

[Securities Regulation Daily Wrap Up, TOP STORY—C.D. Cal.: CFTC's charges fail to deliver in Monex precious metals action, \(May 2, 2018\)](#)

Securities Regulation Daily Wrap Up

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By [John M. Jascob, J.D., LL.M.](#)

A federal district court in California has dismissed the CFTC's charges that three Monex companies and two of their principals engaged in fraudulent, off-exchange precious metals transactions in violation of the Commodity Exchange Act ("CEA"). Judge James V. Selna ruled that Monex's practice of delivering precious metals to independent depositories within 28 days of their purchase by retail customers on margin fell within the "actual delivery exception" to the CFTC's authority. While the actual delivery exception did not divest the CFTC of jurisdiction over all the claims in the complaint, the only plausible interpretation of the applicable Dodd-Frank amendments to the CEA also foreclosed any claims for fraud under Section 6(c)(1) absent market manipulation ([CFTC v. Monex Credit Co.](#), May 1, 2018, Selna, J.).

Labeled by Enforcement Director James McDonald as one of the [biggest precious metals fraud cases in CFTC history](#), the Commission alleged that the Monex firms used high pressure sales tactics to deceptively pitch leveraged precious metals trades as safe, despite causing more than \$290 million in losses to retail customers over the course of almost six years. The CFTC also claimed that Monex structured its Atlas program for leveraged precious metals trading using oversized price spreads, commissions, and fees so that customer losses were all but inevitable. Although the CFTC's action was originally filed in the Northern District of Illinois, the suit was [transferred](#) to the Central District of California on October 19, 2017.

Actual delivery exception. The court turned first to the defendants' contention that the CFTC lacked regulatory jurisdiction over the case pursuant to the "actual delivery exception" to the CEA. Dodd-Frank had amended the CEA to extend the agency's authority over financed retail commodity transactions unless the transactions result within 28 days in "actual delivery," a term undefined in the statute. Relying on the Eleventh Circuit's 2014 decision in [CFTC v. Hunter Wise Commodities](#), the CFTC argued that "actual delivery" only occurs once there has been a transfer of possession of and control over the purchased commodities. In the CFTC's view, the purported delivery in the Atlas program was a "sham" because, under Monex's agreements with the independent depositories, customer positions could be liquidated at any time and in Monex's sole discretion, without notice to customers.

The court disagreed with the CFTC, however, observing that all of the CFTC's allegations related to Monex's business model of selling commodities on a leveraged basis. The court further noted that CEA Sections 4(a), 4(b), and 4b only apply to covered retail commodity transactions, which must be entered into or offered on a leveraged or margined basis or financed by the offeror. If this conduct alone negated "actual delivery," then every financed transaction would violate the Dodd-Frank Act. If the court were to adopt the CFTC's construction, Judge Selna opined, the result would be to eliminate the actual delivery exception from the CEA. Moreover, the CFTC's own final interpretation regarding the meaning of "actual delivery" as well as the legislative history of the Dodd-Frank amendments to the CEA supported this position.

Market manipulation claims. Turning next to the CFTC's market manipulation claims, the court first ruled that the actual delivery exception did not bar an enforcement action against Monex under CEA Section 6(c)(1). By its plain language, Section 6(c)(1)'s prohibition against manipulative or deceptive conduct applies broadly "to any swap, or a contract of sale of any commodity in interstate commerce." Nevertheless, the Commission's claims failed because read in its entirety, the CEA unambiguously forecloses the application of Section 6(c)(1) in the absence of actual or potential market manipulation. Moreover, the court observed, nowhere does the legislative

history of Dodd-Frank contemplate extending CFTC's authority under Section 6(c)(1) to allow it to combat fraud absent market manipulation. Accordingly, the court granted the defendants' motion to dismiss.

The case is [No. 17-01868 JVS](#).

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Companies: Monex Credit Co.; Monex Deposit Co.; Newport Services Corp.

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