A Legislative Improvement to Anti-Spoofing Enforcement Efforts in the Securities Markets

George Leonardo[*]

ABSTRACT

As high-frequency trading becomes more ingrained as a mainstay in financial markets, the need for efficient, fair, and consistent regulation is becoming increasingly important. Although the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") took a strong step forward in reducing market manipulation by explicitly prohibiting a price manipulation practice known as spoofing in the commodities and futures markets, no such clear prohibition currently exists in securities markets. The Securities Exchange Commission ("SEC") has historically brought spoofing enforcement actions under general anti-manipulation and anti-fraud provisions of the Securities Exchange Act of 1934 ("Exchange Act"). Specifically, the SEC has relied on §9(a)(2) and §10(b) of the Securities Exchange Act of 1934, as well as Rule 10b-5. However, almost all spoofing cases brought by the SEC have been settled out of court. Moreover, an analysis of the limited case law applying these general provisions suggests spoofing may not necessarily violate these provisions, particularly in the Second Circuit. Because it is, at best, unclear whether courts will find that spoofing violates §10(b) or Rule 10b-5, or §9(a)(2), this paper argues that Congress should pass legislation that extends application of Dodd-Frank's anti-spoofing provision from commodities and futures markets to the securities markets. Specifically, Congress should provide the SEC the same authority Dodd-Frank provides the Commodities and Futures Trading Commission ("CFTC") by explicitly prohibiting spoofing in securities and defining spoofing as "bidding or offering with the intent to cancel the bid or offer before execution." This language would bolster SEC enforcement efforts by lessening the intent requirement from the current general anti-fraud and anti-manipulation provisions. It would also ensure consistency between anti-spoofing enforcement regimes in futures and securities markets and further deter spoofing generally.

[*] J.D. Candidate, (The George Washington University Law School, 2020); B.A., (Boston College, 2013). The author would like to thank Professor Walter E. Zalenski (Partner—Buckley Sandler LLP) and the BFLR Notes Editors for their valuable guidance throughout this process.

TABLE OF CONTENTS

ABSTRACT 259
TABLE OF CONTENTS 260
I. INTRODUCTION OF SPOOFING. 261
A. Subject Matter Overview 261
B. Regulatory Landscape Overview 262
II. ANALYSIS OF SECOND CIRCUIT CASE LAW UNDER §10B AND RULE 10B-5, GENERALLY 265
A. Second Circuit and the ATSI "Something More" Standard for Market Manipulation 265
i. Facts of *ATSI* 266
ii. *ATSI* Analysis 266
B. SDNY Cases Applying ATSI 268
i. Assumption of Risk Approach 268
ii. Intent of the Party Approach Cases 269
III. APPLICATION OF SECOND CIRCUIT CASE LAW OF §10B AND RULE 10B-5 TO POTENTIAL SPOOFING CASES 269
A. Assumption of Risk Approach 269
B. Intent of Trader Approach 270
C. Policy Goals of §10(b) and 10b-5 271
IV. ANALYSIS OF SPOOFING ENFORCEMENT UNDER §9(A)(2) OF THE SECURITIES EXCHANGE ACT 273
V. ANTI-SPOOFING ENFORCEMENT IN COMMODITIES AND FUTURES MARKETS 274
A. History of CFTC Spoofing Enforcement 274
B. *U.S. v. Coscia* 276
C. Post *Coscia* Impact on CFTC Enforcement Actions 278
VI. LEGISLATIVE SOLUTION TO DEFINE "SPOOFING" UNDER THE EXCHANGE ACT AS IT IS DEFINED UNDER THE COMMODITY EXCHANGE ACT 279
A. Advantages of New Legislation 279
i. Bolster SEC Enforcement Efforts Through Lower Evidentiary Burden 279
ii. Provide Parity in Enforcement Regimes 281
B. Potential Criticisms of Proposed Legislation 282
i. Expressio Unius Est Exclusio Alterius 282
ii. Bright Line Avoidance 282
iii. Deterring Legitimate Trading Activity 283
iv. Political Gridlock 283
CONCLUSION 284

I. INTRODUCTION OF SPOOFING

A. Subject Matter Overview

High frequency trading has reshaped the financial industry. It steadily accounts for nearly half of all equity trading, and reached as high as 60 percent of all equity trades in 2009.[1] In terms of volume, an average of 6.2 billion shares per day changed hands in December 2018 on U.S. exchanges.[2] Given the increased presence of high-frequency trading in the markets, financial regulators have been pursuing a more aggressive enforcement policy in the high-frequency trading arena.[3] In particular, preventing market manipulation through "spoofing" has been a key focus.[4]

Spoofing is a relatively new form of market manipulation.[5] Spoofing occurs when a trader sends a large order into the market, for example, a buy order for the purchase of hard red winter wheat futures, with an intent to cancel the order before it can be executed. When the same trader places the large order, the trader simultaneously places a smaller order on the opposite side of the market, in this example, a sell order for hard red winter wheat futures. The trader hopes that the smaller sell order will be executed. The trader places the large buy order to signal to other traders that demand is moving upwards, creating an increase in price. Once the smaller order is executed, the trader will terminate the large order. When the price goes down as a result of the canceled buy order, which the trader never intended to execute in the first place, the trader will profit from the sell orders. The converse could also occur, where a trader places sell orders to lower the price, and then profits from buying shares that then raise in value.

Spoofing activity can take place over the course of seconds and traders can execute spoofing transactions millions of times in one day. For example, on the day of the Flash Crash of 2010, which temporarily wiped out almost $1 trillion value in U.S. stock markets, one notorious trader, Navinder Singh Sarao was "accused of changing or moving futures contracts more than 20 million times."[6] In just one hour, the Dow Jones Industrial

---

[1] Ryan Vlastelica, *High-frequency Trading Has Reshaped Wall Street in its Image*, MARKETWATCH (MAR. 17, 2017), https://www.marketwatch.com/story/high-frequency-trading-has-reshaped-wall-street-in-its-image-2017-03-1.

[2] Bruce Blythe, *That's Fast! High-Frequency and Algorithmic Trading*, THE TICKER TAPE (Jan. 15, 2019) https://tickertape.tdameritrade.com/trading/high-frequency-algorithmic-trading-17182.

[3] Lewis J. Liman et al., *Cleary Gottlieb Discusses Federal Spoofing*, THE CLS BLUE SKY BLOG (Aug. 16, 2017), http://clsbluesky.law.columbia.edu/2017/08/16/cleary-gottlieb-discusses-federal-spoofing-conviction/.

[4] Michael A. Asaro & Richard Williams Jr., *"Spoofing": The SEC Calls it Manipulation, But Will Courts Agree?*, 258-No. 10 N.Y. L. J. (July 17, 2017), https://www.akingump.com/images/content/5/9/v2/59261/Asaro .Williams.NYLJ.pdf.

[5] *See id.*

[6] Matthew Leising, *Spoofing*, BLOOMBERG (January 19, 2017, 1:01 PM), https://www.bloomberg.com/quicktake/spoofing.

Average experienced a "near 1,000 point loss and recovery."[7] While the Flash Crash magnified spoofing in the public's eye, it appears to be more popular among trading professionals than public awareness would suggest. For example, one estimate proposes "there are ten to twenty highly suspicious trading incidents" per day, and possibly "several hundred more moderately suspicious incidents per day."[8]

Given the speed and volume at which spoofing can impact markets,[9] it is not surprising that regulators have been keying in on eliminating this relatively new form of market manipulation.[10]

B. Regulatory Landscape Overview

Amidst the rise of high-frequency trading and the potential impact of market manipulation of spoofing, Congress enacted Dodd-Frank.[11] Although this comprehensive financial regulatory overhaul was widely impactful, it specifically included a provision targeting spoofing in the commodities and futures markets, but not in securities markets. Specifically, 7 U.S.C. §6c(a)(5), states "It shall be unlawful for any person to engage any trading, practice, or 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)."[12] Penalties for spoofing include a maximum prison sentence of 10 years and a fine of the greater of $1 million or triple the monetary gain resulting from the alleged misconduct.[13] Since the passage of Dodd-Frank, the CFTC and the Department of Justice have more aggressively prosecuted spoofing in the futures market.[14]

---

[7] Mark Melin, *Here's what actually caused the 2010 "Flash Crash",* BUSINESS INSIDER (Jan. 30, 2016 10:57 AM), https://www.businessinsider.com/what-actually-caused-2010-flash-crash-2016-1.

