exchange" prong of *Morrison*'s transactional test translated from the SEA to CEA context. As the court later observed in Choi v. Tower Research Capital LLC, 890 F.3d 60 (2d Cir. 2018), the CEA does not speak in terms of exchanges, but rather "registered entit[ies]." Choi, 890 F.3d at 67 (quoting 7 U.S.C. § 25(a)(1)(D)(i)) (alteration in Choi).

[95] *See* Choi, 890 F.3d at 67-68.

[96] *Id.* at 67-68.

[97] *Id.* at 64.

[98] *Id.* at 63.

[99] *Id.*

[100] *See id.* at 64.

[101] *See id.* at 63.

contracts, plaintiffs were able "to speculate on the value of the KOSPI 200 index at various future dates."[102]

The defendants, Tower Research Capital LLC ("Tower"), a New York-based HFT firm, and its founder, allegedly violated the CEA by making manipulative trades on the KRX night market to inflate the price of KOSPI 200 futures prices.[103] Specifically, the defendants were accused of "spoofing," *i.e.*, submitting false buy and sell orders to artificially inflate the price of KOSPI 200 futures.[104] Defendants purportedly did so by placing a large volume of buy or sell orders and then using Tower's high-frequency technology to (i) cancel their orders before they could be matched, or (ii) ensure that they were their own counterparties on those trades.[105]

The district court dismissed the plaintiffs' CEA claims on extraterritoriality grounds.[106] Specifically, the district court concluded that the plaintiffs could not satisfy *Morrison*'s transactional test because: (i) the Globex, although domestic, was not an exchange; and (ii)[107] the plaintiffs failed to demonstrate that irrevocable liability arose at the time the trades were matched in the United States, considering that they were subject to clearing and settlement in Korea the following trading day..[109] The Second Circuit reversed.[110]

The Second Circuit first addressed what it referred to as the district court's and the parties' assumption that *Morrison*'s "domestic exchange" prong applied to the CEA and that it therefore mattered whether the CME Globex qualified as a national commodities exchange..[111] The Second Circuit noted that the assumption was unfounded because (i) *Morrison*'s creation of the "domestic exchange" prong was rooted in § 10(b)'s specific statutory text, and (ii) the court had yet to concluded that the it also applied to the CEA.[112] The court noted that unlike the SEA, which spoke in terms of "national securities exchanges," the CEA "speaks only of 'registered entit[ies].'"[113] Despite their framing of the issue, the Second Circuit declined to address whether a "registered entity" was the CEA equivalent of a national securities exchange, because it concluded that the plaintiffs satisfied *Morrison*'s "domestic transaction" prong.[114]

Specifically, the Second Circuit concluded that the plaintiffs had plausibly alleged that they incurred irrevocable liability for their night market trades of KOSPI 200 futures

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[102] *Id.*

[103] *See id.* at 64.

[104] *See id.*

[105] *See id.*

[106] *See id.* at 65.

[107] *See id.* at 65. In so ruling, the district court focused on the fact that the Globex was not registered as an exchange with the CFTC or subject to the rules of a registered exchange.

[109] *See id.* at 65.

[110] *See id.* at 70.

[111] *See id.* at 67.

[112] *See id.* at 67.; *See also* Loginovskaya, 764 F.3d at 271, 275.

[113] Choi, 890 F.3d at 67 (quoting 7 U.S.C. § 25(a)(1)(D)(i)). The CEA defines the term "registered entity" to include, *inter alia*, a board of trade designated as a contract market under Section 7 or 7b-1 of the CEA, and a derivatives clearing organization registered under Section 7a-1 of the CEA, *see* 7 U.S.C. § 1a(40).

[114] Choi, 890 F.3d at 67.

when the trades were matched in the United States on the Globex.[115] That determination turned on an examination of the CME Globex's and the KRX's respective rules.[116] The court observed that the plaintiffs not only expressly alleged that KRX night market trades are binding upon matching, but also that the express view of the CME Globex is that matches are essentially binding contracts.[117] Moreover, since there was no suggestion that "a trading party may unilaterally revoke acceptance following matching," the court concluded that "[i]t follows from these allegations that, in the 'classic contractual sense' parties incur irrevocable liability on KRX night market trades at the moment of matching."[118]

