

THE EXERCISE OF ANTI-SPOOFING AUTHORITY IN U.S. FUTURES MARKETS: POLICY AND COMPLIANCE CONSEQUENCES

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Introduction

The purpose of this article is to describe changes in Federal law aimed at the practice of “spoofing” in U.S. futures markets. Spoofing is commonly understood to be a form of market abuse where a person (the “spoofers”) intentionally attempts to cause changes in the futures price by creating a misleading perception of supply and demand for futures contracts in the order book of the futures exchange. Although no precise definition exists, spoofing is understood to work by misleading other

traders and enticing them to react to large orders (or a series of layered orders)² submitted by the spoofer, but where the orders are never intended to be executed. Once the futures price has moved in the direction desired by the spoofer, the orders are immediately cancelled, and smaller previously-placed resting limit orders are executed to the benefit of the spoofer. Through such conduct, a spoofer, if successful, increases the odds of his resting limit orders being executed and can earn a profit by unwinding the transactions using the same process in reverse. In this article, we will a) provide a general overview of the government’s approach to regulating spoofing, b) examine recent enforcement cases, and c) discuss criticisms and consequences arising from regulatory actions and enforcement cases related to spoofing.

Anti-Spoofing Authority

Dodd-Frank and The Commodity Exchange Act

The prohibition of spoofing in futures markets stems from the Dodd-Frank Wall Street Reform and Consumer Protection Act³ (the “Dodd-Frank Act”). Section 747 of the Dodd-Frank Act amends section 4c(a) of the Commodity Exchange Act’s (“CEA”) prohibited transactions provision by adding a new section entitled “Disruptive Practices.” The amended section 4c(a)(5) makes it unlawful for any person to engage in certain disruptive trading practices, including conduct that “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).”⁴

Prior to the enactment of the Dodd-Frank Act, government authorities relied on provisions in Sections 6(c) and 9(a)(2) of the CEA to capture disruptive trading practices such as spoofing. These provisions prohibited manipulative or deceptive trading conduct in general terms without explicitly mentioning spoofing by name. It was not until the enactment of the Dodd-Frank Act that the term spoofing was specifically enumerated as a prohibited trading practice.

A possible motivation for the inclusion of specific prohibited trading conduct (such as spoofing) in the Dodd-Frank Act may be the difficulty the Commodity Futures Trading Commission (“CFTC”) faced in trying to prove manipulation under its existing authority. Former CFTC Commissioner Bart Chilton supported this view proclaiming “currently, we have a nearly impossible manipulation standard, winning only one case in 35 years.”⁵ With respect to spoofing, the CFTC’s enhanced enforcement authority coincided with changes in trading and surveillance technology that allowed regulatory authorities to scrutinize the entire life cycle of buy and sell orders to detect suspicious conduct.

Even with enhanced enforcement authority and the application of additional surveillance tools to detect spoofing conduct, spoofing cases can be difficult to develop for at least four reasons. First, spoofing may not be a widespread practice. Nobody knows for sure how widespread spoofing really is.⁶ Second, spoofing cases will necessarily involve hard-to-detect conduct. This is because for spoofing to successfully mislead

other market participants it must not be obvious. Attempted spoofing that is easily detected by other market participants is unlikely to work. Third, spoofing cases involve the processing of vast amounts of data concerning order submissions, order modifications and cancellations, and order executions.⁷ Finally, interpreting the data requires reliance on financial market experts to help distinguish lawful market conduct from unlawful spoofing conduct.

Although this article focuses on anti-spoofing prohibitions in the U.S. futures markets, it is important to note that similar authorities exist in other markets and jurisdictions. Spoofing allegations have been made in U.S. securities markets by securities market regulators.⁸ The Director of Enforcement at the Securities and Exchange Commission (“SEC”) stated in a November 2015 speech that “[the SEC] will continue to focus on layering and spoofing.”⁹ Spoofing allegations have also been made by the New York Attorney General in relation to trading in the foreign exchange market.¹⁰ Media outlets report that in November 2015, the New York Attorney General subpoenaed records from interdealer brokers suspected of spoofing violations.¹¹ The U.S. Department of Justice (“DOJ”) has pursued criminal cases against spoofing conduct.¹² In addition, spoofing allegations have been made in jurisdictions outside of the United States.¹³ Finally, individual firms can bring private actions under the law.¹⁴ Regulators and market participants alike expect the number of spoofing cases to increase in 2016.

CFTC Interpretive Guidance

A few months after the passage of the Dodd-Frank Act, the CFTC published an Advanced No-

tice of Proposed Rulemaking (“ANPR”),¹⁵ solicited public comments, and held a roundtable to define the term “spoofing” and its qualifying conduct. However, due to the difficulty in defining the term “spoofing” among other reasons, the CFTC terminated its rulemaking efforts, and in its place, finalized interpretive guidance with respect to disruptive trading practices.¹⁶ The guidance stressed that a person must intend to cancel a bid or offer before execution to engage in “spoofing.”¹⁷ Recklessness is not enough for a violation of this provision, and instead, a trader must act with some degree of intent beyond recklessness.¹⁸ The CFTC also affirmed that it will not consider orders, modifications, or cancellations to be “spoofing” if they were submitted as part of a legitimate, good-faith attempt to consummate a trade.¹⁹ For a criminal violation, prosecutors have the burden to prove that the spoofer “knowingly” intended to engage in spoofing conduct.²⁰

The CFTC guidance states that a violation does not require a pattern of activity because even a single instance of trading activity can amount to a violation.²¹ The CFTC indicated that it will evaluate the market context, examining the person’s pattern of trading activity (including fill characteristics of orders), and other relevant facts and circumstances.²²