[8] John I. Sanders, *Spoofing: A Proposal for Normalizing Divergent Securities and Commodities Futures Regimes*, 51 WAKE FOREST L. REV. 517, 519 (2016) (citing Bradley Hope et al., *Navinder Sarao's 'Flash Crash' Case Highlights Problem of 'Spoofing' in Complex Markets*, WALL STREET J. (May 6, 2015), http://www.wsj.com/articles/navinder-saraos-flash-crash-case-highlights-problem-of-spoofing-in-complex-markets-1430943635).

[9] *See* Blythe, *supra* note 2 ("Today's increasingly powerful computers can execute thousands, if not millions, of transactions in seconds [.]").

[10] *See* Leising, *supra* note 6; s*ee also* James M. McDonald, Dir., CFTC Enforcement, Speech at NYU School of Law: Program on Corporate Compliance & Enforcement (Nov. 14, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald1 (discussing the creation of the Spoofing Task Force).

[11] Lewis J. Liman et al., *Cleary Gottlieb Discusses Federal Spoofing Conviction*, THE CLS BLUE SKY BLOG (August 16, 2017), http://clsbluesky.law.columbia.edu/2017/08/16/cleary-gottlieb-discusses-federal-spoofing-conviction/.

[12] 7 U.S.C. §6c(a)(5) (2012).

[13] *See* 7 U.S.C. §13(a).

[14] *See U.S. v. Coscia*, F. Supp.3d 653 (N.D. Ill. 2015); *see also In re Panther Energy Trading*, CFTC Docket No. 13-26 (2013); *see also CFTC v. Nav Sarao Futures,* No. 15-cv-03398 (N.D. Ill. filed Nov. 9, 2016).

Interestingly, Congress did not include a similar amendment explicitly authorizing the SEC to prohibit spoofing under federal securities laws.[15] Instead, the SEC generally prosecutes alleged spoofing incidents by relying on §10(b) of the Securities Exchange Act of 1934 (§10b) and Rule 10b-5.[16] These provisions are general anti-fraud provisions,[17] and courts generally interpret them to give the SEC broad enforcement authority to promote the integrity of the market. Some scholars have posited that under these broad provisions, spoofing is and has been prohibited.[18] However, virtually all spoofing actions brought by the SEC have been settled out of court.[19] Thus, no court has specifically weighed in on whether placing an order with an intent to cancel before execution is a clear violation of §10b or Rule 10b-5.[20]

In fact, based on the Second Circuit's current application of §10b and Rule 10-b5 to other forms of market manipulation beyond spoofing, it is unclear whether spoofing constitutes a violation of these provisions.[21] Meanwhile, under the D.C. Circuit Court of Appeals application of the generic market manipulation standards, spoofing *likely* would be a violation.[22] The Second Circuit standard requires "something more" than an otherwise legal open-market securities transaction that creates a false impression of how market participants value a security in order to constitute market manipulation.[23] Courts have interpreted that "something more" to

---

[15] Although why Congress chose not to include the same language is unclear, one possible explanation is that loss potential in futures markets is generally unbounded, and thus manipulation may have more significant effects than in securities markets, where losses or generally limited to the amount of money invested. *See* Ellen Chang, *Futures vs. Options: Which to Invest In?,* THE STREET (Nov. 14, 2018) https://www.thestreet.com/investing/options/futures-vs-options-14781578.

[16] Asaro & Williams Jr., *supra* note 4.

[17] *See Gregory* Scopino, *Preventing Spoofing: From Criminal Prosecution to Social Norms*, 84 U. CIN. L. REV. 1069, 1074 (2016).

[18] *Id.*; *see also* Leising, *supra* note 6.

[19] As of the writing of this Note, there is one case, *SEC v. Lek Securities Corporation*, where there is a judicial opinion analyzing whether § 10(b) and Rule 10b-5 applies to layering, commonly used as another name for spoofing. However, it is a derivative liability case and the opinion analyzes a Rule 12(b)(6) motion. Although the court denied the motion in finding a claim might exist, the case is currently pending review of a summary judgment motion. *SEC v. Lek Sec. Corp*., 267 F. Supp. 3d 49 (S.D.N.Y. 2017).

[20] Clifford C. Histed, *A Look at the 1st Criminal 'Spoofing' Prosecution: Part 1*, LAW360, (April 20,2015 12:01 PM), http://www.klgates.com/files/Publication/7185c754-97ca-4998-ae01-f65e8fc4480d/Presentation/PublicationAttachment/4535dc28-5cfe-41be-8ed4-faadf9e83b53/A_Look_At_The_1st_Criminal_'Spoofing'_Prosecution_Part_1.PDF.

[21] Asaro & Williams Jr., *supra* note 4.

[22] *See Markowski v. SEC*, 274 F.3d 525, 528 (D.C. Cir. 2001) (finding that an otherwise legal-open-market transaction may violate §10(b) and Rule 10b-5 merely with a showing the transactions were executed with the intent to move the price of a security).

[23] *ATSI Comm., Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 101; s*ee also Nanopierce Tech. v. Southridge Capital Mgmt., No. 02 Civ. 0767(LBS),* 2008 WL 250553, at *2 (S.D.N.Y. Jan. 29, 2008) (finding that "something more" is not satisfied by "subjective intent to affect the price of a stock" alone).

mean different things by analyzing three main factors: (1) intent of the party, (2) assumption of risk by the party, and (3) general policy goals of §10b and Rule 10b-5.

The D.C. Circuit standard, on the other hand, merely requires an intent to move the price of a security, even if the open-market transaction is otherwise legal.[24] For example, in *Koch v. SEC*, the Court held that Koch violated §10(b) by purchasing bank stocks near the close of the market with the intent of driving up the stock price for his clients.[25] Even though the stock purchases themselves were legal (and Koch's efforts to drive the price up ultimately failed), the Court held that "intent—not success—is all that must accompany manipulative conduct to prove a violation of the Exchange Act and its implementing regulations."[26] And, because the record contained clear evidence Koch intended the purchases to boost the stock price, the Court found the SEC satisfied the Court's manipulation standard.[27]

Under the D.C. standard, spoofing would most likely be a violation of §10(b). Similarly to the otherwise legal stock purchases found manipulative in *Koch* because of intent to drive up the price,[28] the cancelation of orders before execution would likely be found manipulative under D.C. standard merely by showing intent to drive up (or down) the price. The legality of canceling orders before execution and the assumption of risk assumed by the party, which both weigh against a finding of manipulation in the Second Circuit, are irrelevant under the D.C. standard. Moreover, whereas the D.C. standard focuses on the intent to *move* the price of the security,[29] the Second Circuit keys in on the intent to *artificially* affect the price of a security.[30] Because of these additional factors, the Second Circuit standard for §10(b) and Rule 10b-5 allows for significantly greater analysis of whether spoofing violates these provisions. As a result, the Second Circuit standard will be the focus of this paper.

Alternatively, the SEC has also prosecuted spoofing cases under §9(a)(2) of the Exchange Act.[31] This section is aimed more specifically at punishing market manipulation. It makes it unlawful to engage in trading activity that results in the manipulation of the market by "creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."[32] Like spoofing enforcement actions brought under

---

[24] *Markowski*, 274 F.3d, at 529 (concluding that Congress "determin[ed] that 'manipulation' can be illegal solely because of the actor's purpose).
[25] *Koch v. SEC*, 793 F.3d 147, 152 (D.C. Cir. 2015).
[26] *Id.* at 153-54.
[27] *Id.* at 153 (Specifically, there was evidence of Koch directing an employee in writing to buy stock "30 minutes to an hour before the close of market" and to "get a closing price for High Country in the 20-25 [dollar] range, but certainly above 20.").
[28] *Id.* at 152-56.
[29] *See Markowski*, 274 F.3d at 529.
[30] *See ATSI*, 493 F.3d at 100.
[31] Sanders, *supra* note 8, at 525.
[32] *Id.* at 525-26 (quoting Securities Exchange Act of 1934, 15 U.S.C. §78i(a)(2) (2012).

