UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

U.S. COMMODITY FUTURES TRADING COMMISSION,

Plaintiff,

v.

PARNON ENERGY INC., ARCADIA PETROLEUM LTD., ARCADIA ENERGY (SUISSE) SA, NICHOLAS J. WILDGOOSE and JAMES T. DYER,

Defendants.

Docket No.
11 Civ. 3543 (WHP)

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES

STATUTES

OTHER AUTHORITIES

Defendants Parnon Energy Inc., Arcadia Petroleum Ltd., Arcadia Energy (Suisse) SA, James Dyer and Nicholas J. Wildgoose (collectively, "Arcadia" or "Defendants") respectfully submit this Memorandum in Support of their Motion to Dismiss the Complaint filed by the Commodity Futures Trading Commission ("CFTC").

PRELIMINARY STATEMENT

Arcadia rejects the claims of the CFTC. Arcadia did not manipulate nor attempt to manipulate the price of any commodity in interstate commerce or the price of any futures contract. Nor did Arcadia manipulate or attempt to manipulate the value of any calendar spread. The allegations of the Complaint fail to demonstrate otherwise.

Even without addressing the infirmities of the CFTC's manipulation allegations, however, the Complaint should be dismissed because the CFTC does not have jurisdiction over the claims asserted. First, the Complaint's allegations that Arcadia manipulated or attempted to manipulate four West Texas Intermediate crude oil ("WTI") calendar spreads during January, March and April 2008 fall outside the plain language of Sections 6(c), 6(d) and 9(a)(2) of the Commodity Exchange Act (the "CEA"), which makes clear that the CFTC's jurisdiction extends only to the manipulation or attempted manipulation of the market price of a commodity in interstate commerce or a futures contract. Congress has never given the CFTC authority to pursue manipulation or attempted manipulation of a calendar spread, which is the differential between market prices for a commodity in two different time periods.

Second, the WTI cash market activities that are the linchpin of the CFTC's Complaint are exempt from the CEA and the Commission's jurisdiction pursuant to CEA Section 2(g). The CFTC's attempt to plead around this fact, relying on unsupported and inadequate conclusions, does not meet the requirements of Rules 9(b) or 8. Because the CFTC does not have jurisdiction over either the means of the alleged manipulation – Arcadia's cash market contracts for physical WTI – or its purported end result –

manipulation of spreads – the Complaint fails to state a claim upon which relief may be granted and should be dismissed in its entirety, with prejudice, pursuant to Rule 12(b)(6).

Likewise, the CFTC's selective, conclusory and incomplete factual allegations relating to Arcadia's alleged manipulation and attempted manipulation fail to meet federal pleading requirements. Only by omitting key facts and taking Arcadia's actions out of context can the CFTC even construct its misleading story of manipulation. The Complaint's patchwork of conclusions fails to provide Defendants with the specificity required by Rule 9(b) or even the minimal notice required by Rule 8. For this additional reason the Complaint fails to state a claim and should be dismissed.

SUMMARY OF ALLEGATIONS

The Complaint alleges that in January and March 2008 Arcadia entered into cash market contracts to purchase physical WTI crude oil, held those long physical positions past expiration of the New York Mercantile Exchange ("NYMEX") WTI futures contract and then sold those positions toward the end of the cash window. (Complaint, ¶ 3, 25.) The physical crude oil contracts were priced on a Calendar Month Average ("CMA")[1] basis using the average of the settlement prices of the prompt futures contract on NYMEX for each trading day of the delivery month. (*Id.*, ¶ 19) The Complaint alleges that while building these long physical positions Arcadia also purchased long WTI calendar spread positions in the prompt spreads (February/March in January and April/May in March) and sold calendar spread positions in the second spread (March/April in January and May/June in March).[2] (*Id.*, ¶¶ 32, 35, 44.) Arcadia's alleged intent was to drive up the prompt spread prior to NYMEX expiration (which typically occurs on the third business day preceding the twenty-fifth day of the month) and drive down the second spread during the

---

1 In its Complaint the CFTC uses the term "Calendar Merc Average." (Complaint, ¶ 19.) The more appropriate name for the type of contracts Arcadia entered into is "Calendar Month Average."

2 For futures, the second spread becomes the "prompt" spread on the day following the expiration of the prompt futures contract – *e.g.*, the March/April futures spread became the prompt spread on January 23, the day after expiration of the February contract on NYMEX and notwithstanding that the February/March cash spread continued to trade.

cash window. (*Id*., ¶¶ 30, 34, 42.) The Complaint further alleges that Arcadia attempted to manipulate spread values in April 2008. (*Id*., ¶¶ 49-50.)

ARGUMENT

The Complaint should be dismissed pursuant to Rule 12(b)(6) because it does not and cannot allege manipulation or attempted manipulation in violation of the CEA. In deciding a motion to dismiss under Rule 12(b)(6) a district court must accept all facts alleged in the complaint as true and construe all reasonable inferences in the plaintiff's favor. *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 196 (2d Cir. 2009). A court is not required to accept as true legal conclusions or threadbare recitals of the elements of a cause of action supported only by conclusory statements. *Harris v. Mills*, 572 F.3d 66, 72 (2d Cir. 2009). Rather, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. ---, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570, 127 S. Ct. 1955 (2007)).

To survive a motion to dismiss "[f]actual allegations must be enough to raise a right to relief above the speculative level." *Twombly*, 550 U.S. at 555. "A pleading that offers 'labels and conclusions' or 'a formulaic recitation of the elements of a cause of action will not do.' Nor does a complaint suffice if it tenders 'naked assertion[s]' devoid of 'further factual enhancement.'" *Iqbal*, 129 S. Ct. at 1949 (quoting *Twombly*, 550 U.S. at 555). A complaint's allegations must not only be consistent with, but also tend to establish the plaintiff's claim: "Where a complaint pleads facts that are 'merely consistent with' a defendant's liability, it 'stops short of the line between possibility and plausibility of "entitlement to relief."'" *Id.* (quoting *Twombly*, 550 U.S. at 557).

Generally, the Court may not consider extrinsic evidence in deciding a Rule 12(b)(6) motion to dismiss. Here, in order to provide context for the CFTC's allegations relating to Arcadia's trading, Arcadia requests the Court to take judicial notice of the information contained in Exhibit A to the Declaration of

Timothy J. Carey ("Exhibit A"), a chart reflecting published WTI settlement prices and spread values calculated from those prices, as well as open interest and trading volumes on NYMEX during the relevant periods. *See Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 166 n.8 (2nd Cir. 2000) ("[T]he district court may take judicial notice of well-publicized stock prices without converting the motion to dismiss into a motion for summary judgment."); *In re Smith Barney Transfer Agent Litigation*, 765 F. Supp. 2d 391, 396-97 (S.D.N.Y. 2011) ("A court may consider 'any written instrument attached to the complaint, statements or documents incorporated into the complaint by reference, legally required public disclosure documents filed with the SEC, and documents possessed by or known to the plaintiff and upon which it relied in bringing the suit.'" (quoting *ATSI Communications, Inc. v. Shaar Fund Ltd.*, 493 F.3d 87, 98 (2d Cir. 2007)); *In re SLM Corp. ERISA Litigation*, 2010 WL 3910566, at *9 (S.D.N.Y. 2010) (taking judicial notice of how share prices of other publicly-traded student loan providers compared to Sallie Mae's).