Additionally, the CFTC provided guidance as to what activity is subject to the prohibition of spoofing. Section 4c(a)(5)(C) covers bid and offer activity on all registered entities—including designated contract markets (“DCMs”) and swap execution facilities (“SEFs”)—and includes all bids and offers in pre-open periods or during exchange-controlled trading halts.²³ The applicability of this provision is not restricted to

trading platforms and venues only having order book functionality. Rather, “spoofing” may occur on any trading platform or venue where a market participant has the ability to either send executable bids and offers to market participants or transact against resting orders.²⁴ Non-executable market communications such as requests for quotes and other authorized pre-trade communications do not qualify as “spoofing.”²⁵

The CFTC guidance also provided four “non-exclusive” examples of “spoofing” behavior, including: 1) submitting or cancelling bids or offers to overload the quotation system of a registered entity (sometimes referred to as “quote stuffing”); 2) submitting or cancelling bids or offers to delay another person’s execution of trades; 3) submitting or cancelling multiple bids or offers to create an appearance of false market depth; and 4) submitting or canceling bids or offers with intent to create artificial price movements upwards or downwards.²⁶

Rules of Self-Regulatory Organizations

The CME Group (“CME”) and ICE Futures U.S. (“ICE”), as self-regulatory organizations (“SROs”), have also developed their own rules with respect to spoofing. Although spoofing has always been prohibited at the SRO level under general conduct rules, the new rules specifically address spoofing conduct. CME Rule 575(A) states that “no person shall enter or cause to be entered an order with the intent, at the time of order entry, to cancel the order before execution or to modify the order to avoid execution.”²⁷ The CME rule also identifies conduct that would not be considered spoofing such as 1) an “order, entered with the intent to execute a *bona fide* transaction, that is subsequently modified or

cancelled due to a perceived change in circumstances”; 2) an “unintentional, accidental, or ‘fat-finger’ order”; and 3) a *bona fide* stop-loss order.²⁸ The CME Rule 575 Market Regulation Advisory Notice states that the execution of orders and the amount of time an order is exposed to the market are not safe harbors.²⁹ Unlike the CFTC’s view that recklessness is not a sufficient level of intent to constitute spoofing, the CME views recklessness as a sufficient level of intent for a spoofing violation.³⁰

In 2015, ICE amended Rule 4.02 to address disruptive trading practices in a manner that is very similar to the CME’s rule.³¹ Although the rule does not address “spoofing” by name, Rule 4.02 prohibits any person from “knowingly entering any bid or offer for the purpose of making a market price which does not reflect the true state of the market, or knowingly entering, or causing to be entered, bids or offers other than in good faith for the purpose of executing *bona fide* transactions.”³² Unlike the rule text, the FAQ ac-

companying the ICE Rule does address “spoofing” by name and also identifies conduct that would not be considered spoofing.

Recent Cases Involving Instances of Alleged Spoofing

CFTC Enforcement Proceedings

Since the passage of the Dodd-Frank Act, prosecuting spoofing conduct in futures markets has become a top priority for the CFTC. The CFTC has brought five cases related to spoofing conduct.³³ Aitan Goelman, CFTC Director of Enforcement, stated that “spoofing seriously threatens the integrity and stability of futures markets because it discourages legitimate market participants from trading”³⁴ and that “the CFTC is committed to prosecuting this conduct and is actively cooperating with regulators around the world in this endeavor.”³⁵ Table A summarizes information regarding the five cases brought by the CFTC.

Table A: CFTC Spoofing Cases

CFTC Case	Date of Charges	Dodd-Frank Authority	Current Status	CFTC Civil Monetary Penalty	CFTC Dis-gorgement
Eric Moncada ³⁶	December 4, 2012	No ³⁷	Settled on October 1, 2014 ³⁸	\$1.56 Million	None
Michael Coscia and Panther Trading LLC ³⁹	July 22, 2013	Yes	Settled on July 22, 2013 ⁴⁰	\$1.4 Million	\$1.4 Million
Navinder Sarao ⁴¹	April 21, 2015	Yes	Pending	Pending	Pending

CFTC Case	Date of Charges	Dodd-Frank Authority	Current Status	CFTC Civil Monetary Penalty	CFTC Disgorgement
Heet Khara and Nasim Salim ⁴²	May 5, 2015	Yes	Settled on April 5, 2016. The settlement order also imposed permanent trading and registration bans on Khara and Salim ⁴³	\$1.38 Million (Khara) \$1.31 Million (Salim)	None
Igor Oystacher ⁴⁴	October 19, 2015	Yes	Pending	Pending	Pending

SRO Disciplinary Proceedings

In 2015, the CME Group brought 16 cases related to spoofing before the CME Business Conduct Committee, which was a substantial increase over the number of spoofing cases considered in 2014.⁴⁵ Table B below summarizes those 16 cases. As can be seen, none of the CME actions relied upon specific anti-spoofing authority pursuant to the CME's Rule 575 Advisory Notice. This highlights that the CME, similar to the CFTC, can rely on more general enforcement authority with respect to conduct that may resemble spoofing. Table B also includes and summarizes the CME proceedings for the five spoofing cases that also had parallel CFTC proceedings (as described in Table A). Observations show that the CME's disciplinary actions preceded the CFTC proceedings for Moncada and Oystacher, while the proceeding against Coscia was settled simultaneously. Khara and Salim were suspended from trading before the CFTC filed and settled its charges, but the final CME disciplinary action is pending. Navinder Sarao is also awaiting a final resolution of CME disciplinary proceedings. Further, the Table illustrates that trading bans ranged from 10 days to six months (for bans falling short

of a permanent suspension), and monetary penalties ranged from \$25,000 to \$600,000.

