

CLIENT ALERT

Spoofing Cases Provide Insight into Civil Penalties and Highlight Criminal Exposure

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On January 29, 2018, the Commodity Futures Trading Commission (“**CFTC**”) announced coordinated enforcement action with criminal authorities related to the disruptive trading practice known as “spoofing.”¹ The civil and criminal actions highlight the fact that spoofing can be prosecuted criminally and civilly. In addition, these cases are part of the growing trend toward more concurrent civil and criminal enforcement actions for alleged violations of U.S. commodities laws.² Interestingly, most of the CFTC settlement orders, the civil complaints, and the criminal complaints encompass conduct that predates the addition of spoofing as a prohibited disruptive trading practice under the Commodity Exchange Act (“**CEA**”).

The CFTC issued settlement orders with three companies, Deutsche Bank AG and Deutsche Bank Securities Inc. (collectively “**DB**”), UBS AG (“**UBS**”), and HSBC Securities (USA) Inc. (“**HSBC**”).³ These companies agreed to pay civil monetary penalties in the following amounts: \$30 million for DB; \$15 million for UBS; and \$1.6 million for HSBC. Each company also agreed to undertakings, including the implementation of systems to detect spoofing and training for relevant employees. Apart from the settlement orders, the CFTC also filed civil complaints in various federal district courts against the companies’ former traders along with civil complaints against other individuals, as well as against an electronic trading

¹ The CFTC press release announcing the collective action related to spoofing activity is available [here](#).

² See prior Willkie Farr & Gallagher (“**Willkie**”) summary of the new Administration’s hard line against spoofing available [here](#).

³ The CFTC published copies of the company settlement orders: DB (available [here](#)); UBS (available [here](#)); and HSBC (available [here](#)).

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software developer - Edge Financial Technologies.⁴ On the same day as the announcement of the CFTC actions, the U.S. Department of Justice (“DOJ”) filed criminal complaints against eight individuals for essentially the same conduct addressed in the CFTC settlement orders.⁵

I. CFTC Settlement Orders

A. Spooling and Manipulation Strategies

The CFTC settlement orders with DB and UBS involve substantially similar facts. According to the settlement orders, the relevant period for DB’s disruptive trading activity covered approximately five and one-half years (February 2008 through September 2014) and the relevant period for UBS spanned nearly six years (January 2008 through December 2013). Both settlements involve traders allegedly placing large spoof orders to buy in the COMEX precious metals markets along with small resting orders to sell on the other side of the market (or *vice versa*). According to the settlement orders, the traders placed the large spoof orders with the intent to cancel them before execution in order to induce market participants to buy or sell futures contracts and execute the small resting order on the other side of the market. In certain instances, a trader from one company would place the resting order for execution and a trader from the other company would place large spoof orders to help execute the resting order.

Two of the settlement orders summarize trader communications that detail the traders’ intent to place orders to induce others to trade and then cancel the orders before execution.

- December 16, 2008: Trader B writes: “i am bidding futur[e]s at 854 in size.” Trader A responds: “For anyone. Or a spoof?” Trader B explains: “spoof.” Trader A notes: “Don’t leave i[t] out too long . . . U don’t want people leaning on it.”
- January 29, 2009: After Trader A placed and canceled a large number of orders to help Trader C execute his resting order, Trader A writes to Trader C: “so glad I could help . . . got that up 2 bucks . . . that does show u how easy it is to manipulate it so[me]times.”
- July 20, 2011: Trader H notices potential spoofing activity and writes to Trader G: “u saw those good offers in silver?” Trader G replies: “LOL . . . yes . . . it was my colleague . . . mucking around . . . just trying to fill my bid.” Trader H then asks: “he got some kinda spoof program that does that?” and Trader G replies: “no comments.”
- February 11, 2011: Trader E writes to Trader C: “shall we spoof.” Trader C responds: “sure.”

⁴ The CFTC published copies of the Federal civil complaints: Andre Flortron (available [here](#)); James Vorley and Cedric Chanu (available [here](#)); Krishna Mohan (available [here](#)); Jiongsheng Zhao (available [here](#)); and Jitesh Thakkar and Edge Financial Technologies (available [here](#)).

⁵ The DOJ press release announcing the individual indictments is available [here](#).

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The DB and UBS settlement orders also detail alleged manipulative strategies whereby traders from one entity would disclose customer stop-loss orders to traders at the other entity. The traders would coordinate trading to push up or down the price of precious metals futures in order to trigger the customer's stop-loss order and enter into futures positions at artificially high or low prices.

- November 18, 2010: Trader G tells Trader H: “[I] have chunky stop at 27.35 ... keep to urself.” Trader H responds: “go get that chunky monkey.” Trader G then asks: “u wanna come on boar[d]?” After Trader H agrees, Trader G responds by calling them “the hunt brothers.” In response, Trader H wrote: “chill man, they went to jail.”

Compared to the DB and UBS settlements, the spoofing activity described in the HSBC settlement order involves a shorter time period (approximately three years) and is limited to a single HSBC trader who did not appear to coordinate with other traders at HSBC or other firms. These factors likely contributed to the significant difference between the \$30 million and \$15 million civil monetary penalties against DB and UBS, respectively, and the \$1.6 million penalty against HSBC. Importantly, the CFTC described the spoofing strategies in the bank settlement orders as “manual” strategies, which shows that the CFTC’s focus on spoofing is not limited to algorithmic trading.