In this Circuit, claims for manipulation and attempted manipulation are subject to the heightened pleading standard of Rule 9(b). As the Second Circuit explained in *ATSI Communications,* a securities manipulation case, "Because a claim for market manipulation is a claim for fraud, it must be pled with particularity under Rule 9(b)." 493 F.3d at 101. *See also Rombach v. Chang*, 355 F.3d 164, 342 (2d Cir. 2004) (even though securities claims under § 11 do not require proof of fraud to establish liability, compliance with Rule 9(b)'s heightened pleading was required "insofar as the claims are premised on allegations of fraud").

Rule 9(b) has been applied to manipulation claims in the commodity context by other courts in this district. *See In re Amaranth Natural Gas Commodities Litigation*, 587 F. Supp. 2d 513, 535 (S.D.N.Y. 2008) (following *ATSI*, reasoning, "[T]here is no principled reason to distinguish between commodities manipulation and securities manipulation in selecting the applicable pleading standard ... [M]arket manipulation is inherently deceptive"); *In re Natural Gas*, 358 F. Supp. 2d 336, 343 (S.D.N.Y. 2005) (requiring compliance with Rule 9(b) where complaint alleged a commodity price manipulation scheme that was "'classically associated with fraud': the dissemination of 'inaccurate, misleading, and false trading information,' and participation in 'a variety of fraudulent trade reporting strategies'"); *In re Crude Oil Commodity Litigation*, 2007 WL 1946553, at *5 (S.D.N.Y. 2007) (requiring compliance with Rule 9(b) where complaint alleged concealment of availability of crude oil supplies, making of false and misleading statements and 'bidding up' or 'trashing' spot market prices).[3] The Complaint here alleges, *inter alia*, that Arcadia "wanted to lull market participants into believing that supply would remain tight" (Complaint, ¶ 30) – clearly implying fraud. The CFTC's allegations therefore should be held to the Rule 9(b) standard.

Even if Rule 9(b) is not applied the Complaint fails to meet the less onerous pleading standards of Rule 8. Rule 8 provides that a complaint "shall contain ... a short and plain statement of the claim showing that the pleader is entitled to relief." Rule 8 is designed to ensure that a complaint provides a defendant with sufficient notice of the claims against him. *See Blakely v. Wells*, 209 Fed. Appx. 18, 20, 2006 WL 3770840 (2d Cir. 2006). A complaint that fails to give the defendant adequate notice, and thus does not allow the defendant to frame an intelligent defense, is subject to dismissal. *See Sheehy v. Brown*, 335 Fed. Appx. 102, 2009 WL 1762856, at *1 (2d Cir. 2009). As discussed more fully below, the Complaint does not meet the Rule 8 standard.

The CFTC's Complaint cannot survive application of Rules 9(b) and/or 8 in light of the standards articulated by the Supreme Court in *Twombly* and *Iqbal*.

I. THE COMPLAINT FAILS TO STATE ANY CLAIM AGAINST ARCADIA BECAUSE THE ACTIVITY DESCRIBED, EVEN IF TRUE, DOES NOT CONSTITUTE A VIOLATION OF THE CEA

Pursuant to Section 6c of the CEA the CFTC may only seek relief against a defendant in a district court of the United States when the defendant "has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of [the CEA] or any rule regulation, or order thereunder

---

[3] *Compare CFTC v. Amaranth Advisors*, L.L.C., 554 F. Supp. 2d 523, 535 (S.D.N.Y. 2008) (Rule 9(b) was not implicated by manipulation allegations based on "marking the close").

...." 7 U.S.C. § 13a-1(a);[4] *see also* Complaint, ¶ 6. In order to state a claim, therefore, the Complaint must allege a violation of the CEA. A CFTC complaint that does not allege a violation of the CEA should be dismissed. *See U.S. v. Radley*, 632 F.3d 177 (5th Cir. 2011) (affirming dismissal of indictment because conduct at issue fell within statutory exclusion from CEA); *CFTC v. White Pine Trust Corp.*, 574 F.3d 1219 (9th Cir. 2009) (holding that CFTC lacked jurisdiction to bring action under the CEA relating to discretionary commodities trading accounts in foreign currency options); *CFTC v. Zelener*, 373 F.3d 861 (7th Cir. 2004) (holding that speculative transactions in foreign currency were excluded spot sales rather than regulated futures contracts); *Dunn v. CFTC*, 519 U.S. 465, 117 S. Ct. 913 (1997) (reversing appellate court decision to allow CFTC action based on transactions that fell within a statutory exemption from the CEA).

As in *Radley*, *White Pine Trust*, *Zelener*, and *Dunn*, the CFTC here seeks to extend its jurisdiction beyond the scope granted by Congress. Also as in each of those cases, the plain language of the statute makes clear that the CFTC's attempt cannot succeed. The allegations in the Complaint, even if true, do not describe a violation of the CEA; therefore, the CFTC has no jurisdiction to proceed and the Complaint should be dismissed with prejudice.

A. According to the Plain Language of CEA Sections 6(c), 6(d) and 9(a)(2) the CFTC Does Not Have Jurisdiction to Bring a Complaint for Manipulation or Attempted Manipulation of Calendar Spreads

The Complaint alleges that Arcadia violated Sections 6(c), 6(d) and 9(a)(2) of the CEA, 7 U.S.C. §§ 9, 13b, and 13(a)(2), by manipulating or attempting to manipulate "the price spreads of the NYMEX WTI ... February/March 2008 Calendar Spreads ... March/April 2008 Calendar Spreads ... April/May 2008 Calendar Spreads [and] ... May/June 2008 Calendar Spreads." (Complaint, ¶¶ 55, 60.) The fatal problem with the CFTC's allegations is that Congress has never given the CFTC authority to bring an action for the

[4] All sections of the CEA quoted or cited in this brief are from the version of the statute in effect during the time period at issue, January through April 2008.

alleged manipulation of a spread – neither in CEA Sections 6(c), 6(d) or 9(a)(2), nor elsewhere in the statute. Section 6(c) provides, in pertinent part:

> If the Commission has reason to believe that any person (other than a registered entity) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the *market price of any commodity*, in interstate commerce, or for future delivery on or subject to the rules of any registered entity ... it may serve upon such person a complaint stating its charges in that respect ...

7 U.S.C. § 9 (emphasis added). Likewise, the relevant provision of Section 6(d) provides:

> If any person (other than a registered entity) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the *market price of any commodity*, in interstate commerce, or for future delivery on or subject to the rules of any registered entity… the Commission may upon notice and hearing, ... make and enter an order directing that person shall cease and desist therefrom ...