In 2015, ICE also brought disciplinary proceedings using general enforcement authority related to conduct that may resemble spoofing, but in 2016, started to commence charges under its amended Rule 4.02 disruptive trading practices authority.⁴⁶ For example, on April 1, 2016, ICE settled charges against Alan Rabinowitz for a trade practice violation under Rule 4.02(1).⁴⁷ ICE Market Regulation Staff determined that Rabinowitz "engaged in a pattern of trading activity in the Coffee 'C' ('KC') Futures market between March 2015 and May 2015 where numerous order book imbalances were created wherein he entered a small order relative to market conditions to buy or sell at the best price on one side of the market and a large order to sell or buy on the opposite side of the market," and he was "able to benefit from the price of KC futures he put on to hedge KC options positions that he held by approximately \$8,081.95."⁴⁸ Rabinowitz neither admitted nor denied the Rule 4.02 violations and paid a monetary penalty of \$81,928.75 and a disgorgement amount of \$8,081.25.⁴⁹ The settlement notice explained that ICE took an alterna-

tive method to calculate the disgorgement amount, by taking the difference between the best bid/offer prior to the entry of the large order by Rabinowitz and the fill price he received for the small order.⁵⁰ He was also suspended from trading on any ICE market for 10 days.⁵¹ These recent

trends should alert market participants that the number of SRO disciplinary proceedings will likely increase in the near future.

Table B: CME Spoofing Cases

Case	Effective Date of Disciplinary Action	CME Rule Violation(s)	Exchange	Current Status	CME Fine	Trading Ban / Remedies
Eric Moncada ⁵²	May 2, 2011	Rule 534 Wash Trades Prohibited; Rule 539 Prearranged, Pre-Negotiated and Non-Competitive Trades Prohibited ⁵³	CBOT	Settled	\$25,000	N/A
Panther Energy Trading LLC ⁵⁴	July 22, 2013	Rule 432 General Offenses	CBOT	Settled	\$600,000 ⁵⁵	\$1,312,947.02 in Disgorgement ⁵⁶
Michael Coscia ⁵⁷	July 22, 2013	Rule 432; Rule 576 Identification of Globex Terminal Operators	CME	Settled	\$200,000 ⁵⁸	\$1,312,947.02 in Disgorgement ⁵⁹ / 6 Months
Navinder Sarao ⁶⁰	Pending	Pending	Multiple	Pending	Pending	Pending
Heet Khara ⁶¹ and Nasim Salim ⁶²	Pending	Rule 413 Summary Access Denial Actions	COMEX	Pending	Pending	60 Day Access Denial from All CME Markets ⁶³
Igor Oystacher ⁶⁴	November 28, 2014	Rule 432	COMEX	Settled	\$150,000 ⁶⁵	1 Month
Robert Leeds ⁶⁶	January 20, 2015	Rule 432	NYMEX	Settled	\$40,000	15 Days

Case	Effective Date of Disciplinary Action	CME Rule Violation(s)	Exchange	Current Status	CME Fine	Trading Ban / Remedies
Jonathan Brims ⁶⁷	January 22, 2015	Rule 432	CBOT	Settled	\$50,000	10 Days
Stephen Gola ⁶⁸	January 22, 2015	Rule 432	CBOT	Settled	\$65,000	10 Days
Michel Simonian ⁶⁹	March 20, 2015	Rule 432	COMEX	Settled	\$35,000	15 Days
Himanshu Kalra ⁷⁰	June 1, 2015	Rule 432	COMEX	Settled	\$35,000	30 Days
Stephen Duggan ⁷¹	June 5, 2015	Rule 432	CBOT	Settled		2 Years
Simon Posen ⁷²	June 18, 2015	Rule 432	COMEX	Settled	\$75,000 ⁷³	5 Weeks
Raphael Kurlansik ⁷⁴	June 18, 2015	Rule 432	NYMEX	Settled	\$35,000	10 Days
James Groth ⁷⁵	July 20, 2015	Rule 432	CBOT	Settled	\$55,000	10 Days
Peter DiStaulo ⁷⁶	July 24, 2015	Rule 432	CBOT	Settled	\$20,000	60 Days
William Silva ⁷⁷	August 21, 2015	Rule 432	CME	Settled	\$75,000 ⁷⁸	2 Weeks
Banco BTG Pactual S.A. ⁷⁹	August 21, 2015	Rule 432 ⁸⁰	NYMEX	Settled	\$50,000	N/A
Michael Franko ⁸¹	August 21, 2015	Rule 432	COMEX	Settled	\$100,000	15 Days
Bruno Cordeiro ⁸²	October 2, 2015	Rule 432	NYMEX	Settled	\$50,000	10 Days
Nitin Gupta ⁸³	October 12, 2015	Rule 432	COMEX	Settled	\$100,000	Permanent Suspension
Matthew Garber ⁸⁴	November 6, 2015	Rule 432	CBOT	Settled	\$40,000	20 Days

Criminal Proceedings

The first and only criminal spoofing case to date involves Michael Coscia, who faced accusations from four different authorities with respect to his alleged spoofing conduct.⁸⁵ Although Coscia settled actions brought by the CME and the CFTC simultaneously on July 22, 2013, and the U.K. Financial Conduct Authority (“FCA”), he still faced criminal prosecution by DOJ.⁸⁶