The Second Circuit also rejected the defendants' argument that, under KRX's rules, night market trades become irrevocable only when they are cleared and settled on KRX the following day, because, prior to that point in time, the KRX could cancel or restate trades due to matching errors.[119] According to the court, the KRX's purported ability to cancel or modify trades "says nothing about whether either trading party is free to revoke its error-free acceptance of a trade after matching."[120] The court ruled that since there was no support for unilateral revocation, the fact that a third-party could cancel a trade did not alter the fact that the parties were sufficiently bound to one another at the time of matching to satisfy Morrison's domestic transaction prong.[121]

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[115] In so ruling, the court "quickly dispatch[ed]" with the defendants' argument that a CEA claim based on a commodity trades on a foreign exchange is automatically impermissibly extraterritorial, even if the plaintiff incurred irrevocable liability in the United States, Choi, 890 F.3d at 67. The court observed that "Morrison itself refutes Defendants' argument," because it "clearly provided that the 'domestic transaction' prong is an independent and sufficient basis for application of the [SEA] to purportedly foreign conduct" even where the securities were listed on a foreign exchange, *id.* *See also* City of Pontiac Policemen's & Firemen's Ret. Sys., 752 F.3d at 181-82 (assessing whether purchases of securities on a foreign exchange satisfied Morrison's "domestic transaction" prong).

[116] *See id.* at 67-68.

[117] *See id.* at 67-68.

[118] *Choi*, 890 F.3d at 67 (quoting Absolute Activist, 677 F.3d at 68).

[119] *See id.* at 67-68.

[120] *Id.* at 68.

[121] *See id.* *See also* Poseidon Concepts Sec. Litig., No. 13 Civ. 1213, 2016 WL 3017395, at *12 (S.D.N.Y. May 24, 2016) ("Once [plaintiff] entered his order to purchase Poseidon stock, he no longer had the discretion to revoke acceptance, and title was transferred to him.") (emphasis added)"". The Second Circuit recently expanded on this point in Giunta v. Dingman, 893 F.3d 73, 80-82 (2d Cir. 2018). There, the court held that the parties had entered into a binding contract in the United States for the purchase of securities issued by a Bahamian company, notwithstanding that the agreement was subject to a condition precedent: there, the approval of Bahamian authorities. *See* Giunta, 893 F.3d at 80-82. The court reasoned that the fact that parties' obligations were ultimately subject to a condition precedent did not mean that either party was free to unilaterally "change its mind," *Id.* at 81. Rather, where the parties have committed to one another, and where the circumstances permitting revocation are "entirely out of [the parties'] control," that commitment satisfies the second prong of *Morrison's* transactional test if it occurred in the United States, *id.*

V. *CHOI'S* ANSWERS AND OPEN QUESTIONS: ANTICIPATING THE STATE OF TRANSNATIONAL COMMODITIES/ FUTURES LITIGATION IN THE SECOND CIRCUIT

Choi represents the Second Circuit's most in-depth examination of the presumption against extraterritoriality in the CEA context to date. However, for as many answers as *Choi* has provided, it has also left a number of issues open for future debate.

Perhaps most importantly, *Choi* reiterated that the "domestic exchange" and "domestic transaction" prongs of *Morrison*'s transactional test are independently sufficient bases for establishing that a claim is permissibly territorial, and that the involvement of a foreign exchange is not a determinative factor.[122] Specifically, the defendants in *Choi* argued that because the trades at issue involved a foreign exchange, the plaintiff's CEA claims were automatically extraterritorial.[123] The Second Circuit flatly rejected the argument, holding that if a plaintiff incurred irrevocable liability for such trades in the United States, its CEA claims were sufficiently domestic even though the plaintiff could not establish the "domestic exchange" prong.[124]

The fact that CEA claims involving commodities/futures listed on foreign exchanges are not automatically extraterritorial is critical, because, as previously noted, foreign commodities/futures markets have increasingly made themselves accessible to investors *via* electronic trading platforms physically located in the United States. Thus, for example, a trader can purchase a variety of energy-related futures contracts offered by London-based ICE Futures Europe *via* ICE's trading platform and matching engines located in Chicago, Illinois.[126]

Choi also instructed that the determination as to whether irrevocable liability occurred in the United States for a trade executed on a foreign exchange is primarily a question of contract formation.[127] A court's task is to determine the precise point in time when such liability arose, and then determine the location of that event. For this reason, an exchange's rule, which often define the point in time, between the placement of an order and its final execution, when a party can no longer revoke a trade, are critical to determining where liability arose. In *Choi*, the court concluded that the plaintiffs were unable to revoke their trade offers once they were matched on the Globex, even though they were not finally executed until the following day on the foreign exchange.[130]

Other foreign exchanges with products available to United States investors *via* electronic platforms should be subject to the same analysis. For example, ICE Futures Europe's rules indicate that a contract is formed when trades are matched, [131] which occurs on

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[122] *See* Choi, 890 F.3d at 67.