7 U.S.C. § 13b (emphasis added). Section 9(a)(2), in similar operative wording, provides:

> It shall be a felony ... for ... [a]ny person to manipulate or attempt to manipulate the *price of any commodity* in interstate commerce, or for future delivery on or subject to the rules of any registered entity ...

7 U.S.C. § 13(a)(2) (emphasis added).

Sections 6(c), 6(d) and 9(a)(2) are unambiguous. They make it unlawful to manipulate or attempt to manipulate the "market price of any commodity," whether in interstate commerce or in a futures contract. In order to violate any of these sections, therefore, the alleged conduct must be directed at the price of a commodity. *See, e.g., In re Hohenberg Bros. Co.*, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,146 (CFTC Mar. 2, 1976) (alleged manipulative conduct directed at the price of December 1971 cotton futures contract); *In re Indiana Farm Bureau Coop. Ass'n*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796 (CFTC Dec. 17, 1982) (alleged manipulative conduct directed at the price of the July 1973 corn futures contract); *In the Matter of Abrams*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,237 (CFTC Sept. 15, 1994) (alleged manipulative conduct directed at the price of the September 1984 orange juice futures contract).

The Supreme Court has explained that in a statute "Congress says ... what it means and means ... what it says." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6, 120 S. Ct. 1942 (2000) (internal quotation marks omitted) (where statutory language is plain, the sole function of the courts is to enforce the statute according it its terms); s*ee also Dunn*, 519 U.S. at 470 (the CFTC's interpretation of statutory language violated the ordinary meaning of a key word in the Treasury Amendment); *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 173, 114 S. Ct. 1439 (1994) (plaintiff could not bring action under the Securities and Exchange Act for acts not prohibited by the text of the statute).

If the language of the statute is clear, the analysis begins and ends with that language. *Harris Trust & Savings Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 254, 120 S. Ct. 2180 (2000); s*ee also Barnhart v. Sigmon Coal Company*, 534 U.S. 438, 449-51 (2002) (affirming appellate court decision that statutory language was clear and unambiguous and court was bound to read language exactly as written; court could not simply ignore unambiguous language because it could "imagine a preferable version").

A spread is not a commodity. As defined in Section 1a(4) of the CEA a "commodity" includes (a) goods and articles; as well as (b) services, rights and interests that are the subject of a futures contract. 7 U.S.C. ¶ 1a(4). A "spread" or "calendar spread" as alleged in the Complaint is not a good or article; nor is it a service, right or interest that is the subject of a futures contract. Rather, a spread is the differential between the prices of two commodities or the prices of the same commodity in different time periods. It is not the actual price of either of those contracts. (*See* Complaint, ¶ 20.)

Nor is a spread the market price of any commodity. A spread is executed by "trading the differential" – "providing a bid or offer on the size of the differential" – not by providing bids or offers on the individual commodities that make up the spread. CFTC, July 24, 1978 (42 F.R. 32092), Comm. Fut. Archive (CCH) ¶ 20,643. The objective of spread trading is to profit on the change in price differential between the two legs of the spread. Dobson and Reimer, Understanding Spreads at 14-15 (http://www.scribd.com/doc/18187273/Understanding-Spreads) Traders Press, 2007 (last visited 9/29/11).

A spread trader looks at the relationship or differential between two futures contracts – not at the price of the individual contracts. Diane Krueger, Spread Trading 101, Futures, Vol. 29, Issue 11, 2000 WLNR 6898679 *1 (10/1/00). Thus, the outright price of the commodity is irrelevant to a spread trader.

The reason the "market price of a commodity" is the subject of a proper action under Sections 6(c), 6(d) and 9(a)(2) but a spread value is not can be illustrated by a simple example: on January 16, 2008, the first day in January on which the CFTC alleges NYMEX WTI spread values were artificial as a result of Arcadia's actions, the February/March spread settled at $.48. (Complaint, ¶ 32.) As demonstrated by Exhibit A, this spread value reflected an *increase* of $.31 from the previous day. By contrast, the market prices of WTI futures contracts for February and March delivery settled at $90.85 and $90.37, respectively. These prices were *decreases* of $1.06 and $1.37, respectively, from the previous day. The movement of the spread value bore no relationship to the movement of the outright prices of the commodity, other than the fact that the spread was the difference between the February and March futures prices. Indeed, as Exhibit A demonstrates, despite *downward* movements of almost $10.00 in the outright prices of the February and March WTI futures contracts from January 2 through 22, 2008, the net spread value *increased* by just $.35 over the same period.

Market values in March reflect a similar disparity with respect to spread values versus outright prices of the commodities. For example, Exhibit A shows that from March 14 to March 19, 2008 (the period during which the Complaint alleges manipulation), the market prices of WTI futures for delivery in April and May *fell* more than $5.00 each. In the same time period the April/May spread *increased* just $.47 (even if one accepts the CFTC's allegation that April/May spread traded at $1.94 on March 19[5]). Again, the

[5] For purposes of this motion only Arcadia treats the allegation of a $1.94 spread value as true. As the CFTC is aware, this number does not reflect the value of any spread transaction actually executed on that day.

movement of the spread value is opposite to, and far smaller than, the movement of the market price of the commodity.

The Court should not permit the CFTC to utilize this action to extend its jurisdiction beyond what Congress intended. Other courts faced with similar efforts by the CFTC have applied the plain meaning of the statutory language and limited the CFTC to the jurisdiction expressly granted by Congress. For example, in *White Pine Trust*, *supra*, the CFTC attempted to exert jurisdiction over off-exchange trading through discretionary trading accounts in foreign currency options. 574 F.3d at 1223. Rejecting the CFTC's claim that the CEA granted it jurisdiction over such accounts, the court concluded, "[T]he CFTC has not been able to point to any language in the Act that bears such interpretation. Therefore, we must conclude that it does not have power to bring this action." *Id.* at 1227.

In *Zelener*, *supra*, the CFTC attempted to assert jurisdiction over certain spot sale transactions not covered by the CEA. The CFTC argued that in practice the transactions appeared to be contracts for future delivery. 373 F.3d at 863-64. The Seventh Circuit focused on the language of the statute as well as the form of the contracts at issue in finding that no violation of the CEA had occurred:

> The Commission's principal substantive contention is that BCG deceived its clients. That could form the basis of a mail-fraud or wire-fraud prosecution, a civil or criminal action under RICO, or fraud litigation in state court .... It is unnecessary to classify the transactions as futures contracts in order to provide remedies for deceit. Why stretch the Commodity Futures Act – with resulting uncertainty, litigation costs, and potentially unhappy consequences for other economic arrangements that may be swept into a regulatory system not designed for them – when other remedies are ready to hand?

Id. at 867.