Over a year after the case was settled by the CFTC and the CME, criminal authorities charged Coscia with both “spoofing” and commodities fraud.⁸⁷ DOJ’s decision to pursue criminal action for a case already settled in the previous year by market regulators represents an uncommon and unusual course of action.⁸⁸ They alleged that Coscia, a 28-year veteran commodities futures trader, developed and implemented a high-

frequency trading strategy that allowed him to enter and cancel large volume orders allegedly for the purpose of moving prices in the market so that he could purchase (at a lower price) or sell (at a higher price) contracts for his benefit.⁸⁹ To accomplish this, Coscia hired a computer programmer to design a computer program that would apply this strategy in 17 CME operated markets and three ICE operated markets.⁹⁰ The indictment claimed that Coscia realized up to \$1.5 million in profits.⁹¹

In response to the criminal complaint, on December 15, 2014, Coscia filed a motion to dismiss the indictment asserting that the anti-spoofing provision in the Dodd-Frank Act was “unconstitutionally vague, and the government’s effort to hold [him] criminally responsible . . . fails as a matter of law.”⁹² Coscia’s defense rested, in part, on the fact that the CFTC was unable to finalize a rule outlining what might constitute “spoofing” and that there was concern expressed by industry participants that it was hard to define spoofing. He argued that the anti-spoofing provision “prohibits a wide range of trading activity without offering any reasonably ascertainable standard for separating legitimate trading from illegitimate spoofing.”⁹³ With respect to the commodity fraud charge, Coscia argued that the commodity fraud counts are legally invalid because: 1) the underlying spoofing counts upon which they are based are vague; 2) Coscia did not make affirmative or implied misrepresentations to market participants (he simply placed bids and offers); and 3) the fraud statute is vague as applied to his conduct because he had no notice that his conduct might constitute a violation of the fraud statute.⁹⁴

On April 16, 2015, the U.S. District Court for

the Northern District of Illinois ruled on Coscia’s motion to dismiss the case.⁹⁵ When considering a motion to dismiss, the Court must assume that all of the government’s factual allegations are true and consider only the legal sufficiency of the government’s case. The Court explained that when accepting as true Coscia’s conduct (as alleged by the Government) for purposes of the motion, the Government sufficiently alleged a violation of “spoofing” because it claimed that he engaged in: “bidding or offering with the intent to cancel the bid or offer before execution.”⁹⁶ Also, the Court said that the intent to cancel requirement was significant because “when the government must prove intent and knowledge, these requirements do much to destroy any force in the argument that application of the statute would be so unfair that it must be held invalid.”⁹⁷ The Court distinguished Coscia’s conduct, which allegedly involved entry of a large number of orders with the *intent* to immediately cancel, from lawful activity involving a “fill or kill” order or a partial fill order.⁹⁸ In the “fill or kill” order or a partial fill order scenario, a trader places an order knowing the order or some part of the order might be cancelled, but with the *intent* to consummate a trade.⁹⁹ The Court responded to other arguments made by Coscia, but denied his motion to dismiss the indictment.¹⁰⁰

The case ultimately went to trial, and on November 3, 2015, Coscia was convicted on 6 counts of spoofing and 6 counts of commodities fraud.¹⁰¹ Coscia’s sentencing hearing was originally scheduled for March 17, 2016, but has been postponed indefinitely. He faces up to 25 years in prison and a \$250,000 fine for each count of commodities fraud, and ten years in prison and a \$1 million fine for each count of spoofing.¹⁰² Some commentators expect Coscia to appeal his con-

viction by arguing that the spoofing statute is unconstitutionally vague, as he did in his unsuccessful attempt to dismiss the claim prior to trial.¹⁰³

Private Actions

Recently, it has been reported that some market participants have actively scrutinized order flow in an attempt to detect whether spoofing or other suspicious conduct is being used against their own trading algorithms.¹⁰⁴ The results of such private surveillance, when shared with regulatory authorities, help enhance the ability of regulators to detect and deter spoofing conduct. For example, Bloomberg has reported that hedge fund operator Citadel has filed a request with the CFTC for whistleblower status for uncovering alleged spoofing conduct on futures exchanges beginning in 2013. Bloomberg also reports that a former trader at HTG Capital Markets, had also filed as a whistleblower with the CFTC concerning similar allegations of spoofing conduct.¹⁰⁵

Such private surveillance can also be used to support private legal actions.¹⁰⁶ Also, the use of private resources to police markets points out that the victims of spoofing are market participants trading either on their own behalf or on the behalf of their customers. Spoofing can impose losses on these traders either by luring them into money-losing trades or causing them to refrain from profitable trades in an attempt to avoid interactions with suspected spoofers.

Using public data for private surveillance can detect suspicious conduct, but cannot identify the parties involved in the conduct because futures trading is anonymous. Identification of the trading firms behind the suspicious conduct can only be made by the relevant SRO (or the CFTC using

SRO data). Such information is considered highly confidential and can only be obtained by a court order. In one instance, HTG Capital Partners, LLC (“HTG”), sued the CME to obtain the identities of the trading firms suspected of spoofing conduct in dealing with HTG. On September 29, 2015, U.S. District Judge Edmond Chang ruled that the CME must reveal the identities of the trading firms associated with the suspected activity under seal, to be seen only by the judge. Further, Judge Chang ordered the CME to provide HTG’s lawyers with a table that masked the identities of the trading firms using a number instead of a name. The CME had argued that they should not be compelled to reveal the names of trade counterparties.¹⁰⁷

An Aside on Damages Resulting from Spoofing Conduct

In the cases seen to date, there is little evidence that either gain-based or harm-based approaches to penalties have been applied to punish and deter spoofing conduct. Regulators have alleged in general terms that spoofing conduct damages market integrity and stability. Some commentators have made preliminary attempts to address the issue of quantifying the gain or harm resulting from spoofing conduct. For example, Craig Pirrong, Professor of Finance at the University of Houston, has pointed out that the damage caused by spoofing is likely to be small when compared to other types of market abuse.¹⁰⁸ He observes that spoofing cannot cause the price to diverge persistently from where it otherwise would be, such as would be the case with other forms of manipulative conduct.¹⁰⁹ Pirrong argues that the harm from spoofing is likely to be limited to people induced to trade when they otherwise would not.¹¹⁰

