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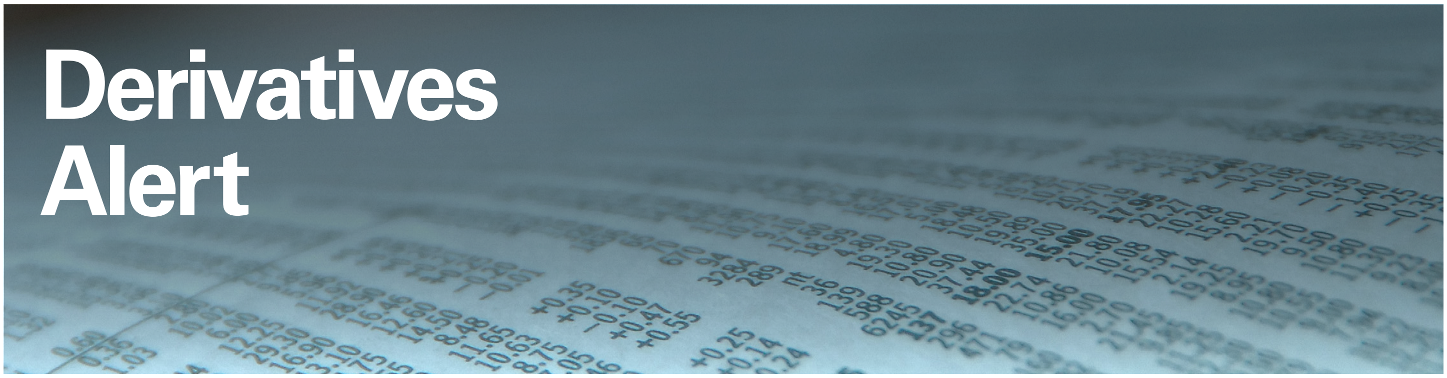
Skadden



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CFTC and DOJ File a Flurry of Spoofing Actions

On January 29, 2018, the Commodity Futures Trading Commission (CFTC) announced the filing of eight anti-spoofing enforcement actions: three settlements with financial institutions and five complaints filed in federal district court against six individuals and one corporation.[1] The cases were investigated by the CFTC's new Spoofing Task Force, comprised of personnel from CFTC offices across the U.S., according to CFTC Division of Enforcement Director James McDonald.[2] On the same day, the Department of Justice (DOJ) announced that it had brought federal criminal charges against seven individuals — including the six individuals in the CFTC actions — for spoofing.[3] The DOJ also charged an eighth individual with commodities fraud.[4]

In 2010, Dodd-Frank Act amendments to the Commodity Exchange Act imposed civil and criminal penalties for any person that entered an order to buy or sell with the intent to cancel the bid or offer before execution — activity commonly known as "spoofing." The prohibitions extend to futures contracts executed pursuant to the rules of a CFTC-regulated futures exchange or swaps executed on a swap execution facility (SEF).

Previously, only three people had been publicly charged with criminal spoofing.[5] On February 2, 2018, Michael Coscia, the first person to be convicted of spoofing in the U.S., petitioned the U.S. Supreme Court to review his conviction, asserting that the anti-spoofing statute, 7 U.S.C. § 6c(a)(5)(C), is unconstitutionally vague — a challenge he lost in the lower courts.[6]

Many spoofing schemes follow a relatively similar pattern: A trader places a bid or offer (a "resting" order) on one side of the market and then a larger bid or offer (a "spoof" order) on the opposite side of the market. The trader intends to cancel the spoof order before it is filled. Although not a required element of spoofing, the spoof order gives a

[1] *See* Press Release, "CFTC Files Eight Anti-Spoofing Enforcement Actions Against Three Banks (Deutsche Bank, HSBC & UBS) & Six Individuals," CFTC (Jan. 29, 2018) [hereinafter "CFTC Release"].

[2] *See* "Statement of CFTC Director of Enforcement James McDonald," CFTC (Jan. 29, 2018) [hereinafter "Statement of CFTC Director of Enforcement"].

[3] *See* Press Release, "Eight Individuals Charged With Deceptive Trading Practices Executed on U.S. Commodities Markets," DOJ (Jan. 29, 2018) [hereinafter "DOJ Release"].

[4] *See id.*

[5] *See id.*

[6] *See* Pet. for Writ of Cert., *Coscia v. United States*, No. 17A527 (S. Ct. Feb. 2, 2018). The statute makes unlawful conduct that "is, is of the character of, or is commonly known to the trade as 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution)." 7 U.S.C. § 6c(a)(5)(C) (2012).

false appearance of market depth meant to induce other market participants to fill the trader's resting order. When the resting order is filled, the spoof order is promptly canceled, either manually or by an algorithm designed for this purpose.