In *Dunn*, *supra*, even though the CEA's Treasury Amendment specifically exempted transactions in foreign currency, the CFTC argued that transactions in options to buy or sell foreign currency were not covered by the exemption. 519 U.S. at 469-470. The Supreme Court disagreed: "Absent any 'indication that doing so would frustrate Congress's clear intention or yield patent absurdity, our obligation is to apply the statute as Congress wrote it.'" 519 U.S. at 470 (citation omitted). *Cf. Vitanza v. Board of Trade of City of New York*, 2002 WL 424699, at *5 (S.D.N.Y. 2002) (dismissing claim alleging manipulation of settlement prices because the settlement price was "not the value of the contract itself or the value of the commodity underlying the contract.").

The clear, unambiguous language of Sections 6(c), 6(d) and 9(a)(2) prohibits the manipulation or attempted manipulation of the market price of a commodity in interstate commerce or of a futures contract. The CFTC alleges only that Arcadia manipulated and attempted to manipulate calendar spreads. (Complaint, ¶¶ 57, 62.) Accordingly, the Complaint does not allege a violation of the CEA and should be dismissed. Further, since no pleading amendment the CFTC could offer would bring alleged manipulation of spread values within its authority, the Complaint should be dismissed with prejudice.

B. Section 2(g) Excludes Arcadia's Alleged Conduct from Application of the CEA, Including Sections 6(c), 6(d) and 9(a)(2)

The CFTC does not have jurisdiction over the cash market activity alleged in the Complaint because it is excluded from the CEA under Section 2(g). While Section 2 of the CEA generally grants the CFTC jurisdiction over "accounts, agreements … and transactions involving contracts of sale of a commodity for future delivery, traded or executed" on exchanges regulated by the CFTC, 7 U.S.C. § 2(a)(1)(A), that jurisdiction is limited by a number of express exclusions and exemptions. In 2000, as part of the Commodity Futures Modernization Act, Congress enacted Section 2(g), which provides:

> No provision of this Act (other than section 5a (to the extent provided in section 5a(g)), 5b, 5d or 12(e)(2)) shall apply to or govern any agreement, contract, or transaction in a commodity other than an agricultural commodity if the agreement, contract, or transaction is –
>
> > (1) entered into only between persons that are eligible contract participants at the time they enter into the agreement, contract, or transaction;
> >
> > (2) subject to individual negotiation by the parties; and
> >
> > (3) not executed or traded on a trading facility.

7 U.S.C. § 2(g). As demonstrated below, this language excludes from application of the CEA (including application of Sections 6(c), 6(d) and 9(a)(2) at issue here), all of the CMA contracts on which the CFTC's allegations of manipulation and attempted manipulation are founded.

Significantly, Congress did not reserve authority under the CEA to prohibit manipulation related to any of the agreements, contracts or transactions excluded by Section 2(g). This stands in stark contrast to Section 2(h), in which Congress exempted certain transactions from the CEA but expressly reserved application of the anti-manipulation provisions. Section 2(h) provides, in pertinent part:

> (2) An agreement, contract, or transaction described in paragraph (1) of this subsection shall be subject to –
>
> * * *
>
> (C) sections 6(c), 6(d), 6c, 6d, 8a, and 9(a)(2), to the extent such sections prohibit manipulation of the market price of any commodity in interstate commerce and the agreement, contract, or transaction would otherwise be subject to such sections.

7 U.S.C. § 2(h).[6] Congress clearly understood how to retain the CEA's prohibition on (and the CFTC's jurisdiction to prosecute) manipulation of commodity prices via a contract, agreement or transaction exempted under Section 2(h). Its decision *not* to include language retaining such jurisdiction in Section 2(g) leaves no room for debate: Sections 6(c), 6(d) and 9(a)(2) do not apply to contracts, agreements or transactions excluded under Section 2(g).

It is a court's duty to "apply the statute as Congress wrote it." *Dunn*, 519 U.S. at 470 (1997) (quoting *Hubbard v. United States*, 514 U.S. 695, 703 (1995)). In *Dunn* the Court held that the plain meaning of an explicit exemption of certain commodity transactions from the reach of the CEA precluded a

[6] The CFTC's claims of attempted manipulation are also foreclosed by Section 2(h), since Congress opted only to preserve the CFTC's jurisdiction under Sections 6(c), 6(d), and 9(a)(2) to the extent those sections prohibit "manipulation" – *not* attempted manipulation – of the market price of any commodity in interstate commerce.

CFTC enforcement action for violation of its anti-fraud provisions in connection with such transactions. *Id.* at 467, 470.

As alleged in the Complaint the physical crude oil purchases and sales through which Arcadia allegedly conducted its manipulative scheme were all OTC transactions priced on a CMA basis. (Complaint, ¶ 19.) The Complaint alleges that Arcadia manipulated WTI spread values by contracting to purchase physical WTI via CMAs, holding the long physical WTI position those CMAs represented past NYMEX expiration and then selling off the physical WTI position during the cash window. (Complaint, ¶¶ 19, 28-29, 37, 43, 46.) These purchases and sales of CMAs are the only actions alleged in the Complaint to have been wrongful or manipulative in any way.

These contracts, however, fall squarely within the exclusions of Section 2(g). First, they are contracts, agreements or transactions for a non-agricultural commodity, *i.e.*, WTI crude oil.[7] Nothing in the Complaint alleges otherwise. Second, they were entered into between Arcadia and eligible contract participants.[8] Third, they were individually negotiated and were not executed on a trading facility (despite the CFTC's erroneous allegations discussed in footnote 9). Pursuant to the clear, unambiguous language of Section 2(g), therefore, each of those transactions is exempt from application of the CEA and from the CFTC's regulatory authority. *See U.S. v. Radley*, 659 F. Supp. 2d 803 (S.D. Tex. 2009), *aff'd* 632 F.3d 177 (5th Cir. 2011).

In *Radley*, the government attempted to write the 2(g) exclusion out of the CEA in connection with an indictment for, *inter alia*, manipulation of February 2004 TET propane prices in violation of Section 9(a)(2). Similar to the allegations here, the government in *Radley* alleged that the defendants acquired a

---

[7] WTI crude oil is not an agricultural commodity.

[8] "'Eligible contract participants' under the Commodity Exchange Act are the equivalent of 'accredited investors' in securities markets: wealthy persons who can look out for themselves directly or by hiring experts." *Zelener*, 373 F.3d at 862 (citing 7 U.S.C. § 1a(12); 15 U.S.C. § 77b(a)(15)). Arcadia and its CMA counterparties were all "eligible contract participants" – indeed, the Complaint does not allege otherwise.

dominant long position in 2004 physical TET propane, withheld a portion of their long position from sale in order to artificially inflate the price, placed "stacked bids" and high bids on the Chalkboard trading platform and attempted to conceal their manipulation by misrepresenting to other traders their own company's demand for propane. *Id.* at 807-808. On the defendants' motion to dismiss the indictment based in part on CEA Section 2(g), the district court held that the TET propane transactions described in the indictment met the requirements of Section 2(g) and thus were not covered by the CEA and could not support an indictment. *Id.* at 810-812.