For these traders, their losses will approximately equal the spoofer's gains, which may be no larger than the bid-ask spread. Since the trader may have hit the spoofer's bid or offer even in the absence of spoofing, he contends that only a fraction of those with whom the spoofer trades are damaged.¹¹¹ Pirrong has also argued that the impact of spoofing conduct may be limited because the victims of spoofing tend to be sophisticated traders who quickly realize that they have been victimized and take prompt action to protect themselves from further damage.¹¹² Further, he suggests that damages would be hard to estimate because it is virtually impossible to identify who traded because of the spoofing, and who pulled a quote and gave up an opportunity to trade because of the fear of encountering spoofing conduct.¹¹³ Therefore, the number of market participants impacted by spoofing conduct would be difficult to determine.

Criticisms and Consequences of Spoofing Regulation and Enforcement

Criticisms

Critics of the Dodd-Frank Act's prohibition of spoofing argue that the term is vague and may inhibit lawful and desirable trading activity that may have a similar appearance to prohibited activity. The vagueness concern has been prevalent since the passage of the Dodd-Frank Act. During the CFTC public roundtable on disruptive trading practices, Gregory Mocek, former CFTC Director of Enforcement, speaking on behalf of the Commodity Markets Council, shared his concerns on the vagueness of the statute.¹¹⁴ Mocek warned that "vagueness is going to chill legitimate trading," and "vagueness is also going to impede the ability of the Enforcement Division to bring cases."¹¹⁵ He further

opined that a court will find that the statute is unconstitutionally vague because there is no common understanding of the meaning of the terms, no clear meaning to be derived from the statute, no prior judicial construction, no available treatise, and no commonly used industry term within the statute available to conduct appropriate analysis of certain statutory terms by the courts.¹¹⁶

In response to the CFTC ANPR, the CME, the largest futures exchange in the world, also submitted comments regarding the statute's vagueness. The CME explained that "in order to effectively implement Section 747, the Commission must first promulgate rules that give market participants appropriate notice of the specific trading practices which run afoul of Section 747," and "as written, Section 747 is vague and susceptible to constitutional challenge because due process precludes the government from penalizing a private party for violating a rule without first providing adequate notice that his contemplated conduct is forbidden by the rule."¹¹⁷

This concern has become even more pronounced since the conviction of Michael Coscia for commodities fraud and spoofing. "The conduct that is being prohibited just seems very hard to define,"¹¹⁸ says Stephen Obie, former acting director of the CFTC's Division of Enforcement. "The CFTC does a disservice when it fails to have bright-line rules, particularly when trading activity is being criminalized."¹¹⁹ Without a clear bright-line rule determined through the CFTC's policy-making procedures, market participants face a moving compliance target where the dividing line between lawful and unlawful conduct is determined as the result of enforcement actions. Market participants worry about not having

explicitly defined safe harbors and instead having CFTC enforcement proceedings serve as a substitute means for shaping the Commission's policy around this type of conduct.¹²⁰

Consequences for Compliance Officers

As spoofing has become a priority for market regulators, preventing spoofing has also become a priority for compliance officers at trading firms who find themselves responsible for preventing this type of conduct. However, compliance officers may encounter difficulties in this endeavor as spoofing is not precisely defined and cannot be easily distinguished from lawful trading activity that may be beneficial to market quality. In spite of the CFTC interpretive guidance, although helpful in generally describing conduct that may be considered spoofing, it offers little practical guidance for compliance officers, who are left with no bright-line separating lawful conduct from prohibited spoofing conduct.

Consequences for Market Participants

One lawful and beneficial activity that could be inhibited by aggressive enforcement of spoofing conduct is market making. This is due to the difference in "intent" between prohibited conduct and lawful conduct under the new rules. As Bloomberg View Columnist Matthew Levine has observed, ". . . the same actions—putting in an order, cancelling it, and trading the other way—are legal or illegal depending on what was going on in [the trader's] mind in the relevant half-second."¹²¹ Market makers are professional traders who bridge the gaps between natural buyers and sellers of futures contracts who may not be in the marketplace at exactly the same time. For

these professional traders, the ability to quickly revise quotes (that is, to cancel and replace bids and offers) in response to market information is an essential risk management tool. It is this risk management ability that enables these traders to offer narrower bid-ask spreads, provide liquidity, and quote for larger trade sizes. Nonetheless, the fear of being accused of spoofing may lead to less aggressive quoting, when a lawful market maker becomes reluctant to revise orders for fear of regulatory scrutiny and/or enforcement. The unintended consequence of spoofing regulation may be wider bid-ask spreads resulting in less liquidity and higher costs for market users.

Conclusion

The frequency with which spoofing conduct has been alleged and prosecuted has increased steadily since the Dodd-Frank Act explicitly prohibited this type of conduct in 2010. This increase is expected to continue as market regulators focus on detecting and deterring spoofing conduct. In addition to the frequency of allegations, the severity of the penalties resulting from the prosecution of spoofing conduct, including significant criminal penalties, have made compliance a high priority at trading firms.

The high profile of spoofing allegations has also generated public policy concerns with respect to the consequences, both intended and unintended, of how spoofing prohibitions are enforced. In this article, we describe the government's approach to regulating spoofing, examine recent enforcement cases, and discuss criticisms arising from these regulatory and enforcement actions. We describe the concerns of market participants who seek a clearly-defined safe harbor, determined through the CFTC's policy-making procedures. These participants worry that

without a bright-line rule distinguishing the boundary between lawful and unlawful conduct that the boundary will be determined on a case-by-case basis through enforcement actions. Finally, we describe the difficulty authorities face in prosecuting cases such as distinguishing between prohibited spoofing conduct and lawful conduct such as market making.

