On October 2, 2014, the U.S. Attorney for the Northern District of Illinois announced the indictment of Michael Coscia, the owner of Panther Energy Trading ("Panther"), for six counts of commodities fraud and six counts of spoofing. This indictment represents the first ever criminal case to use the anti-manipulation authority provided in the Section 747 of the Dodd-Frank Act to charge spoofing in the context of commodities transactions, and is one of the first major cases announced by the newly-formed Securities and Commodities Fraud section of the U.S. Attorney’s Office for the Northern District of Illinois.

The indictment alleges that Coscia perpetrated the fraud during the fall of 2011 when he designed a trading program that used an algorithm to submit orders that were frequently cancelled before execution. The alleged unlawful conduct affected contracts traded on the CME’s Globex and ICE Futures Europe in various futures contracts including energy products, metals, interest rates, agricultural products, stock indices, and foreign currency futures contracts.

These criminal charges come more than one year after the July 2013 announcement of several civil actions brought by the Commodity Futures Trading Commission ("CFTC"), the CME Group ("CME"), and the U.K. Financial Conduct Authority ("FCA") in which Coscia and Panther agreed to pay significant fines and penalties and to disgorge the profits gained as a result of this trading activity. Specifically, on July 22, 2013, the CME settled a disciplinary action against Panther and Coscia that resulted in the imposition of fines totaling $800,000 and ordered disgorgement of $1.3 million in profits. The CME placed a six-month trading ban on Coscia. Also on July 22, 2013, Panther and Coscia settled the CFTC claims for $2.8 million, comprised of a $1.4 million civil monetary penalty and $1.4 million in disgorged profits. Simultaneously, the FCA imposed a fine on Coscia for approximately $903,000 (£597,000) concerning allegations of market abuse on ICE Futures Europe for the same conduct.

The indictment has important legal implications for several reasons:

- It pushes the boundary of criminal prosecution of conduct that the CFTC previously pursued;
- It reminds market participants that multiple regulatory bodies are potentially interested in pursuing claims for the same conduct; and
- The use of the criminal code to charge the conduct at issue as commodities fraud results in more than double the maximum imprisonment term (25 years) compared to the criminal spoofing charge under the Commodity Exchange Act ("CEA"), which results in a maximum 10 year term.

Based on what appear to be the same facts as those in the settled CME, CFTC, and FCA actions, the indictment charges Coscia individually with criminal violations of the CEA and federal anti-fraud statutes. The indictment raises interesting legal issues, and the progress of the case should be of great interest to market participants – especially since spoofing has never before been alleged to be criminal behavior under the CEA.

The allegations in the indictment seem to indicate that the same conduct constitutes both commodities fraud and criminal spoofing, which raises the question of whether spoofing can be a stand-alone charge. It appears that the prosecutors’ theory is that spoofing misrepresents fraudulently to market participants the volume of bids and offers in the market. If prosecutors believe that spoofing is a
form of fraud, but different in some way, in kind or degree, from fraud charged under the CEA, we might expect to see more indictments that allege commodities fraud – with its 25 year maximum prison term – in addition to spoofing charges in the future.

In light of the fact patterns and evolution of the Panther/Coscia actions, another recent case warrants a close look by market participants and advisors. On December 4, 2012, the CFTC filed a civil complaint in the Southern District of New York against Eric Moncada, BES Capital LLC, and Serdika LLC alleging eight counts of violations of the CEA in the Fall of 2009.7 The Moncada case presents several important differences from the Coscia case. First, the conduct at issue was executed manually, without the aid of an algorithmic program. Second, the alleged spoofing orders occurred at just one price level of the order book rather than the layering alleged in the Coscia indictment. Third, since the conduct took place in 2009, it preceded the antidisruptive trading authority in the Dodd-Frank Act. Thus, the CFTC charged Moncada with counts of attempted manipulation and fictitious sales under the CEA.

Although “spoofing” is not explicitly alleged in the complaint, the allegations bear a strong resemblance to the allegations in the Coscia indictment. Specifically, the CFTC alleges that Moncada utilized trading tactics in the CBOT #2 Soft Red Winter Wheat futures contract on Globex that included placing and immediately cancelling numerous large orders “with the intent to create the misleading impression of increasing liquidity in the market,” “placing these large-lot orders at or near the best bid or offer price in a manner to avoid being filled by the market,” and “placing small-lot orders on the opposite side of the market from these large-lot orders with the intent of taking advantage of any price movements that might result from the misleading impression of increasing liquidity.”8 The Court ruled in its summary judgment order in July 2014 that “the most compelling inference one might draw from the trading records is that Moncada was indeed trying to manipulate the market.”9 Under a Consent Order issued on October 1, 2014, Moncada was ordered to pay a civil monetary penalty in the amount of $1.56 million.10