Apparently recognizing that Section 2(g) bars its claims in this case, the CFTC seeks to plead around that provision by suggesting that CMAs are not individually negotiated because only the price and quantity are negotiable. (Complaint ¶ 19.) Nowhere in the Complaint, however, does the CFTC allege with whom Arcadia entered into CMA contracts or how Arcadia reached agreement on those contracts – *i.e.*, whether Arcadia and its counterparties negotiated any or all of the individual terms or what proportion of its CMA contracts were not individually negotiated. In short, the Complaint nowhere alleges that Arcadia's CMA transactions followed the process for purchases and sales of CMAs alleged in the Complaint. (Complaint, ¶ 19.) The Complaint thus fails to meet the pleading requirements of Rule 9(b).

Further, even assuming only the price and volume terms of Arcadia's CMAs were actually negotiated, application of Section 2(g) is not precluded. As the district court explained in *Radley,* even contracts with some standardized or predetermined terms will be considered subject to negotiation:

> [A] contract can be subject to negotiation, even if some of the terms are predetermined.... Most contracts for delivery of a commodity will have some of the terms predetermined. Once a party has decided which commodity it would like to purchase, the quality specifications for that particular quantity as well as the place for delivery will often already be set. The fact that those terms are the same in any contract for a given commodity cannot make a contract ineligible for the protection of Section 2(g). If it did, the exception would be so narrow that it would not bring the desired certainty to the market.

659 F. Supp. 2d at 811.

The CFTC also seeks to avoid dismissal under Section 2(g) by alleging that Arcadia executed CMAs on HoustonStreet, an electronic trading facility. (Complaint ¶ 19.) In support of this proposition the CFTC alleges that "CMA contracts are traded: (1) on the HoustonStreet electronic trading facility ... (2) through brokers and (3) directly between counterparties. The Defendants' purchases and sales of WTI physical oil ... were conducted in CMA transactions through all these methods." These allegations are insufficient to defeat the application of Section 2(g). First, nowhere in the Complaint does the CFTC identify any specific CMA contract that was executed on HoustonStreet or any other trading facility.[9] Section 2(g) is specific: it exempts agreements, contracts or transactions from the CEA. Any CMA contract that was not executed on a trading facility and otherwise meets the requirements of Section 2(g) is exempt from CFTC jurisdiction regardless of whether other CMA contracts are not exempt. Second, the Complaint does not allege with specificity when Arcadia supposedly executed CMA contracts on HoustonStreet. Even if Arcadia did so in February, May or other months in 2008, Section 2(g) would nevertheless apply to transactions in January, March and April. In short, the Complaint fails to allege facts sufficient to meet the requirements of Rules 9(b) and 8.

Because the CMA contracts underpinning the CFTC's Complaint are exempt from the jurisdiction of the CFTC under Section 2(g), the CFTC has no authority to bring this case and the Complaint should be dismissed with prejudice.

[9] In fact, the allegation that Arcadia bought CMAs on HoustonStreet during the relevant period is simply false. At no time relevant to the Complaint did Arcadia execute any CMA contract for WTI on HoustonStreet. The CFTC knows this, or in the exercise of reasonable diligence should know this, from information and documents produced during the three year investigation preceding the filing of the Complaint. *See Smith Barney Transfer Agent Litigation*, 765 F. Supp. 2d at 396-97. The CFTC's misstatement of this fact in the Complaint is inexplicable.

II. THE COMPLAINT FAILS TO ALLEGE SUFFICIENT FACTS TO STATE A CLAIM AGAINST ARCADIA FOR MANIPULATION

The Complaint should be dismissed for the further reason that it fails to allege with sufficient specificity the elements of a claim for manipulation. In order to state a claim for manipulation the CFTC must plead sufficient facts to show that (1) the defendant possessed the ability to influence market prices; (2) an artificial price existed; (3) the defendant caused the artificial price; and (4) the defendant specifically intended to cause the artificial price. *In re Cox,* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786 at 34,061 (CFTC July 15, 1987). Where, as here, a plaintiff alleges manipulation through a squeeze, the plaintiff must offer sufficient factual allegations that the defendant held a controlling dominant long position in the market in order to show the requisite ability to direct the market price.[10] *Frey v. CFTC*, 931 F.2d 1171, 1175 (7th Cir. 1991).

A. The Complaint Fails Adequately to Allege that Arcadia Had the Ability to Influence Market Prices Via a Dominant Position

The Complaint seeks to meet the first element of a claim for manipulation via squeeze by alleging that Arcadia's contracts for physical WTI, allegedly representing 50% or more of the total supply/demand balance that Arcadia estimated would exist at Cushing at a point in the future, gave it a "dominant physical position." (Complaint, ¶¶ 34, 43.) Conspicuously, the Complaint nowhere alleges the actual supply and demand amounts for WTI to be delivered at Cushing in February, April or any other month. Nor does it allege that Arcadia actually knew those amounts at any time (much less more than a month before those respective balances existed at Cushing) or that Arcadia's alleged estimates of what the February and April balances would be were even accurate. In other words, the Complaint offers no factual basis for the Complaint's conclusion that Arcadia "held a dominant position." (Complaint, ¶¶ 28, 43.)

---

[10] The Complaint includes conclusory allegations that suggest that the CFTC is alleging a manipulation by providing misinformation to the market. As discussed *infra*, these allegations are also insufficient to state a claim.

Dominance of the cash market is a function of the deliverable supply of a commodity. *In re Cox,* [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,767, at 27,075 (CFTC Jan. 3, 1983). The deliverable supply of a commodity is that which is readily available for delivery at a specified time, either because it is locally stored or because it is within a deliverable distance from the market. *See Cargill Inc. v. Hardin*, 452 F.2d 1154, 1165 (8th Cir. 1971); *see also* CFTC Glossary ("Deliverable supply" is "[t]he total supply of a commodity that meets the delivery specifications of a futures contract").[11] Here the specified time period is the whole of the delivery month. *See Cox,* ¶ 23,786, at 34,062. For example, a February contract requires delivery of an agreed amount more or less ratably over twenty-eight days.

Dominance is a crucial factor in the manipulation analysis because manipulation is possible only when the delivery option, and therefore deliverable supply, disappears. *Indiana Farm Bureau,* ¶ 21,796, at 27,285 ("[T]he adequacy of 'deliverable supply,' as distinguished from supply generally, and the role of market participants in the supply scenario is of great significance in any analysis" (footnote omitted)). *See also Apex Oil Co. v. DiMauro*, 713 F. Supp. 587, 601 (S.D.N.Y. 1989) ("[W]here a long squeeze is alleged, it must be pleaded and proved 'that the respondent accumulated a position in the futures market that exceeded the available deliverable supply.'" (quoting T. Russo, Regulation of the Commodities Futures and Options Markets, Sec. 12.11 at 12-22 (1983)).