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ENDNOTES:

¹Delta Strategy Group is a full-service consulting firm that works closely with Congress, the CFTC, the SEC and other regulatory agencies to provide clients with innovative solutions to their regulatory concerns. DSG has decades of combined government service and offers a wealth of expertise in the regulation of commodity futures, capital markets, over-the-counter derivatives and exchanges, energy issues, and agriculture appropriations policy. DSG represents clients including exchanges, energy and agribusiness companies, trade groups, financial services firms, investment funds, and Fortune 500 companies in connection with key regulatory reforms and landmark financial legislation (<http://deltastrategygroup.com>).

²Layering is a form of spoofing where orders are placed at a series of prices (or layers) in the order book to give a misleading impression of market depth.

³Pub. L. 111-203, 124 Stat. 1376 (2010).

⁴7 U.S.C. § 6c(a)(5).

⁵See, e.g., The Waiting, Statement by Commissioner Bart Chilton Regarding Anti-Fraud and Anti-Manipulation Final Rules, (July 7, 2011), <http://www.cftc.gov/PressRoom/Speeches/Testimony/chiltonstatement070711>.

⁶Matthew Leising, *Spoofing Went Mainstream in 2015*, BloombergBusiness, (Dec. 21, 2015), <http://www.bloomberg.com/news/article/2015-12-22/nabbing-the-rogue-algo-inside-th>

[e-year-spoofing-went-mainstream](#).

⁷Matthew Leising, Mira Rojanasakul, and Adam Pearce, *How To Catch a Spoofers*, (Sept. 4, 2015), <http://www.bloomberg.com/graphics/2015-spoofing/>.

⁸See SEC Announces Charges for Spoofing and Order Mismarking, (Dec. 3, 2015), <https://www.sec.gov/news/pressrelease/2015-273.html>.

⁹See, e.g., Market Structure Enforcement: Looking Back and Forward, (Nov. 2, 2015), <http://www.sec.gov/news/speech/ceresney-speech-sifma-ny-regional-seminar.html>.

¹⁰Keri Geiger, *Currency Spoofing Is Said To Be New York's Latest Target*, (Nov. 23, 2015), <http://www.bloomberg.com/news/articles/2015-11-23/currency-spoofing-is-said-to-be-new-york-s-latest-target>.

¹¹Laura Matthews, *Current Spoofing Probe Could Spell Trouble for Forex Options*, Risk.net, (Jan. 7, 2016), <http://www.risk.net/risk/news/2440938/currency-spoofing-probe-could-spell-trouble-for-forex-options>.

¹²*U.S. v. Coscia*, Case No. 14 CR 551 (N.D.Ill. Dec. 15, 2014), Dkt. No. 28.

¹³For a description of spoofing enforcement by the British Financial Conduct Authority (FCA) and how FCA authority differs from U.S. authority, see David Yeres, Robert Houck, Benjamin Berringer and Carlos Conceicao and Oliver Pegden, *"Spoofing: The First Criminal Conviction Comes in the U.S.—Perspectives from the U.S. and UK"*, Futures and Derivatives Law Report, Vol. 36, issue 1 (Jan. 2016), pg. 1-11.

¹⁴See *HTG Capital Partners LLC v. Doe(s)*, 15-cv-02129, (N.D. Ill. Mar. 10, 2015).

¹⁵76 FR 14943.

¹⁶78 FR 31890.

¹⁷*Id.* at 31896.

¹⁸*Id.*

¹⁹*Id.*

²⁰7 U.S.C. § 13(a)(2).

²¹78 FR 31896.

²²*Id.*

²³⁷ U.S.C. § 6c(a)(5).

²⁴⁷⁸ FR 31896.

²⁵*Id.*

²⁶*Id.*

²⁷Found at <http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/files/RA1405-5.pdf>.

²⁸*Id.*

²⁹*Id.*

³⁰*Id.*

³¹Found at https://www.theice.com/publicdocs/futures_us/exchange_notices/IFUS_Disruptive_Practices_Notice.pdf.

³²*Id.*

³³See *In the Matter of Panther Energy Trading LLC and Michael J. Coscia*, CFTC Docket No. 13-26 (July 22, 2013); *CFTC v. Heet Khara et al.*, 15-cv-03497, (S.D.N.Y. May 5, 2015); *CFTC v. Nav Sarao Futures Ltd. PLC et al.*, 15-cv-03398, (N.D.Ill. Apr. 17, 2015); *CFTC v. Igor B. Oystacher et al.*, 15-cv-09196, (N.D.Ill. Oct. 19, 2015); and *CFTC v. Eric Moncada, et al.*, 12-cv-8791, (S.D.N.Y. Dec. 4, 2012).

³⁴See *supra* note 36.

³⁵Michael Mackenzie and Phillip Stafford, *Why US Regulators Target Spoofing*, *Financial Times*, (Oct. 21, 2015), <http://www.ft.com/intl/cms/s/0/cbf0aeaa-76ff-11e5-933d-efcdc3c11c89.html#axzz3wIqFJhO>.

³⁶ See CFTC Files Complaint in Federal Court Against Eric Moncada, BES Capital LLC, and Serdika LLC Alleging Attempted Manipulation of Wheat Futures Contract Prices, Fictitious Sales, and Non-Competitive Transactions, (Dec. 4, 2012), <http://www.cftc.gov/PressRoom/PressReleases/pr6441-12>.