The three recent settlements with financial institutions alleged the classic type of spoofing activity. *See In re Deutsche Bank AG*, *In re UBS AG* and *In re HSBC Securities Inc.* According to the CFTC, in two of the actions, the traders also engaged in spoofing techniques designed to trigger customers' stop-loss orders — orders to buy or sell contracts at a certain price. The actions imposed fines ranging from $1.6 million to $30 million, which was the highest CFTC spoofing penalty to date (albeit substantially lower than the penalties imposed in the Libor and foreign exchange spate of cases). The CFTC praised each of the financial institutions for their cooperation and UBS' additional self-reporting, which the CFTC said led to reduced penalties.[7] The CFTC's orders highlighted the evidentiary significance of electronic communications, as the CFTC alleged that traders discussed spoofing plans in electronic chats and messages.

The CFTC also filed four U.S. District Court complaints against individuals alleging that they engaged in spoofing and manipulative and deceptive schemes with respect to a variety of futures contracts,[8] and one complaint against an individual and his corporation for aiding and abetting spoofing and a manipulative and deceptive scheme with respect to E-mini Standard & Poor's 500 index futures contracts on the Chicago Mercantile Exchange.[9] In the latter case, the CFTC alleged that the defendants developed custom software for a trader who engaged in spoofing that was designed to prevent spoof orders from being executed and to cancel spoof orders as soon as any part of that order was hit or lifted.

Announcing the filing of the actions, Director McDonald stated that while "[t]he technological developments that enabled electronic and algorithmic trading have enabled new opportunities in [the] markets[,] ... at the same time, we recognize that these new developments also present new opportunities for bad actors."[10] He stated that spoofing allows some market participants to gain an unfair advantage over others, harms competition and integrity, drives traders away from markets and reduces liquidity. He further commented that "spoofing harms businesses ... that use [the] markets to hedge their risks in order to provide stable prices that all Americans enjoy."[11]

The DOJ cases were filed in the U.S. District Courts for the Northern District of Illinois, Southern District of Texas and District of Connecticut. Five of the individuals charged by the DOJ — including three charged by the CFTC — were arrested last week.[12] Another individual charged by the CFTC and DOJ with spoofing was arrested in September 2017 but was included in the DOJ's January 29, 2018, announcement.[13] Two other individuals facing both CFTC and DOJ spoofing charges are residents of the United Kingdom and France, respectively.[14] The DOJ has not issued statements concerning plans to initiate extradition proceedings, although it was reported that according to U.S. officials, the U.K. defendant faces possible extradition.[15] Acting Assistant Attorney General John P. Cronan of the DOJ's Criminal Division said that spoofing "poses significant risk of eroding confidence in U.S. markets," and that the DOJ and its law enforcement partners would "use all of the tools at [their] disposal, including cutting-edge data analysis, to detect these types of schemes and bring those who engage in them to justice."[16]

Last year saw a marked uptick in the CFTC's anti-spoofing enforcement activity. The filing of these actions, as well as the new Spoofing Task Force and the apparent close coordination with the DOJ, reflect a continuation of that trend.

[7] For more on the CFTC's self-reporting and cooperation initiatives, see Skadden's February 8, 2017, article and August 15, 2017, and October 4, 2017, client alerts.

[8] Complaint, *CFTC v. Mohan*, No. 4:18-cv-00260 (S.D. Tex. Jan. 28, 2018) (alleging spoofing of E-mini Dow ($5) futures contracts on the Chicago Board of Trade and E-mini NASDAQ 100 futures contracts on the Chicago Mercantile Exchange (CME)); Complaint, *CFTC v. Zhao*, No. 1:18-cv-00620 (N.D. Ill. Jan. 28, 2018) (alleging spoofing of E-mini S&P 500 futures on the CME); Complaint, *CFTC v. Flotron*, No. 18-158 (D. Conn. Jan. 26, 2018) (alleging spoofing of precious metals futures); Complaint, *CFTC v. Vorley*, No. 18-cv-00603 (N.D. Ill. Jan. 26, 2018) (same).

[9] Complaint, *CFTC v. Thakkar*, No. 1:18-cv-00619 (N.D. Ill. Jan. 28, 2018).

[10] CFTC Release.

[11] Statement of CFTC Director of Enforcement.

[12] *See* Barney Jopson, *et al.*, "U.S. Regulator Fines European Banks for 'Spoofing'" Financial Times (Jan. 29, 2018). Krishna Mohan and Jitesh Thakkar were arrested in the U.S., and Jiongsheng Zhao was arrested in Australia. *See* Tom Schoenberg, *et al.*, "U.S. Plans to Make Arrests, Levy Fines in Futures Spoofing Cases," Bloomberg (Jan. 29, 2018) [hereinafter "U.S. Plans to Make Arrests"].

[13] *See* U.S. Plans to Make Arrests.

[14] DOJ Release.

[15] *See* Daniel Bates, "London Precious Metals Traders Charged in U.S. over 'Spoofing' Markets," Evening Standard (Jan. 30, 2018).

[16] DOJ Release.

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