Contrary to the requirements of *Cargill* and the CFTC's own precedents, the Complaint here fails to allege any factual basis for its conclusion that Arcadia held dominant cash market positions in January and March 2008. Rather, it seeks to limit the deliverable supply to the amount that Arcadia estimated would be locally stored (*i.e.* the end of month Cushing balance/surplus). The Complaint thus ignores all amounts that were within a deliverable distance from Cushing and all alternative grades of crude oil that were deliverable

---

[11] http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/glossary_d.html (last visited 9/29/11).

against the NYMEX contract. On this basis alone, the Complaint does not allege facts sufficient to establish whether Arcadia held a dominant position.

Further, the basic calculation of deliverable supply is a market tool that is unrelated to a trader's intent. *Cox*, ¶ 23,786 at 34,062. It is an objective calculation and not the mere estimates, assumptions or inferences of a trader about other persons' commitments. *Id.* Under the CFTC's theory Arcadia held a dominant physical position in January 2008 because it allegedly estimated that the supply/demand balance at Cushing (*i.e.*, the surplus supply) at the end of February 2008 would be 7 million barrels and it held a 4.6 million barrel cash position. The Complaint thus incorrectly alleges that "dominance" is a measure of individual expectations and not objective market fact. Arcadia's alleged estimates of just one part of the deliverable supply calculus – the supply/demand balance at Cushing, weeks in advance of when the actual balance was even capable of being known – are not facts at all, and in any given month may or may not have been accurate. Indeed, the Complaint does not allege the amount of supply that was either held in storage in, or available for delivery at, Cushing in either February or April, the months for which Arcadia allegedly squeezed WTI.

The Complaint's allegations of market dominance are wholly inadequate for the additional reason that they are limited to the cash market only. The CFTC has made clear that dominance sufficient to allow a party to influence market prices requires dominant positions in *both the cash and futures markets*:

> Squeezes in general and manipulative squeezes in particular are possible only when the delivery option disappears and its tempering effect is lost….
>
> The acquisition of market dominance is the hallmark of a long manipulative squeeze. For without the ability to force shorts to deal with him either in the cash or futures market, the manipulator is not able to successfully dictate prices because a short may buy grain from other sources and deliver against his commitments. Where a trader builds up a cornering or near cornering interest in the cash market and a large long interest in the futures market, he has 'laid the base for a squeeze,' and subsequent trading activity must be scrutinized carefully.

Indiana Farm Bureau, ¶ 21,796 at 27,285 (citations and footnote omitted). *See also Cox,* ¶ 21,767 at 27,075 (dominance exists when "during the delivery period, and most particularly as the last day of trading in a futures contract approaches or arrives, the position is a majority of the total long open interest [of futures], and is also larger than the supply of ... [a] commodity available to deliver against that position" (quoting testimony by John Mielke, then CFTC Director of Office of Market Surveillance)); Philip McBride Johnson and Thomas Lee Hazen, Derivatives Regulation §§ 5.03(1) (3d ed. 2004) ("[A] successful manipulation of the futures market requires control of both means of contract satisfaction: (1) delivery of the cash commodity, and (2) offset of positions in the futures markets." (footnotes omitted)).

As the district court in *Apex Oil*, recognized:

> There is a compelling reason to require that market dominance be established before a long can be held liable for a squeeze. It is well understood that many, if not most, market squeezes occur naturally and without unlawful activity. *See Indiana Farm Bureau*, ¶ 21,796 at 27,284 ("Some--or, in fact, most--squeezes are inevitable on both the physical and the exchange markets and are not the result of illegal manipulation") (citation omitted). … Where the squeeze is caused by market forces unrelated to long activity, the market dominance requirement will quite properly insulate the long from liability as it is not prevented from acting in its own self-interest to obtain the highest price.

713 F. Supp. at 602. Here the Complaint does not even attempt to allege facts showing that Arcadia maintained a dominant futures position or a dominant combined futures/cash position.

Finally, the allegations of the Complaint themselves undercut the theory that Arcadia had the ability to influence or dictate the price of WTI. As the Commission observed in *Cox*: "The accused lacks the ability to influence prices if other market participants can bypass his demands and extinguish their obligations elsewhere." *Cox,* ¶ 23,786 at 34,061. The Complaint alleges that in both January and March 2008 Arcadia sold its physical position at lower prices (*i.e.*, at a loss). (Complaint, ¶¶ 39, 47, 52.) If Arcadia could only sell at lower prices, including at levels that moved the spread from backwardation to contango, it is apparent that it did not have "the ability to force shorts to deal with [it] either in the cash or futures market," and hence did not have a dominant position. *See Indiana Farm Bureau*, ¶ 21,796 at 27,285. Because the

Complaint fails to allege facts sufficient to support the first element of manipulation, it should be dismissed pursuant to Rule 12(b)(6).

B. The Complaint's Allegations Regarding Artificial Commodity Prices are Conclusory and Implausible

The Complaint does not allege a single artificial *commodity price*, only allegedly artificial spread values. Spread values are not commodity prices. *See* discussion *supra* at 8-9. The Complaint fails to state a claim for manipulation for this reason alone.[12]

Further, even if allegations of artificial spread values were sufficient, all such allegations in the Complaint are conclusory and insufficient to meet the pleading requirements of either Rule 9(b) or Rule 8. The Complaint asserts that February/March WTI spread values were artificially high on January 16 ($.48), 17 ($.56), 18 ($.65) and 22 ($.64); and that March/April WTI spread values were artificially high on January 23 ($.37) and 24 ($.42). (Complaint, ¶¶ 32, 35.) The Complaint also alleges that April/May WTI spread values were artificial on March 14 ($1.47), 17 ($1.45), 18 ($.92) and 19 ($1.94); and that May/June WTI spread values were artificial on March 20 ($.78) and 24 ($.62). (Complaint, ¶¶ 45, 47.) That is it. There is nothing more. These allegations are the type of "naked assertion[s]" devoid of "further factual enhancement" found lacking in *Iqbal*, 129 S. Ct. at 1949, and *Twombly*, 550 U.S. at 557.

The Commission observed in *Cox* that to establish price artificiality one should look to data from contemporaneous markets, including the cash market, for the underlying commodity. Further, to determine an artificial price one must look to "the broadest possible range of relevant cash market transactions." *Cox,* ¶ 23,786, at 34,065. Yet the CFTC alleges not even the barest form of factual support for its conclusory allegations that the spread values identified above were artificial. The Complaint cites no market or historical data against which its bald assertions can be evaluated. It does not allege prompt or second spread values for the remainder of the days in January or March, or outright prices for the February, March,

---

[12] This defect is also fatal to the CFTC's claims with respect to the elements of causation and intent.

April or May WTI futures contracts or any physical market prices. In short, the Complaint fails utterly to allege facts sufficient to show that an artificial price existed.

This infirmity is easy to explain. As Exhibit A demonstrates, on multiple days before the alleged period of manipulation the Feb/March NYMEX spread settled near to or higher than the $.48 value alleged to be "artificial" on January 16 – and the spread had been in an upward trend since the beginning of January. Further, the pricing data shows that outright prices for February and March WTI futures decreased almost $10.00 across January, including during the period January 16 to 22 when the CFTC alleges Arcadia's holding of physical WTI was exerting upward pressure on the market. (Complaint, ¶ 30.)