§10(b) and Rule 10b-5, these actions have primarily settled out of court and settlement agreements have been quite lenient.[33]

This note will examine the current state of market manipulation standards as applied to securities market transactions under §10(b) and Rule 10b-5 in the Second Circuit, and §9(a)(2) in turn. It will then apply these standards to show that it is unclear whether a potential spoofing case would constitute a violation. In doing so, it will contrast the securities market's general market manipulation standard with Dodd-Frank's specific standard for spoofing in futures and commodities markets under §6c(a)(5). Finally, it will conclude with a legislative proposal to improve enforcement of anti-spoofing actions in securities markets and to deter forum shopping for spoofing activities.

II. ANALYSIS OF SECOND CIRCUIT CASE LAW UNDER §10B AND RULE 10B-5, GENERALLY

A. Second Circuit and the ATSI *"Something More" Standard for Market Manipulation*

The Second Circuit standard for market manipulation, as set forth in *ATSI*, holds that an otherwise legal open-market securities transaction must be willfully combined with something more to create a false impression of how market participants value a security.[34] *ATSI* found short-selling not to be manipulative because it was a legal open-market transaction that lacked the "something more."[35] Similarly, the Court found the purchase of convertible securities with limitless loss potential, even when coupled with short-selling, not inherently manipulative.[36] Here, again, the Court reasoned that such open-market transactions lacked the "something more" necessary to create a false impression of market value.[37] Spoofing orders are also open-market securities transactions. Thus, whether transactions are actionable in the Second Circuit likely comes down to whether they contain the "something more" required under *ATSI*. Courts in the Southern District of New York ("SDNY") applying *ATSI* to other alleged market manipulation acts (though not to spoofing), have primarily looked to three factors when answering this question: (1) intent of the party, (2) assumption of risk by the party, and (3) policy goals of §10b and Rule 10b-5. This section walks

[33] *E.g.*, Press Release, Sec. & Exch. Comm'n, SEC Charges N.Y.-Based Brokerage Firm with Layering (Sept. 25, 2012), https://www.sec.gov/news/press-release/2012-2012-197htm [hereinafter *Trade Alpha*] (where executives who orchestrated spoofing schemes for at least a year after receiving express warnings from FINRA were suspended for only two to three years).
[34] *ATSI*, 493 F.3d at 101.
[35] *Id.*
[36] *Id.*
[37] *Id.*

through the Second Circuit's analysis in greater detail to determine whether spoofing would constitute market manipulation.

i. Facts of ATSI

In *ATSI*, the transaction at issue involved defendants allegedly short-selling securities in ATSI Communications, Inc. ("ATSI") in order to create a "death spiral" whereby ATSI's stock price plummeted.[38] Defendants would short sell ATSI's stock to drive down its price. At the same time, they converted preferred stock into common stock to cover their short position, which in turn diluted existing common shares. This dilution led to further decline in stock price, thus further benefiting the Defendants' short positions.[39] ATSI alleged this scheme constituted market manipulation under §10(b).

ii. ATSI Analysis

In its analysis, the Court began by noting §10(b) is a general prohibition against market manipulation.[40] Citing the Supreme Court, the Second Circuit defined manipulation as something that "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."[41] The key inquiry, then, turned on whether defendants had the requisite intent and what activity constitutes "artificially" affecting a security's price in a deceptive manner.[42] Importantly, the intent requirement stated here is linked to artificially affecting the price of securities on the market as a whole.[43] This is an important distinction from the Dodd-Frank requirement in Commodities and Futures markets, as will be seen below, where intent is merely linked to a trader's *own* conduct, that is, canceling the orders before execution.[44] Moreover, *ATSI* noted that the intent requirement in manipulation claims is of particular importance "because in some cases scienter is the only factor that distinguishes legitimate trading from improper manipulation."[45]

Ultimately, the Court found that the short-selling did not artificially affect stock prices and the defendants did not intend to deceive the market. In reaching this conclusion, the court noted that deception arises when investors are led to believe prices at which they buy and sell securities are not determined by natural market forces of supply and demand.[46] If a transaction sends a false pricing signal to the market, it is likely outside of

[38] *Id.* at 96.
[39] *Id.*.
[40] *Id.* at 100.
[41] *Id.* (citing *Ernst & Ernst v. Hochfielder,* 425 U.S. 185, 199 (1976)).
[42] *Id.* at 100.
[43] *Id.* at 102 (Stating "the complaint must plead with particularly facts giving rise to a strong inference that the defendant intended to deceive investors by artificially affecting the market price of securities.")
[44] 7 U.S.C. §6c(a)(5) (2012).
[45] *ATSI*, 493 F.3d at 102.
[46] *Id.* at 100.

the "natural interplay of supply and demand."[47] Importantly, the court stated that "trading engineered to stimulate demand can mislead investors into believing that the market has discovered some positive news and seeks to exploit it."[48] Borrowing a policy rationale from the Seventh Circuit, the Court concluded protecting against such trading is consistent with the fundamental goal of §10(b) to prohibit market distortions, prevent market rigging, and promote efficient markets.[49]

Despite its statement of market manipulation, the *ATSI* Court did not find that short-selling artificially affected prices but rather found short selling actually enhanced pricing efficiency by moving prices of overvalued securities closer to their actual values.[50] Extending this logic, the Court held that short selling combined with the purchase of convertible securities with limitless loss potential is not inherently manipulative because such purchases also provided a useful market purpose in equipping distressed companies with capital and in hedging against a short sale.[51] Thus, these transactions were not willfully combined with the "something more" necessary to create a false impression of how market participants valued a security. Thus, the transactions were not manipulative. The Court did, however, point to "wash sales, matched orders, or rigged prices" as examples of what may contain the "something more" necessary to constitute market manipulation.[52]

Drilling down on the intent requirement, the *ATSI* Court noted that manipulation claims required a heightened standard of scienter. Specifically, the Court stated: "the complaint must plead with particularly facts giving rise to a strong inference that defendant intended to deceive investors by artificially affecting the market price of securities."[53] Ultimately, the Court concluded that ATSI failed to allege specific facts to meet the scienter requirement for two reasons.[54] First, the investment vehicles the defendant profited from were perfectly legal, which is insufficient to create an inference of intent to manipulate.[55] Second, there was a plausible non-culpable

---

[47] *Id*.
[48] *Id.* at 101.
[49] *Id.* at 100 (quoting *Sullivan & Long, Inc. v. Scattered Corp.,* 47 F.3d 857, 861 (7th Cir. 1995)).
[50] *ATSI*, 493 F.3d at 101.
[51] *Id.*
[52] *Id*. Wash sales occur when a party sells or trades securities at a loss and within 30 days or after buys substantially identical securities, generally with the purpose of recognizing an artificially created capital loss. *See Fast Answers: Wash Sales, Sec. & Exch. Comm'n,* https://www.sec.gov/answers/wash.htm. Matched orders are transactions where colluding parties enter buy and sell orders that are substantially similar to create an artificial spike in trading volume without actually assuming any risk. *See* Cent. Bank Bahr., *Manipulating Transactions*, http://www.complinet.com/cbb/display/viewall_display.html?rbid=2176&element_id=3287.
[53] *ATSI*, 493 F.3d at 102.
[54] *Id.* at 104.
[55] *Id*.

alternative explanation for defendant's intent, which is that ATSI and defendants simply entered a mutually beneficial financial transaction.[56]

B. *SDNY Cases Applying* ATSI

Courts in the Southern District of New York have applied the *ATSI standard* to other market manipulation claims, but with mixed methods of analysis.[57] The primary difference between methodologies appears to be whether the court found the critical distinction between legitimate trades and illegitimate trades to be based on the assumption of risk by the trader or the intent of the trader.[58]

i. Assumption of Risk Approach

In *Nanopierce Technologies*, the court explained the *ATSI* decision to hold for the proposition that short-selling with the intent to drive down a price does not constitute market manipulation.[59] Notably, the court distinguished deceptive manipulative activities from legal activities by analyzing the risk assumed by the alleged manipulator. Inherently deceptive trades, as pointed out by *ATSI*, include wash sales and matched orders, which involve little to no risk, whereas activities like short-selling, carry substantial risk.[60] For example, in a wash trade, a trader and broker are generally colluding with each other by buying and selling from each other at a pre-established price. As a result, neither the trader nor broker take on any substantial risk. Short-selling, on the other hand, carries a virtually unlimited risk.[61] This is because, as another court in the Southern District of New York in *Cohen* pointed out, the seller will be forced to cover at whatever price the stock rises to and there is no ceiling on how high the price may rise.[62] Because the short seller takes on such risk, the *ATSI* court determined that the transaction should be viewed as legitimate.[63]