³⁷ Eric Moncada was charged by the CFTC in 2012 under the CFTC's pre-Dodd Frank anti-manipulation authority for conduct allegedly similar to spoofing. Specifically, the CFTC alleged that the conduct constituted a "manipulative scheme."

³⁸ See Federal Court Orders Eric Moncada to

Pay \$1.56 Million Penalty for Attempting to Manipulate the Wheat Futures Market, (Oct. 1, 2014), <http://www.cftc.gov/PressRoom/PressReleases/pr7026-14>.

³⁹ In the Matter of Panther Energy Trading LLC, CFTC Dkt. No. 12-26 (July 22, 2013).

⁴⁰ *Id.*

⁴¹ See CFTC Charges U.K. Resident Navinder Singh Sarao and His Company Nav Sarao Futures Limited PLC with Price Manipulation and Spoofing, (Apr. 21, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7156-15>.

⁴² See CFTC Charges United Arab Emirates Residents Heet Khara and Nasim Salim with Spoofing in the Gold and Silver Futures Markets, (May 5, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7171-15>.

⁴³ See Federal Court Orders UAE Residents Heet Khara and Nasim Salim to Pay Combined Civil Monetary Penalties of \$2.69 Million for Spoofing in the Gold and Silver Futures Markets, (April 5, 2016), <http://www.cftc.gov/PressRoom/PressReleases/pr7353-16>.

⁴⁴ See CFTC Charges Chicago Trader Igor B. Oystacher and His Proprietary Trading Company, 3 Red Trading LLC, with Spoofing and Employment of a Manipulative and Deceptive Device While Trading E-Mini S&P 500, Copper, Crude Oil, Natural Gas, and VIX Futures Contracts, (Oct. 19, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7264-15>.

⁴⁵Leising, *supra* note 5.

⁴⁶ICE has not specified which of their general conduct disciplinary proceedings involve conduct that resembles spoofing. Therefore, we cannot provide a table similar to Table B for the CME cases.

⁴⁷See ICE Futures U.S., Disciplinary Notice Settlement of Charges Against Alan Rabinowitz, CASE Number 2015-025 (April 1, 2016).

⁴⁸*Id.*

⁴⁹*Id.*

⁵⁰*Id.*

⁵¹*Id.*

⁵² See CME Group, Notice of Disciplinary Action Against Eric Moncada, File No. CBOT 09-04100-BC (May 2, 2011).

⁵³ The CME Group charged Moncada for rule violations unrelated to spoofing conduct.

⁵⁴ See CME Group, Notice of Disciplinary Action Against Panther Energy Trading, LLC, File No. CBOT 11-8581-BC (July 22, 2013).

⁵⁵ Of the \$600,000, \$191,100 was allotted to CBOT.

⁵⁶ Panther Energy Trading, LLC and Coscia were held jointly and severally liable for \$1,312,947.01 in disgorgement, and of that amount, \$393,884.11 was allotted to CBOT.

⁵⁷ See CME Group, Notice of Disciplinary Action Against Michael Coscia, File No. CME 11-8581-BC (July 22, 2013).

⁵⁸ Of the \$200,000, \$76,760 was allotted to CME.

⁵⁹ Panther Energy Trading, LLC and Coscia were held jointly and severally liable for \$1,312,947.01 in disgorgement, and of that amount, \$525,178.81 was allotted to CME.

⁶⁰ See CME Group, CME Group Statement, Chicago, Illinois (Apr. 22, 2015), <http://cmegroup.mediaroom.com/2015-04-22-CME-Group-Statement>. The CME Group issued a press release in response to the CFTC charges against Navinder Sarao.

⁶¹ See CME Group, Notice of Summary Access Denial Action Against Heet Khara, File No. COMEX 15-0103-SA-2 (Apr. 30, 2015).

⁶² See CME Group, Notice of Summary Access Denial Action Against Nasim Salim, File No. COMEX 15-0103-SA-1 (Apr. 30, 2015).

⁶³ Pursuant to Rule 413, this access denial may be extended for an additional period of time if the Chief Regulatory Office or his delegates provide written notice.

⁶⁴ See CME Group, Notice of Disciplinary Action Against Igor Oystacher, File No. COMEX 11-08380-BC (Nov. 28, 2014).

⁶⁵ Of the \$150,000, \$50,000 was allotted to

COMEX.

⁶⁶ See CME Group, Notice of Disciplinary Action Against Robert Leeds, File No. NYMEX 12-8886-BC (Jan. 20, 2015).

⁶⁷ See CME Group, Notice of Disciplinary Action Against Jonathan Brims, File No. CBOT 12-8860-BC (Jan. 22, 2015).

⁶⁸ See CME Group, Notice of Disciplinary Action Against Stephen Gola, File No. CBOT 12-8860-BC (Jan. 22, 2015).

⁶⁹ See CME Group, Notice of Disciplinary Action Against Michel Simonian, File No. COMEX 13-9598 (Mar. 20, 2015).

⁷⁰ See CME Group, Notice of Disciplinary Action Against Himanshu Kalra, File No. COMEX 12-9004-BC (June 1, 2015).

⁷¹ See CME Group, Notice of Disciplinary Action Against Stephen Duggan, File No. CBOT 12-9134-BC (June 5, 2015).

⁷² See CME Group, Notice of Disciplinary Action Against Simon Posen, File No. COMEX 13-9258-BC (June 18, 2015).

⁷³ Of the \$75,000, \$45,000 was allotted to COMEX.

⁷⁴ See CME Group, Notice of Disciplinary Action Against Raphael Kurlansik, File No. NYMEX 14-9952 (June 18, 2015).