**What Constitutes Spoofing According to the Allegations?**

To date, regulators have provided market participants with little practical guidance around the definition of spoofing, and it is unclear of what elements the criminal offense of spoofing consists.11 In turn, potential defendants facing claims of spoofing under the CEA can plead defenses associated with the vague nature of the statute.12 According to the amended CEA and CFTC Interpretive Guidance and Policy Statement (“CFTC Interpretive Guidance”) related to Antidisruptive Practices Authority dated May 28, 2013, “spoofing” is currently defined as “bidding or offering with the intent to cancel the bid or offer before execution.”13 As also noted in the CME’s Rule 575 and Market Regulation Advisory Notice that became effective September 15, 2014, “[a]ll orders must be entered for the purpose of executing bona fide transactions … 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.”14 In addition, “[p]lacing a bona fide order on one side of the market while entering order(s) on the other side of the market without intention to trade those orders violates Rule 575.”15

Indeed, the spoofing counts in the Coscia indictment outline only a few basic facts about each episode. For one example, which we discuss further below, the indictment specifies only:

---

7  *See Complaint, CFTC v. Moncada, No. 12-8791 (S.D.N.Y. Dec. 4, 2012) (“Moncada Complaint”). The complaint alleges that Moncada violated Sections 6(c), 6(d) and 9(a)(2) of the CEA, 7 U.S.C. §§ 9, 13(b) and 13(a)(2) (2006). Id. at 2. In addition, the complaint also alleges “fictitious sales” undertaken by Moncada by using different accounts controlled by Moncada, which violated Section 4c(a) of the CEA, 7 U.S.C. § 6c(a) (2006), and constituted non-competitive conduct that violated CFTC Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2012). Id. at 3.*

8  Moncada Complaint at 2.


10  *Consent Order for Permanent Injunction, Civil Monetary Penalty and Other Equitable Relief Against Eric Moncada at 17, CFTC v. Moncada, No. 12-8791 (S.D.N.Y. Oct. 1, 2014) (“Moncada Consent Order”).*


12  *Kolender v. Lawson, 461 U.S. 352, 356 (1983) (a statute can be voided due to vagueness if it fails to “define the criminal offense with sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement.”).*


15  *Rule 575 Advisory Notice at 9. This includes cases in which a market participant enters orders in Market A that are not intended to be executed but rather to elicit certain reactions in a related Market B. Id. at 10.*
On or about September 2, 2011, at approximately 9:39 a.m., at Aurora, in the Northern District of Illinois, Eastern Division, and elsewhere, MICHAEL COSCIA, defendant herein, knowingly engaged in trading, practice and conduct, on and subject to the rules of CME Group markets, that was, was of the character of, and was commonly known to the trade as, “spoofing,” by causing to be transmitted to a CME Group server gold commodity futures contract orders that he intended to cancel before execution, so he could purchase 28 contracts at a below-market price and then sell them immediately thereafter for a higher price, in order to obtain a profit of approximately $560 in less than a second… 16

To shed more light on the potential considerations that have been discussed by the regulators to assess “spoofing” or similar manipulative activity, we will discuss the various fact patterns as well as examples of actual trading patterns observed for each of the Panther/Coscia and Moncada cases.

U.S. v. Michael Coscia

According to the indictment, Coscia’s trading scheme involved designing programming algorithms which would allegedly place several layers of large orders (“quote orders”) near the best bid or offer (“BBO”), often within three ticks, “to create the illusion of market interest” in order to induce other traders to react to the deceptive market information that he created, and to move activity and the price toward small bona-fide resting order on the opposite side (“trade orders”).17 Allegedly, “Coscia intended to, and did, mislead other traders, causing them to react, because his quote orders appeared to represent a substantial change in the market.”18

The indictment mentioned that “it was unlawful for traders to bid or offer with the intent to cancel the bid or offer before execution.”19 According to the indictment, Coscia’s algorithm was specifically designed to cancel those “misleading quote orders” immediately if any quote order was partially filled. As a result, the vast majority of those orders were cancelled.20 In contrast, a much higher percentage of smaller “trade orders” on the opposite side of the large “quote orders” were filled or executed.

The algorithm purportedly looked for favorable market conditions for Coscia’s trading strategy when placing the large orders, such as price stability, low volume at the best bid/ask, and a narrow spread.21 The algorithm also allegedly allowed the order activity to be conducted frequently and within fractions of a second.

Although the indictment explains that the program would automatically cancel all remaining large quote orders following a partial execution of any large quote orders, a partial execution of smaller trade orders in contrast would not result in cancellation.22 After Coscia filled his trade orders, Coscia allegedly would immediately perform the same trading pattern on the opposite side, which would allow him to make a profit on the difference in price between the first and second trade orders.23 In addition, he purportedly would sometimes place a “ping order” of one contract to test the market to ensure that his strategy would work well, and repeat similar trading patterns many times (sometimes hundreds of times) a day.