---

[56] *Id*.
[57] *Compare Nanopierce*, 2008 WL 250553, at *2 (S.D.N.Y Jan. 29, 2008) (focusing analysis on risk assumed by parties in distinguishing legitimate trading activity with illegitimate trading activity) *with In re Amaranth Natural Gas Commodities Litig*, 587 F. Supp. 2d 513, 534 (S.D.N.Y. 2008) (focusing on the intent of parties).
[58] *Nanopierce*, 2008 WL 250553, at *2.
[59] *Id.* at *2.
[60] *Id.* at *4.
[61] *ATSI,* 493 F.3d at 96 n.1.
[62] *See Cohen v. Stevanovich*, 722 F. Supp. 2d 416, 424 (S.D.N.Y. 2010); s*ee also ATSI,* 493 F.3d at 96.
[63] *See Nanopierce*, 2008 WL 250553, at *2; *see also ATSI,* 493 F.3d at 96. *See Cohen*, 722 F. Supp. 2d at 424 (S.D.N.Y. 2010) (also adopting risk-based approach in finding short selling not inherently manipulative because unlike a wash sale where the manipulator acts as a buyer and seller without assuming any risk, in a short-sell, "both parties…still bear the market risk of the transaction").

ii. Intent of the Party Approach Cases

In contrast to *Cohen* and *Nanopierce*, other Southern District of New York courts have held that open-market transactions may constitute manipulative activity as long as the activity is coupled with an improper motive.[64] In *In re Amaranth Natural Gas Commodities Litigation*, the Court defined the "something more" required by *ATSI* as "anything that distinguishes a transaction made for legitimate economic purposes from an attempted manipulation."[65] And, "because every transaction signals that buyer and seller have legitimate economic motives for the transaction, if either party lacks that motivation, the signal is inaccurate."[66] Under this inquiry, intent to move the price clearly matters.[67] However, unlike *ATSI*, here, the case involved commodities manipulation, not securities. Nonetheless, the distinction between securities and commodities did not deter the court in finding *ATSI* analogous. This case was decided before Congress explicitly authorized the CFTC to enforce spoofing in the commodities market under 7 U.S.C. §6c(a)(5) while leaving the SEC without parallel authority in the securities market.

III. APPLICATION OF SECOND CIRCUIT CASE LAW OF §10B AND RULE 10B-5 TO POTENTIAL SPOOFING CASES

Taking the above cases together, courts in the Second Circuit appear to primarily weigh two factors in applying §10(b): the risk-assumed by the defending party and the intent of the parties executing the transaction. In *ATSI*, the Second Circuit also pointed to general policy goals of §10b and Rule 10b-5. Whether spoofing meets the Second Circuit standard may depend on which of these factors the Court decides is most significant. This section analyzes whether spoofing constitutes market manipulation under each of these factors.

A. Assumption of Risk Approach

If the Second Circuit adopts the approach of *Nanopierce* and *Cohen*, where assumption of risk is the critical inquiry, SEC enforcement efforts would likely face their toughest challenge to anti-spoofing enforcement under §10(b) and Rule 10b-5. Because spoofers do in fact take on risk.

[64] *See In re Amaranth*, 587 F. Supp. 2d at 534; *see also Sharette v. Credit Suisse Int'l*, 127 Fed. Supp. 3d 60 (S.D.N.Y. 2015) (finding the "something more" required under *ATSI* could be satisfied by a showing of "manipulative intent" in conjunction with open-market transactions).

[65] *In re Amaranth*, 587 F. Supp. 2d at 534.

[66] *Id*.

[67] *Id*.

Orders placed by the spoofer are available on the open market and may be executed before cancelled. Like short selling, which the Second Circuit clearly approved in *ATSI*, spoofing imposes real market risk on the party executing the transactions. In *Nanopierce* and *Cohen*, the SDNY courts prioritized the assumption of risk in distinguishing legitimate from illegitimate transactions. If the Second Circuit agrees with these cases, spoofing may be considered a valid open-market transaction on the grounds that the trader assumes market risk. In that scenario, the question will likely be how substantial is the risk being assumed, considering transactions may only be open for milliseconds at a time.

Viewed in this light, the intent of the party to affect the price may not be as significant. Whether the buyer intends to place the order or cancel order, the spoofer's assumption of risk would remain the same. Such risk may also suffice as a market-based deterrent to spoofing. Thus, it is not clear that SDNY courts applying *Nanopierce* and *Cohen* would find spoofing a violation of §10(b) and Rule 10b-5.

B. Intent of Trader Approach

If the Second Circuit were to adopt the approach in *Sharrette* and *In re Amaranth*,[68] and focus on manipulative intent of the trader rather than assumption of risk, the SEC would likely have a stronger argument for spoofing enforcement under §10(b) and 10b-5. Spoofing, as defined under Dodd-Frank, requires an intent to cancel the order before execution.[69] Thus, under this definition, a spoofer does not intend to execute his initial order and therefore spoofing would result in a violation of §10(b) and Rule 10b-5. The most likely alternative explanation for placing the order would be to depress or inflate the price of the security. As a result, this intent to "artificially" affect the price may be enough to satisfy the "something more" test of *ATSI*.

However, even under this approach, whether spoofing is a violation or not is still unclear. First, as mentioned above, spoofing is not defined under securities regulation, only under commodities regulation. It is unclear whether a court would import the definition from the Dodd-Frank statute. If courts choose not to import the definition, the SEC would still have to prove an intent to manipulate the *entire market*, which is much more challenging than simply showing an intent to cancel an order.[70] For example, in *ATSI*, part of the reason the court granted the motion to dismiss was because ATSI failed to show that defendants' actions had ultimately affected the price of the security at issue.[71] This is a critical distinction from the Dodd-Frank

[68] *See Sharette*, 127 F. Supp. 3d at 82; *See In re Amaranth*, 587 F. Supp. 2d at 534.
[69] 7 U.S.C. § 6c(a)(5)(c) (2012).
[70] *See* Sanders, *supra* note 8, at 531.
[71] *ATSI*, 493 F.3d at 102.

standard which holds that whether the spoofer actually had the ability to manipulate the future or commodity market price is irrelevant.[72]

Second, a trader engaged in spoofing activity does indeed place buy orders that can be bought or sold on the open market. Thus, it is unclear whether this activity is "artificially" increasing demand. Technically, the buy orders are on the open market, so the demand curve has shifted up, if even for a miniscule amount of time. In this way, the spoofing activity may be more analogous to short selling. Under the "death spiral" financing at issue in *ATSI*, the defendants there almost certainly intended to cause the stock price of ATSI to decline.[73] The *ATSI* court did not find such a scheme sufficient on its own to satisfy the "something more" test. In fact, the Court stated: "a strong inference of scienter is not raised by alleging that a legitimate investment vehicle . . . creates an opportunity for profit."[74] Thus, on its own, spoofing with the intent to affect the price of a security, like short-selling, may be considered a valid market transaction. Moreover, any purchase of a security likely involves an intent to move the price of a security at some level, as virtually everyone would hope the purchase results in profit. Thus requiring "something more" than intent to move the price is often critical for courts to distinguish between legitimate actions and manipulative ones.[75]

C. *Policy Goals of §10(b) and 10b-5*

Because the *ATSI* Court pointed to the policy goals of §10(b) and 10b-5 to promote fair and efficient markets, it is helpful to examine the policy arguments that would arise in a spoofing case.[76] First, based on general policy of §10(b), one could argue in the Second Circuit that spoofing leads to unfair and inefficient markets.[77] Arguably, a "spoofer" injects inaccurate information into the market by placing a large volume buy or sell order that the trader never intends to execute. As a result, the market will likely interpret a demand for that product above the natural level of market supply and demand. Prohibiting spoofing also appears entirely consistent with the policy goals outlined by the Seventh Circuit to ensure that natural market supply and demand set the market prices for securities, rather than artificial orders spiking demand.[78] Thus, when focusing on policy goals of §10(b), it appears spoofing could constitute a "manipulative act." This is