The CFTC alleges that March/April spread values were artificial on January 23 and 24, yet the $.37 value on January 23 was equal to or less than, the March/April spread values on every preceding January trading day but two (and even these were within pennies of the $.37 value). The March/April spread had begun the month at $.59 on January 2 and seen typical daily increases and decreases through January 22, when it settled at $.45. The fact that the March/April spread began a gradual downward trend on January 25 that continued for the following 15 trading days further indicates that the January 25 spread value was not artificial.

With respect to spread values that were allegedly artificial during the calendar month of March, Exhibit A demonstrates that the prompt spread values actually decreased from March 14 to March 18. Indeed, in Kafkaesque fashion, the Complaint alleges that the April/May value was artificially high on March 18 ($.92) – after it had decreased by $.53 from March 17 ($1.45). (Complaint, ¶ 45.) In fact, the $.92 spread value on March 18 was less than the spread value at any time after March 5. The second spread (May/June) values, far from being artificially high as alleged by the CFTC, were lower on March 20 and 24 than at any time after March 4.

Thus, the CFTC's conclusory and disingenuous allegations that individual spread values were "artificial" are belied by the publicly available data reflected in Exhibit A and are rendered implausible. Even if a defendant had the ability and opportunity to do so, if it "did not in fact cause an artificial price it cannot be guilty of manipulation." *Cargill*, 452 F.2d at 1167; *accord In re Soybean Futures Litigation*, 892 F. Supp. 1025, 1053 (N.D. Ill. 1995) ("Artificiality is a 'crucial element' of a manipulation claim, without which Defendants cannot be found liable for manipulation, regardless of their 'power and opportunity' to influence prices."). On this independent ground the Complaint should be dismissed.

C. The Complaint Fails to Allege With Sufficient Specificity that Arcadia Caused Artificial Prices

The Complaint's allegations that Arcadia's actions caused WTI calendar spread values to increase on twelve days in January and March 2008 are likewise conclusory and inadequate. The singular allegations of causation are that Arcadia "caused or contributed to causing" the spreads to be "artificially high." (Complaint ¶¶ 32, 35, 45.)

As the Commission and the Second Circuit have articulated, to prevail on a claim of manipulation the plaintiff must show that the defendant is a *proximate* cause of an artificial price. *Cox,* ¶ 23,786 at 34,066; *Indiana Farm Bureau*, ¶ 21,796 at 27,286. Here the Complaint alleges in the disjunctive that Arcadia caused or contributed to causing the artificial prices. Even if recitation of the elements of the offense alone were adequate – it is not – merely contributing to an artificial price does not rise to the requisite level of causation. Were it otherwise, the activity of every market participant would be "a" cause of any artificial price alleged.

The Complaint alleges that Arcadia refrained from liquidating its physical WTI position until after the February WTI contract expired on NYMEX in order to "lull market participants into believing that supply would remain tight; that they would not be selling their physical position." (Complaint, ¶ 29-30.) Arcadia's alleged goal in refraining from liquidating its physical WTI positions until the cash periods during these months was to create "upward pressure" on the prompt spreads (February/March in January and April/May in February). (Complaint, ¶ 30.) These assertions are inadequate to show causation.

First, there are no allegations of fact (only unsupported inferences) that the market had any information regarding Arcadia's activity in physical WTI in January or March – either the fact of the purchases or the amount of the position. Second, as the CFTC is aware, futures contracts and cash contracts converge as expiration approaches. *See Indiana Farm Bureau,* ¶ 21,796 at 27,288 n.2 ("As the delivery time draws near, not only do the cash and futures prices converge, but the *markets* converge by virtue of the delivery mechanism.... If trading in the physical market is thin, in terms of quantity, quality or volume, the futures market may be *the market*." (emphasis in original).) In other words, as expiration approaches there is virtually no difference to the market between a sale of a futures contract and a sale of a cash contract. Either sale makes barrels available to the market and, all other factors being equal, reduces upward pressure on the market. Ignoring this known fact the CFTC offers no explanation regarding how Arcadia's holding of contracts for delivery of 4.6 million barrels of physical WTI in February at the same time it was *selling 13.6 million barrels* of February/March futures spreads (the equivalent of selling 13.6 million barrels of WTI for delivery in February and buying 13.6 million barrels of WTI for delivery in March) created "upward pressure" on the February/March spread. Similarly, the Complaint fails to allege how Arcadia's holding of contracts for delivery of 6.3 million barrels of physical WTI in April at the same time it was *selling 14.4 million barrels* of April/May spreads caused any spread values to be artificially high. (Complaint, ¶¶ 43, 44, 46.)

Further, the Complaint treats the increase in a spread value as though it is the same as an increase in outright price. It is not. Unlike outright prices, which move in a single dimension, spread moves may be multi-dimensional. The spread may widen because of: (a) an increase in price for one leg of the spread while the price for the other leg does not change; (b) a decrease in price for one leg while the other does not change; (c) an increase in price for one leg of the spread while the price for the other leg decreases; (d) decreases in both legs of the spread, but to varying degrees; or (e) increases in both legs of the spread, but to varying degrees. To satisfy Rule 9(b) the Complaint must allege more specifically the means by which the spread widened and how Arcadia caused it. Given that outright prices for both February and March WTI were decreasing throughout the calendar month of January, including most of the days on which the CFTC alleges Arcadia's actions were exerting "upward pressure" on the market, this failure to specify how Arcadia's actions impacted price movements giving rise to an increase in the spread is fatal to the CFTC's claim.

The Complaint thus fails to meet even the lenient Rule 8 pleading standard because it does not put Arcadia on notice regarding the alleged misconduct with which it is charged.

D. The Complaint Fails to Support its Conclusory Allegations that Arcadia Specifically Intended to Create an Artificial Price

The CFTC's purported allegations of intent to manipulate or attempt to manipulate are likewise deficient. For example, the CFTC alleges that "[d]uring the relevant period Dyer and Wildgoose expected that their physical WTI trading would affect the calendar spread prices." (Complaint, ¶ 23.) As the Commission has observed:

> Market participants have a right to trade in their own best interest without regard to the positions of others so long as their trading activity does not have as its purpose the creation of 'artificial' or 'distorted' prices.... Moreover, since the self interest of every market participant plays a legitimate part in the price setting process, it is not enough to prove simply that the accused intended to influence price.

Indiana Farm Bureau, ¶ 21,796 at 27,283. The CFTC went on to conclude that to meet the specific intent element of a claim for manipulation or attempted manipulation of a futures contract it must be shown that the accused "acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand." *Id.* at 27,288 n.2; *see also In re Energy Transfer Partners Natural Gas Litigation,* 2009 WL 2633781, at *5 (S.D. Tex. 2009).