The FCA Final Notice issued by the U.K. regulators also mentioned that although Coscia’s trading did not necessarily generate obvious price impact, it allegedly created an impression of false liquidity, and eventually had a detrimental impact on the market’s overall liquidity. The FCA alleged that at least one significant market participant stopped trading as a result of Coscia’s misconduct.24 Interestingly, the FCA also noted that “[t]he market participants who were most likely to trade with Mr[.] Coscia and be impacted by his trading strategy were HFT market participants or traders using algorithmic and/ or automated systems rather than manual traders.”25

16 Indictment at 15, United States v. Coscia, No. 14-551 (N.D. Ill. Oct. 1, 2014) (“Coscia Indictment”). Interestingly, the Dodd-Frank provision for spoofing was enacted in 2010, the activity in question occurred in 2011, the CFTC Interpretive Guidance was not issued until 2013, and CME Rule 575 was not enacted until 2014. This raises an issue of retroactive application of the CEA statute. See generally Gozlon-Peretz v. United States, 498 U.S. 395, 404 (1991).
17 Coscia Indictment at 5. Coscia allegedly designed programming algorithms that would place orders on CME Globex for 17 metals, energy, interest rate, agricultural, stock index, foreign currency products, and on ICE Futures Europe for three contracts during the period from August to October 2011. Id. at 4-5.
18 Id at 5.
19 Id. at 2.
20 Coscia Indictment at 5.
21 Id. at 4.
22 FCA Final Notice at 4.
23 Coscia Indictment at 6.
24 FCA Final Notice at 7.
25 Id.
Compared to the actual market data, these general descriptions have only limited value in describing the alleged conduct. Before discussing the conduct at issue in the context of the market data, it may be helpful to cover background on interpreting the data. An order book consists of offers to sell contracts at specified prices, and bids to buy contracts at specified prices. Figure 1 shows the CME order book and transactions for the gold futures contract from 9:39:00 to 9:40:00, when the alleged spoofing activity described in the indictment occurred. The horizontal bars above the horizontal gray line (the mid-market) represent offers to sell gold futures; the horizontal bars below the gray line represent bids to buy gold futures, with each bar representing orders placed at a distinct price level.26 Thus, at 9:39:30, there are offers to sell gold futures at prices from $1,880.80 (the best offer) and higher, and bids to buy at $1,880.60 (the best bid) and lower. The $0.20 gap between $1,880.60 and $1,880.80 represents the bid-ask spread. The colors of the horizontal bars at each price level represent the quantity shown to be offered or bid at each price level.27 Finally, the lower portion of each panel shows the quantity of consummated transactions.

At around 9:39:35, an episode with high order and transaction quantities on both sides of the market stands out. Figure 2 shows this episode in detail. This is the only episode in the CME market depth data from 9:39:00 to 9:40:00 fitting the general pattern of conduct and magnitude described in the indictment. Around 9:39:34.54, buy orders with a total size of approximately 32 contracts were placed at the best bid of $1,880.70. Immediately thereafter, three layers of large sell orders (i.e., the “quote orders”) were placed at and near (within three tick levels) the best offer at $1,880.90. The existing order quantity at the best offer was 4 before an order of 77 contracts entered the order book at 9:39:34.65. Within the next 0.2 seconds, 2928 contracts were traded at the best bid at $1,880.7, and the layers of large sell “quote orders” were immediately cancelled after the “trade orders” were filled. Three-tenths of a second later, at around 9:39:34.89, a similar pattern appeared on the opposite side of the order book. A sell “trade order” of 28 contracts was placed at the best offer

26 The data used to create the chart come from CME Market Depth, which provides data for a 10-depth order book (i.e., an order book that shows ten price levels on each side of the market) for gold futures.

27 Note that the color represents only the quantity shown to the market. Additional quantities may be available at each level through iceberg/hidden quantity orders (i.e., orders which make only a portion of the quantity visible to other market participants even though the order is valid for a larger quantity).

28 Note that the indictment alleges that Coscia purchased and sold 28 contracts. The publicly-available CME market depth data does not identify the counterparties involved in orders or transactions. See Coscia Indictment at 15.
at $1,880.90. By around 9:39:35.23, four layers of large buy “quote orders” appear, including an order of 75 at the best bid of $1,880.80. A series of trades of more than 30 contracts transacted in the next 0.03 seconds at $1,880.90, after the large orders were placed. Immediately after the sell trade orders were filled (within 0.01 seconds), the layers of large buy “quote orders” were completely cancelled.