[123] *See id.* at 62-63.

[124] *Id.* at 67. *See also id.* (holding that "[p]lainly the reasoning of Morrison does not preclude the application of the CEA to trades made on a foreign exchange when irrevocable liability is incurred in the United States" and "quickly dispatch[ing] Defendants' contention that, under Morrison, the CEA cannot apply to a commodity traded on a foreign exchange").

[126] Bennet Voyles, *ICE Heads North*, TECH. TALK, MAR./APRIL 2008, at 43.

[127] *See* Choi, 890 F.3d at 67-68.

[130] *See id.* at 67.

[131] *See* ICE Future Europe Trading Procedures, § 3.9.4, 2018 ("once a bid or offer has been matched in whole or in part and gives rise to a trade there is no right of withdrawal"). *See also* ICE Clear Europe Clearing Rules,

ICE's trading platform located in Chicago, Illinois.[132] As such, a United States investor should be able to convincingly argue under *Choi* that CEA claims premised on ICE Futures Europe trades are not impermissibly extraterritorial.

Lastly, *Choi* made clear that the right of an exchange or other third-party to void a trade after matching has nothing to do with the issue of when and where a CEA plaintiff incurred irrevocable liability.[133] The Second Circuit rejected the defendants' argument that the plaintiffs' trades on the KRX night market were not binding until final settlement the next day, since the exchange had the right to void trades prior to that moment.[134] The court reasoned that the "irrevocable liability" analysis turns on the right of *the plaintiff* to void a trade, and that the plaintiffs had satisfied *Morrison/Absolute Activist* because they were powerless to rescind a trade after matching on the Globex.[135] Thus, in future cases, unless a defendant can show that the plaintiff had a right of revocation that existed post-matching and that was not extinguished until some action was taken outside the United States, a CEA plaintiff's claims should not be deemed impermissibly extraterritorial.

Turning to the issues that *Choi* left open, the Second Circuit notably failed to address whether *Morrison*'s "domestic exchange" prong applies in the CEA context. Beyond noting that the SEA and the CEA employ different nomenclature, "national securities exchanges" rather than "registered entities," the court provided no basis for declining to view a "registered entity" as simply the CEA corollary of a "national securities exchange" under the SEA. Indeed, as the Second Circuit has previously held, both statutes are focused on transactions.[137] And like the SEA, which is not focused on all securities frauds, but only frauds involving purchases or sales on "national securities exchanges," the CEA, similarly, is not focused on commodities/futures manipulation generally, but instead addresses the manipulation of transactions "on or subject to the rules of a registered entity."[138] Furthermore, to qualify as a "national securities exchange" or a "registered entity" under both statutes, the entity must be designated/registered by the Executive *via* the SEC or CFTC respectively." Thus, given these structural similarities, which the Second Circuit previously held justified *Morrison*'s application to the CEA,[139] a transaction involving a "registered entity" as defined by the CEA should satisfy *Morrison*'s "domestic exchange" prong.

Does *Parckcentral*'s "predominately foreign" inquiry apply to the CEA?[141] Notably, neither *Choi* nor *Loginovskaya* even mentioned *Parkcentral*.[142] While this absence arguably is evidence that *Parkcentral* does not extend to the CEA, there is no doctrinal basis for limiting *Parkcentral*'s reach to only SEA claims.[143] To the contrary, the Second Circuit

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Rule 401, Mar. 25, 2019 (explaining that "two Contracts shall arise automatically" between the seller and the clearing house and the buyer and the clearing house at the moment trades are matched).""; ""

[132] ICE Heads North, *supra* note 25 at 43.

[133] *Choi*, 890 F.3d at 68.

[134] *See id.*

[135] *Id.*

[137] *See* Loginovskaya, 764 F.3d at 270-72.

[138] Agricultural Commodity Exchanges, 7 U.S.C. §§ 9(1)(A), 13(a)(2), 25(a)(1)(D) (2010).

[139] *See* Loginovskaya, 764 F.3d at 272.

[141] Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 216 (2d. Cir. 2014).

