Securities Regulation Daily Wrap Up, COMMODITY FUTURES—N.D. Ill.: Kraft to face class claims that it manipulated wheat futures, (Jun. 27, 2016)

Securities Regulation Daily Wrap Up

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By Kevin Kulling, J.D.

Kraft Foods Group and Mondelez Global LLC must defend allegations that the food company manipulated the price of cash wheat and wheat futures as part of a long wheat futures scheme, a federal court has determined. The court did, however, dismiss allegations that Kraft engaged in a wash trading scheme (*Ploss v. Kraft Foods Group, Inc*., June 27, 2016, Chang, E.).

Kraft wheat purchases. The action before the court was brought by Harry Ploss on behalf of a class of those who claim they lost money because of artificial prices caused by Kraft's allegedly unlawful wheat futures position.

Ploss alleged that Kraft Foods Group, currently Mondelez Global LLC, manipulated the market by maintaining a large position of wheat futures in an attempt to influence prices and not for any legitimate need for wheat. According to the allegations, Kraft buys most of its wheat from the local Toledo, Ohio, wheat market for use in its primary flour mill located there. In addition to buying wheat from the local Toledo cash market, Kraft is able to obtain wheat from the futures market on the Chicago Board of Trade (CBOT).

The complaint alleged that in the summer and fall of 2011, Kraft changed its wheat sourcing strategy when the cash price of No. 2 soft red winter wheat in the Toledo market rose. During that same time, the price of December 2011 wheat futures contracts increased.

Even though there was enough wheat in the Toledo market to satisfy Kraft's needs, senior management allegedly devised a strategy to use its status as a commercial hedger to acquire an enormous long position in December 2011 wheat futures contracts, purchasing $90 million worth of December 2011 contracts. The complaint alleged that the purpose of obtaining this long position was to induce sellers to believe that Kraft would in fact take delivery, and use that wheat in its mill in Toledo. Kraft caused the wheat price in the Toledo cash market to drop, because that cash market believed that there was a greater supply than demand, according to the complaint.

Allegations sufficient. The court concluded that Ploss successfully alleged a commodities manipulation claim by pleading that Kraft misled the market with its actions, even absent an affirmative misrepresentation.

Ploss alleged that Kraft's scheme worked because the price of wheat in the Toledo market dropped and Kraft was able to obtain wheat in the cash market at more favorable prices. Ploss alleged that the long position was not a bona fide futures trade because Kraft never intended to use futures market wheat to meet its commercial needs. Before its 2011 purchase, Kraft had not accepted delivery of CBOT wheat since 2002. Buying wheat on the futures market was inconvenient and uneconomical because Kraft could have incurred substantial transportation and storage costs, according to Ploss. In addition, the complaint said, futures market wheat was of a lower quality, so Kraft would have had to buy additional higher quality wheat for mixing so that the CBOT wheat would meet baking specifications. Finally, Ploss alleged that the lack of storage capacity for $90 million worth of wheat, a six-month supply, shows that Kraft did not have a real commercial need for that much wheat.

Because purchasing wheat from the CBOT market was practically and financially unsound, Ploss alleged that there was only one reason for taking a long position in December 2011 wheat contracts: to affect the market price of wheat in ways that would benefit Kraft.

Exchange for physical wash trading scheme. Unlike the manipulation claim, the court held that Ploss's wash trading allegations failed to adequately state a claim. From 2003 to 2014, Kraft allegedly made non-bona fide exchange for physical (EFP) transactions which involved trading physical commodities for an offsetting

futures contract. Under CME and CBOT rules, bona fide trades must occur between separate accounts under independent control. Parties to an EFP transaction must also document the trade and report it to the exchange.

Ploss alleged that Kraft made off-exchange transactions between two of its own accounts from 2003 to 2013. The complaint said that these transactions constituted illegitimate wash trades because Kraft was the counterparty to its own trades, and there was no physical exchange of wheat. By reporting these EFP transactions, Ploss alleged, Kraft duped the CBOT wheat market into believing that a bona fide ownership transfer of CBOT wheat futures had occurred.

But the court said that Ploss failed to allege how the EFP transactions impacted futures prices, how Kraft gained from the alleged manipulations, and how the plaintiffs were harmed. Regarding the submission of information to the CBOT, which Ploss alleged was false as part of the wash trades, the court said that a fraud claim required allegations of reliance, causation, and loss, which were missing from the complaint.

The case is No. 15-cv-2937.

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

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