Inducing other market participants to fill buy orders at $1,880.70 and then sell orders at $1,880.90 on approximately 28 contracts would have generated profits of approximately $560 within 1 second, consistent with the allegation from the indictment.29

U.S. Commodity Futures Trading Commission v. Eric Moncada, BES Capital LLC, and Serdika LLC

The CFTC alleges that on eight days in October 200930 Moncada employed a “manipulative scheme” by manually placing and immediately canceling large-lot orders (orders with lot sizes above 200 contracts)31 at or near the BBO on CBOT’s Globex for the December 2009 #2 Soft Red Winter Wheat Futures contract (“wheat futures contract”) in a manner to create the misleading impression of increasing liquidity in the market, and by placing small-lot orders on the opposite side of the market immediately before or immediately after placing the large-lot orders in order to benefit from the potential price movements induced by the large-lot orders.32

The CFTC alleges that Moncada never intended to fill his large-lot orders, by pointing to the following evidence:

- The large-lot orders were in the market on average just over 2 seconds.
- Moncada frequently placed the large-lot orders when there were already several orders at the BBO with time priority, to avoid his own large orders being filled.
- Measured by volume, more than 97.7% of Moncada’s large orders were cancelled compared

30 October 6, 12, 14, 19, 26, 27, 29, and 30.
32 Moncada Consent Order at 5-6.
to the rest of the market large-lot orders which had cancellation rates varying between 5.3% and 40.5% on the eight days.

For orders that Moncada eventually executed, Moncada allegedly used “iceberg” orders frequently, a strategy to minimize price movements and hence obtain better execution by placing “orders for a large number of lots that only display a small number of the lots to the market at any one time as predetermined by the trader.”

In contrast, for the large-lot orders, Moncada rarely used iceberg orders so these orders were fully visible to the market participants.

The graphs below depict an example of the wheat futures trading pattern during 10:33 to 10:39 AM CST on October 29, 2009 described in the Court’s Consent Order for Permanent Injunction and Civil Monetary Penalty.

According to the Consent Order and shown in Figures 3 and 4, Moncada bought 25 lots of December 2009 wheat futures contract at prices of $506.5 and $506.75 at about 10:33. Then, as shown in Figures 4-6, Moncada placed six large-lot buy orders on the best bid price at 10:33:25.251, 10:34:40.764, 10:35:41.260, 10:36:42.715, 10:37:40.395, and 10:38:24.755, with lot sizes of either 402 or 500. Each large-lot order stood on the order book less than three seconds. Less than 0.05% of the contracts in total were filled through these large lots, while approximately 2,700 contracts were cancelled. In contrast, as can be seen from Figure 3, most of the resting orders on the CME order book on that day had a size of below 100 contracts.

Moncada then entered into a series of sell orders at around 10:38 to 10:39, as can be seen in Figure 3 and Figure 6, at prices ranging from $507 to $508.75. A total of 66 lots were ultimately filled, which allowed him to benefit from the pricing difference between his buy orders and sell orders that were executed. Note that during this time period there is only a single visible large-lot order in the order book and it appears consistent with the order submission activity discussed in the Consent Order.

33 Id. at 12.
34 Id. at 9.
35 Id. at 8.
36 The time stamps of these orders can be matched with those described in the Moncada Consent Order within 5 milliseconds.
37 Moncada Consent Order at 9.
38 The trades of Moncada have been matched by price and nearest time according to the description of the Consent Order.
39 Moncada Consent Order at 9. Note that it is unclear that the increase in price during the time frame from 10:33 to 10:39 could be directly attributed to the large-lot orders submitted by Moncada.
What Do We Learn from the Evidence of the Two Cases?

Although the trading strategies employed by Moncada and Coscia were different in certain aspects, such as whether a programming algorithm was used, whether “layering” (i.e., large orders were placed on several price levels) was employed, as well as the frequency and duration of the order submissions and cancellations, the two cases share important common characteristics that the regulators rely on to determine whether the conduct constitutes “spoofing” or disruptive practices.

As mentioned in the Rule 575 Advisory Notice, regulators will consider a variety of factors in assessing whether certain conduct is “disruptive,” such as the market participant’s intent, the effect of the activity on the market, the historic pattern of activity, the size, duration, price and time priority of the order relative to the relevant market.40 On the other hand, the CFTC Interpretive Guidance and the Advisory Notice explicitly state that factors such as an execution or a partial fill of an order do not automatically cause the order to be considered compliant with regulation.41

Indeed, as seen in both Coscia and Moncada cases, regulators pointed to the factors such as the duration and cancellation rate of the large quote orders (relative to that of the small order or other market participants), whether the large quote orders were placed systematically on the opposite side of the trading, as well as market impact or other tactics used to assess whether certain conduct should be deemed as “spoofing.”

40 Rule 575 Advisory Notice at 3.
41 Antidisruptive Practices Authority, Interpretive Guidance and Policy Statement at 31,896; Rule 575 Advisory Notice at 4.