[142] *Id.*

[143] *See id.*

has explicitly stated that the *Morrison/Absolute Activist* analysis applies with equal force to CEA claims because of the similarities between the SEA and CEA, which support a common application of *Parkcentral.*[144] For this reason, two district courts in the Southern District of New York have recently held that the *Parkcentral* analysis applies to CEA claims.[145]

Thus, the Second Circuit's failure to apply *Parkcentral* in *Choi* was likely a function of the fact that *Parkcentral* did not amend the *Absolute Activist* standard[146] but instead recognized that in extreme cases a more comprehensive examination of an action's territorial nexus, beyond the occurrence of irrevocable liability in the United States, may be merited to assess whether the claims asserted are sufficiently domestic. [147] Therefore, since *Choi* did not present such extreme circumstances, *Parkcentral*'s more searching "predominately foreign" analysis was not triggered.

Unfortunately, *Parkcentral* expressly declined to explain when a more searching review is appropriate.[148] It also did not identify what factors, if any, would indicate that a given claim called for an impermissibly extraterritorial application of the SEA or CEA, despite the plaintiff's domestic assumption of irrevocable liability.[149] Instead, the Court appeared to be motivated by a case-specific admixture of factors; some of which *Morrison* had already held were irrelevant to the extraterritoriality analysis.[150] Stripping away the

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[144] The more fundamental question, however, is whether Parkcentral itself was correctly decided. Putting aside that the authors of this article believe Parckcentral is flawed in multiple respects, it is worth noting that the Second Circuit appears to have created its own intra-Circuit split of authority: Parkcentral holding that irrevocable liability in the United States is insufficient, in and of itself, to establish a permissibly territorial action, versus *Choi*, which subsequently held that it is. *Compare* Parkcentral, 763 F.3d at 216 ("[W]e conclude that, while a domestic transaction or listing [on a domestic exchange] is *necessary* to state a claim under § 10(b), a finding that these transactions were domestic would not *suffice* to compel the conclusion that the plaintiffs' invocation of § 10(b) was appropriately domestic.") *with* Choi, 890 F.3d at 67 ("Morrison clearly provided that the 'domestic transaction' prong is an *independent and sufficient* basis for application of the Securities Exchange Act to purportedly foreign conduct.") (emphasis added).; *See also* Absolute Activist, 677 F.3d at 68 (quoting with approval the Eleventh Circuit's holding that *"in order to survive a motion to dismiss* premised on Morrison, *it is sufficient* for the plaintiff to allege that title to the shares was transferred within the United States.") (quoting Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1310-11 (11th Cir. 2011)) (emphasis added).: """""""""

[145] *See* Brent I, 256 F.Supp.3d 298, 307-10 (S.D.N.Y. 2017), and London Silver Fixing, LTD., Antitrust Litig., No. 14 MD 2573, 2018 WL 3585277, at *20-23 (S.D.N.Y. July 25, 2018). Remarkably, the district courts in *Brent* I and Silver misread Parkcentral – which limited its predominately foreign test to the second prong of Morrison's transactional test, *i.e.*, where transactions at issue *did not* occur on a domestic exchange, *see* Parkcentral, 763 F.3d at 215-20 -- and held that even where a CEA claim involves a domestic commodities exchange the claim can still be impermissibly extraterritorial under Parkcentral if the conduct giving rise to the claim is predominately foreign.. *See* Brent I, 256 F.Supp.3d at 307-10; Silver, 2018 WL 3585277 at *21-22.'

[146] Parkcentral, 763 F.3d at 214-16.

[147] The Second Circuit stressed that Parkcentral turned, in large part, on the unusual nature of the security at issue and admonished that "[t]he conclusion we have reached on these facts cannot, of course, be perfunctorily applied to other cases based on the perceived similarity of a few facts," *id.* at 217. For this reason, several district courts have declined to extend Parkcentral beyond its specific factual confines, *see, e.g.,* Atlantica Holdings, Inc. v. BTA Bank JSC, No. 13 Civ. 5790, 2015 WL 144165, at *8 (S.D.N.Y. Jan. 12, 2015); *Poseidon Concepts*, 2016 WL 3017395, at *13.

[148] Parkcentral, 763 F.3d at 214-16.