B. Failure to Supervise

The DB settlement order includes a violation by its affiliated futures commission merchant (“**FCM**”) for failure to supervise pursuant to CFTC Rule 166.3.⁶ According to the order, although DB had policies prohibiting spoofing and electronic surveillance systems designed to detect spoofing, DB did not follow-up on the majority of potential instances of misconduct identified by the electronic surveillance system. The HSBC settlement order did not include a violation for the FCM’s failure to supervise.

C. Benefits Attributable to Cooperating and Self-Reporting

Each of the banks received cooperation credit from the CFTC’s Division of Enforcement, which according to the CFTC amounted to a “substantially reduced civil monetary penalty.” Although each bank received cooperation credit for its conduct during the course of the investigation (*e.g.*, proactive disclosure), the CFTC recognized only UBS for the additional self-reporting credit, based on its report to the Division prior to the Division’s investigation. Given the similarity in facts between the DB settlement order, UBS’s 50% lower civil monetary penalty appears to support the Division of Enforcement’s willingness to provide some monetary credit for self-reporting under the CFTC’s new self-reporting guidance.⁷ DB’s violation for failure to supervise also may account for some of the differences among the civil monetary penalties.

⁶ Because the UBS settlement order did not involve one of its CFTC registrants, the CFTC’s failure to supervise rules did not apply.

⁷ Willkie’s summary of the CFTC’s self-reporting guidance is available [here](#).

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II. CFTC Civil Complaints in Federal Court

The civil complaints filed in the Federal courts raise several important considerations for market participants that trade or that provide other services related to trading commodity derivatives.⁸

A. Complaint Against Jitesh Thakkar and Edge Financial Technologies

Perhaps most notable of the civil and criminal complaints is the action against Jitesh Thakkar and Edge Financial Technologies because these defendants were not parties to any “spoofing” trades.⁹ Edge Financial Technologies allegedly designed the computer programs that were used in a “spoofing” scheme, and “willfully aided, abetted, counseled, commanded, induced, or procured the commission” of the “spoofing” acts.¹⁰ According to the complaint, under Section 13(a) of the CEA, they were liable for the spoofing violations “as if they were principals.”¹¹ The CFTC must meet a high standard of intent to prove CEA Section 13(a) violations. Moreover, the complaint alleges that Mr. Thakkar is liable for the violations of Edge Financial Technologies. because Mr. Thakkar was a controlling person who “did not act in good faith or knowingly induced, directly or indirectly, the acts of Edge that constitute violations alleged in” the complaint.¹² The CFTC uses two forms of secondary liability, aiding and abetting, and controlling person, to bring this action against Mr. Thakkar and Edge Financial Technologies.

B. Evidence of Wrongdoing and Implications for Compliance and Surveillance Programs

Several of the complaints included traditional evidence of wrongful intent such as email and instant message communications.¹³ However, some of the complaints relied heavily on trading patterns and statistical analysis of the types of orders that were filled. For example, in the complaint against Krishna Mohan, the CFTC states that, “Mohan placed approximately 2,400 Genuine Orders during the Relevant Period. Of those, about 39% of the contracts associated with the Genuine Orders were filled. In contrast, less than 1% of the contracts associated with the approximately 36,300 Spoof Orders were filled.”¹⁴ In addition, in two complaints against individuals, the CFTC noted that the majority of the spoofing

⁸ While the trading that is the subject of these enforcement actions involved futures on exchanges, the CFTC’s broader anti-manipulation and anti-fraud authority also extends to the cash markets.

⁹ See Complaint at 18, *Commodity Futures Trading Commission v. Jitesh Thakkar and Edge Financial Technologies, Inc.*, Case No. 1:18-cv-00619 (Jan. 28, 2018) (“**Thakkar Complaint**”).

¹⁰ Thakkar Complaint at 18.

¹¹ *Id.*

¹² *Id.*

¹³ See, e.g., Thakkar Complaint at 6-7 (The CFTC alleged that the trader explained to Thakkar how the program should work to effectuate the spoofing scheme, including evidence of an intent to fill certain “genuine orders” while efforts to avoid filling the “spoofing” orders.); Complaint at 11, *Commodity Futures Trading Commission v. James Vorley and Cedric Chanu*, Case No. 18-cv-00603 (Jan. 28, 2018).

¹⁴ Complaint at 13, *Commodity Futures Trading Commission v. Krishna Mohan*, Case No. 4:18-cv-00260 (Jan. 28, 2018) (“**Mohan Complaint**”).

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orders occurred during after-hours when the spoofing orders were less likely to be hit.¹⁵ One takeaway from these facts is that companies that wish to detect and deter this type of behavior should consider using surveillance systems that employ computer programs with specific parameters designed to detect and flag these types of trading patterns. This type of surveillance coupled with ongoing monitoring of communications could provide powerful surveillance and compliance tools for companies.¹⁶

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¹⁵ See Mohan Complaint at 12; Complaint at 9, *Commodity Futures Trading Commission v. Jiongsheng Zhao*, Case No. 1:18-cv-00620 (Jan. 28, 2018).

¹⁶ In revising their rules to expressly prohibit certain disruptive trading practices, the Chicago Mercantile Exchange and ICE Futures U.S. provided various factors that they would evaluate to determine whether there has been a violation. See CME Market Regulation Advisory Notice RA1516-5 (available [here](#)) and ICE Futures U.S. Disruptive Trading Practices FAQ (available [here](#)).