

[Securities Regulation Daily Wrap Up, COMMODITY FUTURES—N.D. III.: Kraft, CFTC battle over market influence for snack food ingredient, \(Aug. 20, 2015\)](#)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

Kraft Foods Group, Inc. has asked a federal judge in Chicago to toss two of four civil counts brought by the CFTC in an effort to short circuit a key part of the agency's case alleging that Kraft illegally swayed wheat prices. But the CFTC told the court that both its Dodd-Frank Act powers and long-standing regulatory views bolster its case against the company. Both the CFTC and Kraft see the case as a test of the agency's new powers and of the company's economic theory of prices in the wheat market ([CFTC v. Kraft Foods Group, Inc.](#), August 19, 2015).

Long futures, cash profits. Kraft's motion to dismiss paints the company as the victim of an overzealous regulator that misunderstands the economic forces that drive the business practices of one of the wheat market's biggest players. The CFTC said Kraft sold its huge long wheat futures positions in order to influence cash market prices for wheat in violation of new Commodity Exchange Act provisions brought about by the Dodd-Frank Act reforms.

Specifically, the CFTC [alleged](#) that Kraft acquired \$90 million in December 2011 wheat futures, enough wheat to last six months. But the agency said Kraft never planned to take delivery of the wheat and instead used its long futures position to entice others in the market to react in a manner that would lower cash wheat prices. The CFTC said Kraft made a \$5.4 million profit on the gambit.

According to Kraft, it initially bought cheaper wheat futures but then closed its long positions in order to buy cash wheat when cash wheat prices fell. The company said it views its conduct as a legitimate effort to source wheat in a cost effective manner. Kraft noted that wheat cash and futures markets had been out of step with each for so long that wheat markets became "dysfunctional."

But at the time the CFTC filed suit, the agency's Director of Enforcement, Aitan Goleman, [said](#) the case was about protecting markets from manipulation. "A market participant who is not happy with cash prices available to it may not resort to manipulative trading strategies in an attempt to artificially lower that price."

Dodd-Frank Act claim. One of the CFTC's theories is that Kraft engaged in either manipulation or fraud based on language added to CEA Section 6(c)(1) by Dodd-Frank Act Section 753(a) and implemented by CFTC Regulation 180.1. The new language makes it unlawful for any person to use or employ (or attempt to use or employ) any manipulative or deceptive device or contrivance in violation of Commission regulations in connection with any swap, contract for sale of any commodity, or for future delivery. This case offers the federal courts a first look at these new provisions.

Kraft [countered](#) that the case was much simpler than the CFTC claimed: "This case is about a snack-food company that made reasonable business decisions to maintain a steady wheat supply in the face of an uncertain market." Kraft argued that the CFTC failed to allege an outward manifestation of fraud by the company, such as making a false representation or injecting inaccurate information into the market. The company urged the court to read CFTC Regulation 180.1 to require this type of fraud indicia in order to protect market participants' legitimate business practices.

For good measure Kraft noted that the CFTC did not allege "classic" manipulative conduct such as wash sales, matched orders, or price rigging, but instead took aim at Kraft's economic theories of the wheat market. Kraft even seemed to mock the agency's theory of the case: "In short, the CFTC's case comes down to this: when

faced with higher wheat prices in one market and lower wheat prices in another, Kraft was required by law to purchase wheat in the more expensive market.”

According to the CFTC’s [response](#), the law and regulation were modeled after the securities law provisions in Exchange Act Section 10(b) and Exchange Act Rule 10b-5 (Kraft’s motion includes an appendix comparing these securities provisions to CEA Section 6(c)(1) and Regulation 180.1). Moreover, the CFTC said the repeated use of “or” in the Commission’s regulation demonstrates that the rule applies to manipulation or fraud, and does not always require specific intent or proof of an actual artificial price, although the CFTC’s rule is clearer on these points than Rule 10b-5.

In addition to arguing that FRCP 9(b)’s heightened pleading standard applies to Count 1 of the CFTC’s complaint, Kraft also took issue with the CFTC’s theory of scienter. According to Kraft, CFTC Regulation 180.1 should be understood to treat scienter just like the securities laws do: recklessness should merge into intent so that reckless conduct is punished only if it is functionally akin to intent (i.e., extreme recklessness).

By contrast, the CFTC emphasized the “distinct” nature of the two possible theories of liability it alleged against Kraft. The agency said its claim that Kraft engaged in a market abuse manipulation did not sound in fraud, so the heightened pleading requirement of FRCP 9(b) was inapt. But the CFTC also said its complaint was sufficient even if heightened pleading is required because it alleged at least recklessness, a scienter theory embraced by the Commission’s regulation.

Specific allegations, said the CFTC, include Kraft’s internal emails and other events showing the company’s sales plan belied its lack of a bona fide need for nearly 50 percent of the wheat it acquired, and that the company knew from a trial run of the plan that delivery of the volume of wheat involved would be cost prohibitive. Kraft said these allegations were too conclusory.

Anti-manipulation claim. The CFTC also alleged that Kraft manipulated and attempted to manipulate the wheat market by taking a big long position in the wheat futures market that would enable it to profit in the cash wheat market.

Kraft said the CFTC’s anti-manipulation count must fail because the company lacked the ability or intent to control both the cash and futures wheat markets. Specifically, Kraft said it could not demand artificially high prices because it did not control enough cash wheat to upset the offset and delivery choices available to traders with short positions. The CFTC countered that it need not show Kraft controlled both the cash and futures markets for wheat.

As for the intent to manipulate, the CFTC pointed to direct evidence that Kraft planned to “flatten” the wheat futures curve and to narrow spreads within a certain time frame. The agency noted circumstantial evidence of Kraft’s inability to use the amount of wheat acquired in the products it sells. The CFTC also argued that Kraft intended to create an artificial price by engaging in market activities that had no economic basis in supply or demand.

Kraft and the CFTC also disagree over whether an artificial price existed. Kraft said prices “converged” as expected in a functioning market, but that the CFTC inaptly focused on price changes rather than the artificiality of prices. Kraft also faulted the CFTC for not presenting historical and other pricing data in its complaint. The CFTC countered that Kraft’s aim was to use its uneconomic position in wheat markets to raise futures prices and lower cash prices.

CFTC and private suits. In mid-May, Judge Blakey, who is handling the CFTC’s case against Kraft, denied a request to reassign and consolidate numerous putative class action suits brought by private plaintiffs with the CFTC’s suit. As of then, the six related private suits filed against Kraft alleged CEA violations and antitrust claims.

Judge Blakey’s order said [Ploss v. Kraft](#) exemplified the varied class action issues among the private suits. He also emphasized that the private suits would add many layers of complexity to the CFTC’s case because they seek different relief from Kraft than does the CFTC. Moreover, each of the private plaintiffs has demanded a jury trial, while the CFTC did not ask for a jury.

The case is [No. 15-cv-2881](#).

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Companies: Kraft Foods Group, Inc.; Mondelēz Global LLC

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