---

[72] *See* Meric Sar, *Dodd-Frank and the Spoofing Prohibition in Commodities Markets*, 22 FORDHAM J. CORP. & FIN. L. 383, 396 (2017).
[73] *See ATSI,* 493 F.3d at 87 (noting that the sellers converted preferred stock to common stock specifically to dilute the shares and benefit from the resulting decline in share price.).
[74] *Id.* at 104.
[75] *Id.* at 102.
[76] *Id.* at 100-01.
[77] *See id.* at 101 (discussing short-selling's impact on improving market pricing efficiency in concluding that short selling is not inherently manipulative).
[78] *See Sullivan,* 47 F.3d 857 at 861.

especially true considering §10(b) has historically been interpreted by courts to give the SEC broad enforcement authority.[79]

On the other hand, an alleged spoofer may defend by arguing that targeting spoofing under §10(b) and 10b-5 may ultimately make markets less efficient. Even former Chairman of the CFTC, Bart Chilton, advocated for the importance of legitimate high-frequency trading: "High-frequency trading – done for profit, for sure – moves supply and demand among long-term investors quickly and efficiently. This serves an important function, reduces volatility and helps makes markets better."[80] Thus, courts may be hesitant to find high-frequency traders to be violating the law if they are fearful their finding may have a chilling effect on legitimate trading, which in turn might reduce market efficiency. Courts may be particularly concerned with this consequence because discerning legitimate high-frequency trading from illegitimate high-frequency trading is already in and of itself so challenging.[81]

In addition, an alleged spoofer could posit some beneficial market purpose for allowing spoofing. Like in *ATSI* where the court failed to find short-selling manipulative, in part because it serves a valid market purpose,[82] a defendant could argue spoofing provides a beneficial market purpose. For example, spoofing occurs over just milliseconds. As a result, affected parties are generally high-frequency traders. Perhaps, it could be argued, the threat of spoofing could act as a market-based deterrent to excessive high-risk high-frequency trading patterns. However, considering the SEC itself considers spoofing adverse to promoting market integrity and that investors are ultimately affected by events like the Flash Crash,[83] these arguments, on their own, would likely prove inadequate. Moreover, the Flash Crash provides a clear example that high-frequency trading at its worst can strongly impact the average investor by wiping out over $1 trillion dollars in market value in a single day.[84]

---

[79] *See Santa Fe Indus. Inc. v. Green*, 97 S. Ct. 1292, 1303 (1977) (stating in passing securities laws, "Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices.").
[80] Bart Chilton, *No Need to Demonize High-Frequency Trading*, *N.Y. Times:* DEALBOOK (July 7, 2014, 2:59 PM) https://dealbook.nytimes.com/2014/07/07/no-need-to-demonize-high-frequency-trading/.
[81] Peter J. Henning, *Why High-Frequency Trading is So Hard to Regulate*, N.Y. Times: DEALBOOK (October 20, 2014, 1:40 PM) https://dealbook.nytimes.com/2014/10/20/why-high-frequency-trading-is-so-hard-to-regulate/.
[82] *See ATSI,* 493 F.3d at 101 (stating short selling provides market liquidity and enhances pricing efficiency by helping to move the prices of overvalued securities toward their intrinsic values).
[83] Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n, Economic Club of New York: Strengthening Our Equity Market Structure (Sep. 7, 2010) https://www.sec.gov/news/speech/2010/spch090710mls.htm (stating that on the May 6th Flash Crash, a "staggering total of more than $2 billion in individual investor stop loss orders is estimated to have been triggered" and that according to a "very conservative estimate…individual investors suffered losses of more than $200 million" as a result).
[84] See Leising, *supra* note 6.

Weighing these policy factors and the above legal approaches together, it appears, at best, unclear whether spoofing would constitute market manipulation under §10(b) and Rule 10b-5. A clear definition of spoofing would provide a bright line rule distinguishing spoofing from legitimate high-frequency trading activity. In particular, amending the intent requirement would ease SEC enforcement efforts by allowing the SEC to merely prove intent to cancel an order before execution, rather than intent to artificially affect the price of the entire market for a security.

IV. ANALYSIS OF SPOOFING ENFORCEMENT UNDER §9(A)(2) OF THE SECURITIES EXCHANGE ACT

The SEC has also prosecuted spoofing claims under §9(a)(2) of the Exchange Act.[85] §9(a)(2) of the Exchange Act makes it unlawful to engage in: "a series of transactions in any security…creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."[86]

Like with §10b and Rule 10b-5, the intent requirement under §9(a)(2) of the Exchange Act diverges from the intent requirement under §6(c)(2) of the Commodity Exchange Act ("CEA").[87] Whereas under §6(c)(2),the CFTC merely has to show the defendant intended to cancel the bid before execution, the SEC has to show the defendant had the specific intent of placing the order to manipulate market prices.[88]

Furthermore, §9(a)(2) requires "a series of *transactions*." This raises the question of whether or not bids and offers, the basis for a spoofing violation under the Commodity Exchange Act, even qualify as "transactions" if they are never executed.[89] However, here, there is case law holding that "series of transactions" under §9(a)(2) includes not only completed purchases or sales, but also bids and orders to purchase or sell securities.[90] In *SEC v. Lek Securities Corporation*, for example, the court adopted the SEC's interpretation of the legislative history of §9(a)(2) to conclude "series of transactions" does indeed encompass bids and orders to purchase or sell securities.[91]

---

[85] 15 U.S.C. § 78j(a)(2).
[86] 15 U.S.C. §78j(a)(2) (2012).
[87] *See* Sar, *supra* note 72, at 412.
[88] *See id.* at 412.
[89] *See* Asaro & Williams, *supra* note 4.
[90] *See Lek Sec. Corp.*, 276 F. Supp 3d at 62; s*ee also SEC v. Malenfant*, 784 F. Supp. 141, 145 (S.D.N.Y. 1992).
[91] *Id.* (the SEC has concluded that Congress "clearly intended its prohibition against manipulation to extend beyond the actual consummation of purchases or sales) (quoting In the Matter of Kidder Peabody & Co., et al., SEC Release No. 3673, 18 S.E.C 559, 1945 WL 332559, at *8 (Apr. 2, 1945).

Despite this favorable case law, the SEC has generally settled spoofing enforcement actions brought under §9(a)(2), under seemingly lenient terms.[92] For example, in a recent case against trading firm Trade Alpha, the SEC complaint alleged the firm had engaged in manipulative practices for over a year and a half.[93] Worse, the executives who had executed the scheme had received express warnings from FINRA for at least a year without any subsequent action.[94] Ultimately, the settlement imposed only two to three years suspension on trading for the executives.[95] Perhaps the lack of enforcement actions prosecuted in court stems not from lack of legal applicability of §9(a)(2), but from the evidentiary difficulty of showing intent to manipulate the market.

V. ANTI-SPOOFING ENFORCEMENT IN COMMODITIES AND FUTURES MARKETS

For the reasons outlined above, success of anti-spoofing enforcement actions in securities markets under the current legal regime appears, at best, unclear. This section will demonstrate how the recent statutory amendment to Dodd-Frank has significantly bolstered anti-spoofing enforcement efforts in the futures and commodities markets. Specifically, legislative language defining spoofing and a narrowing of the scienter requirement to only require a showing of an "intent to cancel" an order has proven to be significantly beneficial to both the CFTC and United States Department of Justice in anti-spoofing enforcement efforts.