Here, absent the conclusory allegations that various spreads were "artificial" (*see* Complaint, ¶¶ 26, 32, 35, 45, 47, 57), the Complaint is devoid of any allegation that identifies (1) what the legitimate forces of supply and demand were at the time of the alleged manipulation; or (2) how the conduct of Arcadia caused

– or even could have caused – a divergence from those supply and demand fundamentals. For this reason alone the allegations of the Complaint fail to meet the requirements of Rule 9(b) with respect to the element of intent.

The CFTC also seeks to plead intent based on allegations of "lulling." (*See* Complaint, ¶ 25, 30, 36.) For example, the CFTC alleges that Arcadia "wanted to lull market participants into believing that supply would remain tight; that they would not be selling their physical position," (Complaint, ¶ 30) but "secretly planned to suddenly sell-off their large physical position in the cash window, which they *expected* would drive down the price of March WTI Derivatives relative to April." (*Id.*, ¶ 34 (emphasis added).) As the Fifth Circuit has observed, however, "intentionality and inevitability are not legally equivalent." *Hershey v. Energy Transfer Partners, L.P.,* 610 F.3d 239, 248 (5th Cir. 2010) (rejecting allegations of manipulative intent as insufficient). In other words, the mere expectation that cash sales will cause a decline in the spread does not constitute an intent to manipulate. The allegation that Arcadia expected prices to decline as a result of its sale of contracts for physical oil simply is insufficient to meet the intent element of the CFTC's claim for manipulation or attempted manipulation. As the *Radley* court observed, "[a]bsent a contract obligation or statutorily imposed position restriction, neither of which was present in this case, a party is never required to sell or purchase anything. To refuse to do so is not misleading or fraudulent, regardless of the motivation." *Radley*, 659 F. Supp. 2d at 816. Thus, the Complaint's allegations that Arcadia did not disclose its plans to sell its physical position indicate nothing as to its intent. It merely reflects normal market conduct.

The Complaint's attempt to plead intent by alleging that Arcadia intentionally built a dominant long physical market position is also insufficient. As demonstrated above (1) the CFTC's allegations of dominance are inconsistent with and contrary to settled precedent; and (2) the Complaint does not, and cannot, allege that Arcadia held a dominant futures position. *See* discussion *supra* at 16-19.

The well-pleaded allegations of "intent" are thus reduced to a recitation of permissible and lawful activities undertaken by Arcadia. Contrary to the CFTC's unsupported insinuations, it is not unlawful for a trader who has no refining or production capacity to buy and hold a physical contract. *See Radley*, 659 F. Supp. 2d at 814. Likewise, there is no obligation to disclose the existence, size or plan of liquidation of such a position to the market. Indeed, Congress recognized and codified this fact in the May 2008 amendments to the CEA:

> Subsection (a)(2) of this section shall not obligate any person, in or in connection with a transaction in a contract of sale of a commodity for future delivery, or other agreement, contract or transaction subject to paragraphs (1) and (2) of Section 5a(g), with another person, to disclose to the other person nonpublic information that may be material to the market price, rate or level of the commodity or transaction ....

7 U.S.C. § 6b(b).

Nor may a general profit motive properly be used as evidence of manipulative intent. The CFTC itself has said, "Holding out for high prices is normally rational and lawful market behavior. Such activity only becomes unlawful when it is accompanied by manipulative intent as generally manifested by conduct other than simply seeking the best price in a pit in which there may be supply shortages." *Indiana Farm Bureau*, ¶ 21,796 at 27,284; *see also Crude Oil Commodity Litigation*, 2007 WL 1946553, at *8 ("Such a generalized motive, one which could be imputed to any corporation with a large market presence in any commodity market, is insufficient to show intent.").

As the court observed in *Amaranth Natural Gas Commodities Litigation*:

> The Complaint alleges that "Amaranth engaged in the classic manipulative act of buying and leaving open increasingly large positions which, due to their extraordinary but increasing size, caused prices to move in their favor." … But although the Complaint contains a detailed description of the many trades in which Amaranth acquired a substantial position in natural gas futures, it fails to allege facts that give rise to a strong inference that Amaranth intended to manipulate the market through these transactions .... But entering into a legitimate transaction knowing that it will distort the market is not manipulation – only intent, not knowledge, can transform a legitimate transaction into manipulation. Allegations of this type are exactly those that Rule 9(b) seeks to prevent. Trading, in and of

> itself, does not constitute market manipulation. Further, the details of the trade do not give rise to a strong inference of *scienter* on behalf of any defendant. Without such an inference, there is nothing to distinguish these transactions from legitimate trading. Therefore, all claims related to these transactions are dismissed.

587 F. Supp. 2d at 539. Where a complaint relies on otherwise lawful acts to establish a violation, the plaintiff must allege "something more" to distinguish between legitimate trading strategies and deliberate attempts at market manipulation. *Id.* at 534.

There is no "something more" in the CFTC's allegations. Therefore, the Complaint should be dismissed pursuant to Rules 9(b) and 12(b)(6).

III. THE COMPLAINT FAILS TO STATE A CLAIM AGAINST ARCADIA FOR ATTEMPTED MANIPULATION

The elements of an attempted manipulation claim are: (1) the defendant intended to affect market prices; and (2) took some overt act in furtherance of that intent. *In re Hohenberg Bros. Co*, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271 at 21,477 (CFTC Feb. 18, 1977). For the reasons stated in Sections I A and B, Counts III, IV and V of the Complaint, which assert claims for attempted manipulation, must also be dismissed. Likewise the allegations of manipulative intent and an overt act in furtherance of that intent are indistinguishable from the allegations of manipulation and must be dismissed for the same reasons stated in Sections II A-D.

CONCLUSION

For all of the foregoing reasons the Complaint should be dismissed pursuant to Fed. R. Civ. P. 9(b) and 12(b)(6). Further, since no set of facts the CFTC could alleged would cure its lack of jurisdiction over alleged manipulation or attempted manipulation of calendar spreads or CMA contracts, the Complaint should be dismissed with prejudice.

Dated: September 29, 2011

By: /s/ Timothy J. Carey
Timothy J. Carey
Elizabeth M. Bradshaw
Brigitte T. Kocheny
DEWEY & LEBOEUF LLP
Two Prudential Plaza
180 North Stetson Avenue, Suite 3700
Chicago, IL 60601
Tel: 312.794.8000
Fax: 312.794.8100
tcarey@dl.com
ebradshaw@dl.com
bkocheny@dl.com

William G. Primps
DEWEY & LEBOEUF LLP
1301 Avenue of the Americas
New York, NY 10019
Tel: 212.259.8000
Fax: 212.259.6333
wprimps@dl.com

Fred F. Fielding
Mark R. Haskell
MORGAN, LEWIS & BOCKIUS LLP
1111 Pennsylvania Avenue, NW
Washington DC 20004
Tel: 202.739.3000
Fax: 202.739.3001
ffielding@morganlewis.com
mhaskell@morganlewis.com

Attorneys for Defendants Parnon Energy Inc., Arcadia Petroleum Ltd., Arcadia Energy (Suisse) SA, Nicholas J. Wildgoose and James T. Dyer