⁷⁵ See CME Group, Notice of Disciplinary Action Against James Groth, File No. CBOT 11-8463 (July 20, 2015).

⁷⁶ See CME Group, Notice of Disciplinary Action Against Peter Distaulo, File No. CBOT 12-9106-BC (July 24, 2015).

⁷⁷ See CME Group, Notice of Disciplinary Action Against William Silva, File No. CME 13-9387-BC (Aug. 21, 2015).

⁷⁸ Of the 75,000, \$25,000 was allotted to CME and \$50,000 was allotted to NYMEX.

⁷⁹ See CME Group, Notice of Disciplinary Action Against Banco BTG Pactual S.A., File No. NYMEX 14-9783-BC (Aug. 21, 2015).

⁸⁰ Banco BTG Pactual S.A. settled charges for failure to supervise Bruno Cordeiro.

⁸¹ See CME Group, Notice of Disciplinary Action Against Michael Franko, File No. COMEX 13-9651-BC (Aug. 21, 2015).

⁸² See CME Group, Notice of Disciplinary Action Against Bruno Cordeiro, File No. NYMEX 14-9783-BC (Oct. 2, 2015).

⁸³ See CME Group, Notice of Disciplinary Action Against Nitin Gupta, File No. COMEX 13-9391-BC (Oct. 12, 2015).

⁸⁴ See CME Group, Notice of Disciplinary Action Against Matthew Garner, File No. CBOT 12-8862-BC (Nov. 6, 2015).

⁸⁵ See CFTC Orders Panther Energy Trading LLC and its Principal Michael J. Coscia to Pay \$2.8 Million and Bans Them from Trading for One Year, for Spoofing in Numerous Commodity Futures Contracts, (July 22, 2013), <http://www.cftc.gov/PressRoom/PressReleases/pr6649-13>.

⁸⁶ Found at <https://www.fca.org.uk/static/documents/final-notices/coscia.pdf>.

⁸⁷ *U.S. v. Coscia*, Case No. 14 CR 551 (N.D.Ill. Dec. 15, 2014), Dkt. No. 28.

⁸⁸ Gregory Mocek and Jonathan Flynn, “Spoofing” - A New, Amorphous Crime with Domestic & International Implications for Traders, *Commodities Now*, (Feb. 2016), <http://www.cadwalader.com/uploads/books/ecef383400c1b1041b556aee35dae608.pdf>.

⁸⁹ *U.S. v. Coscia*, Case No. 14 CR 551 (N.D.Ill. Apr. 16, 2015), Dkt. No. 31.

⁹⁰ *Id.* at 1.

⁹¹ *Id.* at 2.

⁹² *U.S. v. Coscia*, Dkt. No. 28 at 2.

⁹³ *Id.* at 15.

⁹⁴ *Id.*

⁹⁵ *U.S. v. Coscia*, Dkt. No. 31.

⁹⁶ *Id.* at 12.

⁹⁷ *Id.* at 11.

⁹⁸ *Id.*

⁹⁹ *Id.* at 6.

¹⁰⁰ *Id.* at 16.

¹⁰¹ See High-Frequency Trader Convicted of Disrupting Commodity Futures Market in First

Federal Prosecution of “Spoofing,” (Nov. 3, 2015), <http://www.justice.gov/usao-ndil/pr/high-frequency-trader-convicted-disrupting-commodity-futures-market-first-federal>.

¹⁰² *Id.*

¹⁰³ Peter Henning, *Conviction Offers Guide to Future ‘Spoofing’ Cases*, *The New York Times*, (Nov. 9, 2015), <http://www.nytimes.com/2015/11/10/business/dealbook/conviction-offers-guide-to-future-spoofing-cases.html>.

¹⁰⁴ Pirrong, *supra* note 89.

¹⁰⁵ See Matthew Leising and Janan Hannah, “Can a \$24 Billion Hedge Fund Blow the Whistle? Citadel Thinks So,” *Bloomberg* (April 29, 2016), <http://www.bloomberg.com/news/articles/2016-04-29/can-a-24-billion-hedge-fund-blow-the-whistle-citadel-thinks-so>.

¹⁰⁶ Leising, *supra* note 6.

¹⁰⁷ See *HTG Capital Partners, LLC v. Doe(s)*, No. 15-cv-02129 (N.D.Ill. Sept. 22, 2015), Dkt. No. 30.

¹⁰⁸ See Craig Pirrong, *I’m Not Spoofing You About Judicial Overkill*, *Streetwise Professor*, (Nov. 4, 2015), <http://streetwiseprofessor.com/?p=9678>.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² See Craig Pirrong, *Spoof Me Once, Shame on You: Spoof Me Twice, Shame on Me*, *Streetwise Professor*, Dec. 29, 2015, <http://streetwiseprofessor.com/?p=9762>.

¹¹³ *Id.*

¹¹⁴ See Staff Roundtable on Disruptive Trading Practices, Dec. 2, 2010, tr. at 170.

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 171-72.

¹¹⁷ See CME Comment Letter on Antidistruptive Practices Authority, (Jan. 3, 2011) at 2.

¹¹⁸ Roberto Barros, *CFTC Spoofing Crackdown Poses Compliance Challenges*, *Risk.net*, (Nov. 23, 2015), <http://www.risk.net/energy-ris>

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¹¹⁹*Id.*

¹²⁰*See* Futures Industry Association (“FIA”) Comment Letter on Antidisruptive Practices

Authority, (Dec. 23, 2010) at 3.

¹²¹Matt Levine, *Regulators Bring a Strange Spoofing Case*, BloombergView, (Oct. 21, 2015), <http://www.bloomberglaw.com/articles/2015-10-21/regulators-bring-a-strange-spoofing-case>.