A. History of CFTC Spoofing Enforcement

Prior to Dodd-Frank, §9(1) of the Commodity Exchange Act prohibited manipulation. However, under §9(1), the CFTC had to demonstrate that: "(1) the accused had the ability to influence the market prices; (2) that he specifically intended to do so (3) that artificial prices existed; and (4) that the accused caused the artificial prices."[96] This authority was similar to §9(a)(2) of the Exchange Act in that both required a showing

---

[92] *See Trade Alpha*, *supra* note 33; *see also* Press Release, Sec. & Exch. Comm'n, SEC Charges Owner of N.J.-Based Brokerage Firm with Manipulative Trading (Apr. 4, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541406190#.VQCYr-F3HfY.
[93] *See Trade Alpha, supra* note 33.
[94] *See* Sanders, *supra* note 8, at 537.
[95] *Id.*
[96] *Id*. at 525.

of specific intent to influence market prices. This standard proved so challenging that former SEC Chairman Bill Charton described it as a "nearly impossible manipulation standard" at a hearing regarding Dodd-Frank amendments.[97] In fact, at the time of the hearing, July 7, 2011, the CFTC had won only one manipulation case in 35 years.[98] The CFTC's inability to effectively stop the London Interbank Offered Rate ("LIBOR") scandal provides a prime example of the need for reform.[99] In that case, the CFTC failed to act to stop the global rigging of the LIBOR benchmark rate despite being aware of the scheme for five years.[100]

In this context, §747 of the Dodd-Frank Act amended the Commodity Exchange Act by prohibiting specific commodities offenses occurring in regulated markets, including all 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)."[101] In addition, §747 authorized the CFTC to issue "rules and regulations…as are necessary to prohibit the trading practices" enumerated in the section.[102]

In effect, §747 imported three legal assumptions into the previously onerous manipulation legal standard.[103] First, spoofing is a *per se* form of price manipulation.[104] Second, price manipulation is a primary motive for the alleged spoofer.[105] Third, whether the spoofer actually had the ability to manipulate the market price is virtually irrelevant.[106] Consequently, the new standard is a significantly lower burden to satisfy.

In addition to the legislative change, the CFTC interpreted the statute to require something greater than reckless trading.[107] To ensure legitimate, good-faith attempts to cancel a trade are not found in violation, the agency "considers market context, a person's pattern of trading activity, and other relevant facts and circumstances."[108] In May 2013, the CFTC's final interpretive guidance affirmed this test and added four examples of conduct that constitute spoofing: "(1) submitting or cancelling bids or offers to overload the quotation system of a registered entity; (2) submitting or

---

[97] *See* Bart Chilton, Comm'r, CFTC, Statement Regarding Anti-Fraud and Anti-manipulation Final Rules: The Waiting (July 7, 2011), https://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement070711.
[98] *Id.*
[99] *See* Sanders, *supra* note 8, at 529-30.
[100] *Id.*
[101] 7 U.S.C. §6c(a)(5) (2012).
[102] *Id.*
[103] *See* Sar, *supra* note 72, at 396.
[104] *Id*.
[105] *Id.*
[106] *Id.*
[107] Antidisruptive Practices Authority, 78 Fed. Reg. 31890, 31896 (May 28, 2013); s*ee also* Sar, *supra* note 72, at 397.
[108] Jan Paul Miller et al., *The Anti-Spoofing Provision of the Dodd-Frank Act: New White Collar Crime or 'Spoof' of a Law?*, Thompson Coburn LLP, https://www.thompsoncoburn.com/docs/default-source/News-Documents/spoofing.pdf.

cancelling multiple 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 cancelling bids or offers with intent to create artificial price movements upwards or downwards."[109]

Finally, prior to Dodd-Frank, "the CFTC fined and penalized traders who violated section 9(a)(2)."[110] Under the new legal regime, however, Dodd Frank makes a knowing violation of the anti-spoofing provision a felony, carrying a maximum sentence of ten years' imprisonment and a fine of the greater of $1 million or triple the monetary gain resulting from the alleged conduct.[111]

B. U.S. v. Coscia

The paradigm case demonstrating the success of Dodd-Frank's recent language under §6(c) of the CEA is *United States v. Coscia.*[112] This was the first criminal action brought by the United States Justice Department relying on Dodd-Frank's statutory authority.[113] Here, the Court analyzed a motion to dismiss charging Coscia with six counts of spoofing under 7 U.S.C. §1348 and §13(a)(2).[114] Ultimately the Court denied the motion to dismiss. The statute's clear and explicit definition of spoofing and the "intent to cancel" requirement was the most critical factor in the Court's reasoning.[115]

In *U.S v. Coscia*, the indictment charged that in August 2011 Coscia had developed a high-frequency trading strategy that allowed him to enter and cancel large-volume orders in a matter of milliseconds.[116] Coscia employed two sophisticated computer programs in various futures and commodities markets to detect when conditions were most favorable to execute a system of trade and quote orders.[117] The "quote orders" were large-volume orders that were canceled within a fraction of a second.[118] On the other side of the market, bona fide "trade orders" were filled.[119] Once filled,

---

[109] *Id.*
[110] *Id.*
[111] 7 U.S.C. §6c(a)(5)(C).
[112] 100 F. Supp 3d 653 (N.D. Ill., 2015).
[113] *See id.* at 656. Coscia also represents the first successful action brought by the CFTC. However, that resulted in a settlement. Thus, *US v. Coscia* provides the only judicial opinion analyzing the cause of action. The settlement agreement between CFTC and Coscia required Coscia and Panther Energy Trading LLC to pay a $1.4 million civil monetary penalty, disgorge $1.4 million in trading profits, and banned Coscia from trading on any CFTC registered entity for one year. Press Release, CFTC, Release Number 6649-13 (July 22, 2013), https://www.cftc.gov/PressRoom/PressReleases/pr6649-13.
[114] *Coscia*, 100 F. Supp 3d, at 655.
[115] *Id.* at 659.
[116] *Id.* at 655.
[117] *Id.*
[118] *Id.*
[119] *Id.*

Coscia would "enter a second trade order on the other side of the market, again employ misleading quote orders, and ultimately profit on the difference in price between the first and second trade orders."[120]

Coscia's principal argument was that the anti-spoofing provision was void for vagueness. Pointing to varying definitions of "spoofing" in the CFTC's advanced notice of proposed rulemaking just months after passage of Dodd-Frank, and a CFTC roundtable discussion in December 2010, Coscia argued there was no commonly understood meaning of "spoofing" in the world of futures trading.[121] Further, despite proposing guidance in March 2011, which provided and defined three forms of spoofing, in May 2013 the CFTC issued a final interpretive guidance on spoofing, adding a fourth additional example of spoofing, "submitting or cancelling bids or offers with intent to create artificial price movements upwards or downwards."[122] Thus, Coscia argued, the CFTC's ongoing debate over the meaning of "spoofing" evidenced this void for vagueness argument.[123]

The Court soundly rejected Coscia's void for vagueness argument. Despite the CFTC's ongoing attempts to define spoofing, the Court found "without question" the conduct alleged by the indictment "tracks the language of the statute, and constitutes "spoofing" as the statute defines that term: 'bidding or offering with the intent to cancel the bid or offer before execution.'"[124] The *Coscia* Court went even further in highlighting the importance of the statutory language. It distinguished Coscia's case from three other cases in which defendants had prevailed on an as-applied challenge to language in the Commodity Exchange Act, stating: "these cases are distinguishable because in all three instances [cited by Coscia], Congress had not defined the challenged term in the statute."[125] Here, §6(a)(C)(5) provides a clear definition of spoofing.[126] Thus, the clear statutory language effectively undermined Coscia's argument that the statute should be void for vagueness.

Next, the Court turned to the statute's "intent to cancel requirement." Coscia unsuccessfully argued that application of this intent requirement fails to distinguish between lawful and unlawful trading.[127] For example, "Fill or Kill orders," which are recognized as legitimate by the CFTC, involve bids or offers in which the entire order must be filled immediately or canceled

[120] *Coscia*, 100 F. Supp 3d, at 655.
[121] *Id.* at 657 (citing Def's Mem., ECF No. 28, at 7-8 ("I'm not sure if the definition of spoofing can be agreed upon by the ten people around this table").
[122] *Id*. (noting that the fourth and final category to be added to spoofing was the "submitting or cancelling bids or offers with intent to create artificial price movements upwards or downwards").
[123] *Id.*
[124] *Id.* at 658.
[125] *Id.* at 658-59.
[126] *Coscia*, 100 F. Supp 3d, at 659.
[127] *Id.* (noting that the word "manipulation" does not even appear in the Complaint.).

entirely.[128] However, the *Coscia* Court stated "it is far from clear" that such activities necessarily involve an intent to cancel those bids before they are entered. Thus, the statute's "intent to cancel" requirement allows for the distinction between legitimate good-faith cancellation of orders and those that would violate the statute.[129] As a result, Coscia's alleged "intent to cancel" bids *at the outset* was sufficient to distinguish his conduct apart from legitimate trading practices.[130] From the *Coscia* decision, it is clear that statutory definitions of spoofing and a narrowed intent requirement served as significant boons to anti-spoofing efforts.