[149] *See id.*

[150] For example, Parkcentral based its determination on, *inter alia*: (i) "the particular character of the unusual security at issue," *id.* at 201-02; (ii) the fact that the misconduct is alleged to have occurred abroad, *id.* at 216; and (iii) comity concerns, *id.* But each of these bases had already been rejected by the Supreme Court or Second Circuit in prior cases. First, in Absolute Activist, the Second Circuit held that the nature of the specific

court's more controversial considerations, leaves one factor: *foreseeability*. Specifically, the Second Circuit was troubled that the defendant in *Parkcentral* could be subject to liability under the SEA for non-exchange-based transactions that: (i) did involve the defendant; (ii) did not involve the actual purchase or sale of the defendant's shares; and, (iii) of which the defendant was entirely unaware.[151]

Putting aside whether the court's concern is better addressed through the concepts of personal jurisdiction, minimum contacts, causation and/or scienter instead of being injected into the extraterritoriality framework, there are several factual scenarios that are likely to arise in futures cases that would moot this concern. For example, if the defendant actively traded the same types of commodities/futures underlying the plaintiff's claims, then it is certainly plausible that the defendant was aware (or could foresee) that its manipulation would impact the plaintiff's positions in the United States. Similarly, if the defendant was a large producer and/or sophisticated trader of a commodity, it would be hard pressed to argue that it was unaware that the commodity it produced, and/or traded was also the subject of standardized futures contracts and that its manipulation of the price of that commodity would impact futures contracts traded in the United States. In either case, the plaintiff's claims would not be properly rejected at the dismissal phase as extraterritorial under *Parkcentral*.

The Second Circuit, however, will soon have an opportunity to address the issue of whether and under what circumstances *Parkcentral* applies to the CEA in *Brent II*, which is currently on appeal before that court.[152] There, the plaintiffs are traders of Brent oil futures who claim that they were injured by the defendants' manipulation of the Dated Brent Assessment, the spot price for the underlying commodity.[153] Specifically, the plaintiffs allege that the defendants, who include producers and refiners of Brent oil, submitted false trade data to Platts, the price reporting agency that determines and publishes the Dated Brent Assessment based on such submissions.[154]

The district court dismissed the plaintiffs' CEA claims as impermissibly extraterritorial, because it determined that they were "predominately foreign" under *Parkcentral*.[155] The district court's decision turned in large part on the fact that: (i) the uneconomic trades that were reported to Platts occurred in the North Sea (where Brent oil

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security at issue in a given case is irrelevant. *See* Absolute Activist, 677 F.3d at 69. Second, in Morrison, the Supreme Court held that the location of a defendant's misconduct is irrelevant under its transactional test, *see* Morrison, 561 U.S. at 267 (focus of transactional test "is not upon the place where the deception originated, but upon purchases and sales . . . in the United States.") (emphasis added); Absolute Activist, 677 F.3d at 69 (same). Finally, also in Morrison, the Supreme Court held that satisfaction of its transactional test – including the "domestic transaction" prong – eliminated comity concerns., *see* Morrison, 561 U.S. at 269-70 (noting this test should take into account complaints of "interference with foreign securities regulation" in relation to the use of § 10(b) abroad, and holding that "The transactional test we have adopted--whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange--meets that requirement").

[151] *See* Parkcentral, 763 F.3d at 215 (declining to apply the SEA to "wholly foreign activity" because "the foreign defendants *were completely unaware* of it.") (emphasis added).; *See also id.* at 214 (expressing concern over liability based on private transactions "*without the issuers'[...] control or even knowledge.*") (emphasis added).

[152] *See* Brent II, *supra* note 1.

[153] *See* Brent I, 256 F.Supp.3d at 302-04.

[154] *See id.*

[155] *Id.*

originates); (ii) Platts is located in, and disseminates the Dated Brent Assessment from, England; and, (iii) the majority of the plaintiffs' trades occurred on a foreign exchange.[156] In so ruling, the district court gave little credence to the fact that (i) the trades at issue were matched on servers located in the United States (just as in *Choi*); and, (ii) the defendants traded the same Brent oil futures as the plaintiffs *via* the same domestic servers, and therefore could not have been unaware of the impact of their manipulative conduct on domestic commodities transactions.[157]

Thus, *Brent* II represents a golden opportunity for the Second Circuit to harmonize its decisions in *Parkcentral* and *Choi*.

VI. CONCLUSION

In summary, the advancement of electronic trading platforms in futures markets has blurred the lines between foreign and domestic commodities markets. It has made foreign commodities markets far more accessible, while at the same time exposing traders to the risk that unscrupulous market participants will seek to manipulate the price of the commodities or associated futures traded in those foreign markets. Under recent precedent, which applies well-established contract law principles, traders injured by manipulation of the price of commodities or associated futures contracts in foreign markets are not without recourse under the CEA, if they can show that they incurred irrevocable liability for such trades in the United States and that their claims are therefore permissibly territorial. That inquiry should focus on the physical location of the foreign exchange's trading infrastructure, as well as the exchange's rules regarding contract formation.

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[156] *See id.* at 307-10.

[157] *See id.* at 302-05, 316.