C. Post Coscia Impact on CFTC Enforcement Actions

Although CFTC action against *Coscia* settled out of court, the agency's enforcement action is insightful for several reasons. First, the CFTC complaint did not even attempt to show a manipulation scheme.[131] Rather, the CFTC narrowly focused on showing the specific intent to cancel orders, as required under the new statutory language.[132] As mentioned previously, proving intent historically had been the most challenging aspect of prosecuting spoofing. Here, the CFTC and the Justice Department in *Coscia* relied on evidence that Coscia's computer program was specifically designed to place and then quickly cancel orders.[133] This, combined with a lengthy history of bids and offers that were placed and quickly canceled, supported evidence of Coscia's intent.[134] The CFTC has since relied on similar evidence of program design and a long track record of placing and quickly canceling orders when bringing anti-spoofing actions.[135] For example, in another enforcement action against Heet Khara and Nasim Salim, the CFTC complaint against the alleged spoofers argued that intent was clearly evidenced because the traders had cancelled 100% of their sell orders. Moreover, the complaint focused entirely on the intent to cancel trades, rather than intent to affect market prices.[136] Combined, these complaints show that the CFTC has been applying the winning recipe from

---

[128] *Id.*
[129] *Id.*
[130] *Id.*
[131] *See* Sanders, *supra* note 8, at 532.
[132] *See id.*
[133] *See id.*
[134] *See id.* at 534.
[135] *See id.* at 533 (quoting Press Release, Commodity Futures Trading Comm'n, CFTC Charges U.K. resident Navinder Singh Sarao and His Company Nav Sarao Futures Limited PLC with Price Manipulation and Spoofing (Apr. 21, 2015), https://www.cftc.gov/PressRoom/PressReleases/pr7156-15) (stating CFTC alleged Sarao to have used an algorithm and "other manual spoofing techniques whereby Defendants allegedly would place and quickly cancel large orders with no intention of the orders resulting in transactions).
[136] *See* Gregory Meyer, *Two Traders Charged with "Spoofing,"* FIN. TIMES (May 6, 2015, 4:41 AM), http://www.ft.com/cms/s/0/a5765a84-f394-11e4-a979-00144feab7de.html.

the Coscia complaint, which subsequently resulted in a DOJ criminal case victory in *Coscia*, to their current anti-spoofing enforcement efforts.

Another important case highlighting the distinction between CFTC and SEC enforcement efforts against spoofing is the case against Sarao, a purported direct contributor to the Flash Crash as mentioned earlier.[137] In this case, the CFTC complaint alleged two distinct and separate violations: one against spoofing and one against manipulation.[138] Thus, unlike the SEC, the CFTC considers spoofing an entirely distinct offense from a general manipulation case.[139]

VI. LEGISLATIVE SOLUTION TO DEFINE "SPOOFING" UNDER THE EXCHANGE ACT AS IT IS DEFINED UNDER THE COMMODITY EXCHANGE ACT

Given the divergent legal standards applied by the SEC and CFTC in enforcing spoofing matters outlined above, this paper proposes a legislative solution that amends the Exchange Act with similar language to the Dodd-Frank amendments to the CEA. Currently, Dodd-Frank applies only to the enforcement of anti-spoofing in futures markets, not securities markets.[140] The legislative solution should provide the SEC the same authority to protect against spoofing in securities markets that Dodd-Frank provided the CFTC to protect against spoofing in futures markets. Specifically, new legislation should explicitly prohibit spoofing and define spoofing as “bidding or offering with the intent to cancel the bid or offer before execution.”[141] This will bolster SEC enforcement efforts to promote market integrity by clarifying their authority to prosecute spoofing activity in securities markets. As a result, it will also prevent spoofing actors from shifting their manipulative trading practices to securities markets where prosecution is less likely and punishments are less severe.

A. Advantages of New Legislation

i. Bolster SEC Enforcement Efforts Through Lower Evidentiary Burden

First, defining spoofing under the Exchange Act would narrow the intent requirement, which has proven to be one of the most challenging

[137] *See* Sanders, *supra* note 8, at 532.
[138] *Id.* at 533.
[139] *Id.*
[140] *See* 7 U.S.C. § 6c(a)(5)(C) (2012).
[141] *See id.*

aspects to prove in a market manipulation case.[142] As evidenced by *Coscia*, clear statutory language with a clear intent requirement may be a determinative factor in distinguishing legitimate trading activities from illegitimate trading activities.[143]

The critical underlying fact is that high-frequency trading activity, even when legitimate, involves large cancelations of orders.[144] Thus, distinguishing between manipulative cancelations and legitimate cancellations, is challenging and, as a result, it is extremely difficult for enforcement agencies to make an evidentiary showing in court that a cancelation falls on one side of the line or the other. This is why the *Coscia* Court stressed the significance of the "intent to cancel" requirement in the Dodd-Frank statute. Defendants can no longer prevail on arguments that large cancellations were legitimate if the agency can show intent to cancel existed *prior* to the order being placed.[145] Conversely, traders acting in good faith by placing orders that are cancelled because a certain condition was or was not met *after* the order was already placed will be protected. The standardization of complaints by the CFTC in consistently relying on trading histories and patterns of cancelations could serve as a guidepost for the SEC if given the same legal authority. Rather than showing the intent to manipulate the entire market, the SEC could satisfy the intent requirement merely by showing similar patterns to those that were effective in the case against *Coscia*, such as a high percentage of trade cancellations. Moreover, like the CFTC, the SEC could charge spoofing in addition to a general market manipulation. In this way, the proposed amendment would support, rather than supplant, current SEC authority.

Second, new legislation would provide improved deterrence factors against engaging in spoofing in securities markets. As a result of Dodd-Frank's legislative fix, not only were the CFTC and Justice Department more easily able to prevail on anti-spoofing claims, but perpetrators were placed in prison.[146] This punishment is significantly more severe than the short-term suspensions thus far levied by the SEC against alleged spoofers.[147] In addition, the statute has incentivized self-regulatory actions to take on a

---

[142] *See* Sanders, *supra* note 8, at 535 (noting that "Dodd-Frank's requirement to prove an intent to cancel the order to buy or sell commodities futures places a relatively small burden on the CFTC.").

[143] *See Coscia*, 100 F. Supp 3d at 659.

[144] *See* Charles Schwab & Walt Bettinger, *Why Individual Investors Are Fleeing Stocks,* WALL STREET J. (July 10, 2013, 7:25 p.m.), https://www.wsj.com/articles/SB10001424127887323582904578484810838726222 (stating that high frequency trading firms cancel 90% of their market orders just a split-second after flooding the market with orders).

[145] *See* Antidisruptive Practices Authority, 78 Fed. Reg. at 31896 (2013).

[146] Gregg Trotter, *Trader Michael Coscia 1st in Nation to be Sentenced Under 'Anti-Spoofing' Law*, Chicago Tribune (Jul 13, 2016, 4:35 PM), https://www.chicagotribune.com/business/ct-spoofing-trial-sentencing-0714-biz-20160713-story.html.

[147] *E.g. Trade Alpha*, *supra* note 33 (providing two to three-year suspension for illegal trading activity occurring for almost a year and a half).

greater oversight role of spoofing. For example, the Chicago Mercantile Exchange ("CME") Group brought sixteen cases related to spoofing before the CME business Conduct Committee in 2015, which was a substantial increase from 2014.[148]

ii. Provide Parity in Enforcement Regimes

The proposed legislation would eliminate disparity between enforcement in commodities and futures markets and securities markets. Because the current legal regime makes it easier for high-frequency traders to get away with spoofing in securities markets, more high-frequency traders may choose to trade in securities markets to avoid being subject to CFTC enforcement actions.[149] Although potential gains in securities markets are generally smaller than those in future markets, traders afraid of litigation or even criminal penalties like in *Coscia*, may be incentivized to trade in the more lenient legal regime overlooking the securities markets.[150]

Similarly, from an economic perspective, there are real costs associated with complying with federal regulations.[151] If regulatory regimes overseeing spoofing are divergent, then costs associated with complying with those regimes will also be divergent.[152] It hardly seems either fair or efficient to require legitimate high-frequency traders to pay more for complying with rules of trading in futures and commodities markets rather than those trading in securities markets. Moreover, "many high-frequency traders already trade in both the commodities futures and the securities markets."[153] Thus, the cost of these traders shifting their activity into a more favorable regulatory regime is relatively low.[154] As a result, manipulative activity in the securities market is likely to increase and persist until regulatory parity is restored. Moreover, considering that the average investor is more likely to participate in the securities market, the impact of such increased manipulative activity is most likely to be borne by such investors.[155] On these grounds, the legislative proposal would advance the primary mission of the SEC to promote market integrity and protect investors.

---

[148] Sar, *supra* note 72, at 408.
[149] *See* Sanders, *supra* note 8, at 536.
[150] *See* Sanders, *supra* note 8, at 536-537.
[151] *See* COMPETITIVE ENTERPRISE INSTITUTE, *Ten Thousand Commandments, in* THE COST OF REGULATION AND INTERVENTION(2018).
[152] *See* Sanders, *supra* note 8, at 541.
[153] *See* Mathew Philips, *How the Robots Lost: High-Frequency Trading's Rise and Fall,* BLOOMBERG BUS. (June 6, 2013), http://www.bloomberg.com/bw/articles/2013-06-06/how-the-robots-lost-high-frequency-tradings-rise-and-fall.
[154] *See* Sanders, *supra* note 8, at 541.
[155] Danielle Kurtzleben, *While Trump Touts Stock Market, Many Americans are Left Out of the Conversation*, NPR (Mar. 1, 2017), https://www.npr.org/2017/03/01/517975766/while-trump-touts-stock-market-many-americans-left-out-of-the-conversation (noting that according to Gallup, 2% of Americans were invested in a stock, mutual fund, or self-directed 401(k) or IRA in 2016).

B. Potential Criticisms of Proposed Legislation

i. Expressio Unius Est Exclusio Alterius

One guiding principle of statutory interpretation is *expressio unius est exclusio alterius*, or "the inclusion of one means the exclusion of another."[156] Historically, the SEC has relied on §10(b) of the Exchange Act as well as Rule 10b-5 as a catchall provision designed to capture activities from wash sales to insider trading.[157] Likewise, §9(a)(2) is a general prohibition against manipulation.[158] Because the SEC relies on these general provisions to encompass such a broad array of securities violations, the inclusion of a specific statutory prohibition may be used against its broad authority. Alleged perpetrators will likely argue that because spoofing is specifically mentioned, other forms not listed were not intended to be considered violations of securities laws. However, there is already a full body of case law supporting SEC authority to go after the most common forms of fraud or market manipulation.[159] In addition, amending language could specifically state that in no way did Congress intend for this amendment to limit or reduce any of the SEC's current authority. Thus, concerns under this category would likely only apply to future forms of fraud or manipulation yet to be discovered by the SEC.

ii. Bright Line Avoidance

Similarly, providing a bright line rule prohibiting an "intent to cancel" might also provide a bright line path around the rule. Securities lawyers could advise traders to craft their trades and underlying rationale for each trade to disguise their intent to cancel. For example, traders could condition offers by showing full intent to execute an offer unless a highly likely event occurs, for instance, on the condition that treasury yields remain below twenty percent. Conversely, a trader could condition an offer to be executed only if a highly improbable event occurred, such as treasury yields exceed twenty percent. Under both scenarios, the trade almost certainly will not be executed. While these conditions are likely farfetched enough for an agency to show an intent to cancel, what if the condition was more feasible, such that treasury yields only need to remain below or above 15 percent, or say only 10 percent? Ultimately, the closer a trader gets to justifying a trade

---

[156] *See Layzer v. Leavitt*, 770 F.Supp.2d 579, 586 (S.D.N.Y. 2011).
[157] *See Chiarella v. US*, 445 U.S. 222, 234-35 (stating "Section 10(b) is aptly described as a *catchall* provision, but what it catches must be fraud.") (emphasis added).
[158] *See* Sanders, *supra* note 8, at 526.
[159] *See Santa Fe*, 430 U.S. at 477 (stating that in passing securities laws, "Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices."); *see also Prudential Ins. Co. of Amev. SEC*, 326 F.2d 383, 386 (3rd Cir. 1964) (stating that "securities legislation must be broadly construed in order to insure the investing public a full measure of protection").

as a legitimate conditional order, the less likely they will be found to violate the statute's "intent to cancel" prohibition. Consequently, regulators will likely have to provide additional guidance as to how strong the intent to cancel must be. Again, regulators could look towards the CFTC example where anti-spoofing complaints relied upon patterns of cancelation to demonstrate intent.[160] Thus, even if traders had evidence that they did not intend to cancel orders outright at the front end of the transaction, if their trading strategy resulted in a pattern of cancelled trades close to 100 percent, intent to cancel could be inferred.[161] Moreover, the SEC could provide regulatory guidance explaining factors that could be used to demonstrate intent, similar to those of the CFTC, such as trades that create a "false appearance of market depth."[162]

iii. Deterring Legitimate Trading Activity

High frequency trading may provide legitimate market benefits. As mentioned above, high frequency trading "reduces volatility" and "moves supply and demand among investors quickly and efficiently."[163] Further, high-frequency trading, even when legitimate, may involve a large number of cancelled trades.[164] As a result, ensuring good-faith, legitimate trades are not unfairly targeted in anti-spoofing enforcement actions is a key concern. It will also likely be a key source of pushback in passing new legislation. However, these same concerns existed when Dodd-Frank passed.[165] In *Coscia*, the Court specifically stated that it was "far from clear" that legitimate trading activities would involve the entry of bids or offers with the intent to cancel.[166] This demonstrates why the "intent to cancel" requirement is significant.

iv. Political Gridlock

Recognizing the political realities of passing new legislation in a gridlocked Congress, an effective solution would likely need to be bipartisan. Fortunately, there does not seem to be much political support for high-frequency traders. Legislators could point to the successes of Dodd-Frank outlined above to push through the reform. Further, investment in the stock market has declined significantly since 2002.[167] Promoting integrity in

---

[160] *See* Sanders, *supra* note 8, at 534.
[161] *Id.*
[162] *See* Antidisruptive Practices Authority, 78 Fed. Reg. at 31, 896 (2013).
[163] Chilton, *supra* note 80.
[164] *See* Sanders, *supra* note 8, at 526.
[165] *See Coscia*, 100 F. Supp 3d at 657.
[166] *See id.* at 659.
[167] *See* Schwab & Bettinger, *supra* note 144. (In 2002, 67% of Americans participated in the stock market through ownership of stock, mutual funds, or a self-directed 401(k) or IRA. Today, it is around 52%.)

the market might mitigate this decline and restore confidence in the markets. This would promote investment, which in turn spurs job creation, innovation, and economic growth.[168] These goals are likely more politically popular than maintaining the status quo for high-frequency traders.

CONCLUSION

The current case law regarding whether spoofing, defined as placing orders with the intent to cancel before execution, is a violation of securities law is, at best, unclear. Even if the requisite legal authority exists for the SEC to bring claims under the Exchange Act, the evidentiary challenge of proving an intent to manipulate the market remains more challenging than proving the intent to cancel orders before execution. As long as CFTC has specific statutory authority to prosecute spoofing and a narrower intent requirement to satisfy, regulatory disparity will likely persist. New legislation is likely necessary to eliminate this disparity. Language providing the SEC the same authority Dodd-Frank provided the CFTC in combatting spoofing would likely bolster SEC enforcement efforts, deter high-frequency manipulative activity, and eliminate incentives for high-frequency trading to occur in securities markets disproportionately to commodities and futures markets.

---

[168] *See id.*